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Course Description

*Principles of Real Estate I--TREC 121* is a 30-hour course required by the Texas Real Estate Commission (TREC) for anyone who wishes to become a licensed real estate agent in Texas. The course provides a comprehensive overview of real estate principles. TREC mandates that all real estate agents obtain a total of 60 hours of course work in the principles of real estate. For this reason, there is a second, 30-hour, part of this course, *Texas Real Estate Principles Part 2*. While both courses work independently of the other, we suggest that for continuity and convenience, you take both parts together.

*Texas Principles of Real Estate Part 1* covers the following topics:

- Texas License Law
- Real Property Ownership and Land Use
- Agency
- Code of Ethics in Real Estate Practice
- Fair Housing
- Real Estate Descriptions and Ownership Interests
- Contracts
Course Learning Objectives

Upon completion of this course, you should be able to:

- Identify the agencies and laws that govern the practice of real estate.
- State the purpose of the Real Estate Commission (TREC).
- Explain the purpose of the Sunset Act.
- List the Canons of Professional Ethics and identify the appropriate standards of conduct.
- Explain how and when the Real Estate Commission was established.
- Identify how many members are on the Commission and their terms of service.
- List the primary purpose of the Real Estate Commission.
- List at least five examples of who would be exempt from licensure.
- Explain the purpose of the Consumer Information form 1-1.
- Identify the eligibility requirements for a real estate license applicant.
- Explain the procedures for determining moral character, integrity, and competency.
- Identify when the exam requirements need to be met for a valid application.
- List the education and experience requirements for both a salesperson license and broker license.
- Explain the meaning of a certificate holder.
- List the license management and broker office requirements.
- Define the terms “party” and “intermediary”.
- Explain the requirements for disclosure of representation.
- Identify when and if an intermediary broker can make appointments.
- Explain the claim limits of the Real Estate Recovery Trust Account.
- Recognize prohibited practices by license holders.
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- Describe the limits of the Commission’s powers for administrative penalty.
- Describe the process for disciplinary proceedings and hearings.
• Identify the limitations of liability and the civil and criminal penalties.
• Identify the appropriate course of action in given case study scenarios.
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• Describe the difference between land, real estate, and real property.
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• Identify the different types of housing.
• Explain the tax benefits and exemptions for homeowners.
• Identify the types of homeowners insurance policies.
• Identify the ways agency relationships are formed.
• Describe the role of the agent, the principal, and the third party in the agency relationship.
• Name the different types of authority.
• Outline the differences between the general and the special agent.
• State the rules of agency disclosure.
• Describe the duties that an agent owes the principal.
• Recognize the Texas rules governing compensation of agents.
• Outline the idea of tort liability.
• Identify the circumstances under which a licensee may be held professionally liable.
• Describe how the licensee’s duties apply to the four different agency positions.
• Compare and contrast the different forms of listing agreements.
• Interpret buyer representation agreements.
• State the distinctive features of an intermediary relationship.
• Describe how an agency relationship can be terminated.
• Name the laws that prohibit deceptive trade practices.
- List at least 10 of the “laundry list” violations of the Deceptive Trade Practices-Consumer Protection Act (DTPA).
- Identify violations of the laws in case study scenarios.
- Identify the definition of *ethics* as used in this course.
- Describe the four business ethics approaches used in this course.
- List major categories of the Articles of the NAR Code of Ethics.
- Describe the structure of the NAR Code of Ethics and its supporting materials.
- Identify at least two aspirational concepts in the Preamble to the NAR Code of Ethics, describe the concept of general business ethics and identify how the Code of Ethics compares and contrasts with the concept of general business ethics.
- Describe the concepts of at least two of the following Articles of the Code of Ethics: Articles 1, 2, 3, 9, 11, 12, 16, and 17.
- Identify possible violations of the NAR Code of Ethics given interactive learning methods such as case studies, quizzes, role playing, and group discussion of fact scenarios.
- Describe the professional standards enforcement process of a local board or association.
- Differentiate between intentional fraud, negligent misrepresentation, and negligence.
- List the three violations of antitrust laws: price fixing, group boycotts, and market allocations.
- Describe how the existence of and adherence to the NAR Code of Ethics is good for the real estate profession.
- Identify violations of the codes of ethics in given case study scenarios.
- Explain an ethical course of action in given case study scenarios.
- Explain the purpose of the federal Fair Housing Laws and be able to identify the protected classes covered by the Fair Housing Act.
- Name the seven activities considered illegal as a result of the Fair Housing Laws.
- Identify the five exemptions from the federal Fair Housing Laws for property
owners.

- Recognize discrimination in real estate practice.
- Recognize the purpose of the federal Equal Credit Opportunity Act (ECOA) and know the classes it protects.
- Describe the purpose of the Americans with Disabilities Act (ADA).
- Outline how the ADA affects real estate practice.
- Describe how fair housing complaints are handled.
- List the penalties for non-compliance with Fair Housing Laws.
- List various ways a broker might incorporate business practices designed to prevent discriminatory practices.
- Explain the purpose and importance of the HUD/NAR Partnership.
- State the basic principle that should guide licensees in following HUD’s Advertising Guidelines.
- Identify acceptable and unacceptable words and phrases for use in advertisements.
- Describe how to apply the practices that help a licensee show that he or she does not discriminate.
- Identity violations of the fair housing law in scenarios.
- Explain why certain actions violate the fair housing laws in case study scenarios.
- Describe Texas state laws regarding fair housing.
- Outline the basic features of the metes and bounds survey method and the rectangular survey method.
- Locate a parcel of land using the rectangular survey method.
- Distinguish the vertical method of land description from other survey methods.
- Identify boundaries or locate a parcel of land using the meets and bounds description method.
- Identify the benefits, rights, value or concerns in given case study scenarios.
- Explain the differences in tenants in common and joint tenancy.
- Identify what is community property versus separate property.
- Explain the four unities of joint tenancy.
- Explain the differences between a Freehold Estate and Leasehold Estate.
- Identify the classification of different types of liens: Voluntary, Involuntary, Statutory, or General or Specific.
- Explain the concerns with encumbrances and the effect they have on real estate ownership.
- Recognize how ad valorem taxes and special assessments are levied.
- Identify how homeowners and investors can save on federal income taxes and capital gains taxes through the use of tax shelters.
- Name and explain the various components of a valid contract.
- Identify the differences between a unilateral and bilateral contract.
- Describe the various types of contracts.
- Outline the features of a contract (and the contracting parties) that make a contract legally binding.
- List the essential elements for a legally binding contract.
- Identify when a contract can be discharged.
- Recognize the difference between a forbearance and performance agreement.
- Recognize the general features of a completed contract.
- Identify the different kinds of real estate contracts.
- Identify the purpose of specific aspects of contracts on the basis of scenarios.
- Recognize the validity of contractual agreements in given case study scenarios.
- Distinguish the differences in contracts and purchase and sale agreements in the State of Texas.
- Explain the statute of limitations.
- Explain what is meant by “promulgated.”
Texas License Law

Lesson 1: Statutes and Agencies Governing Real Estate Practice

Lesson Topics
This lesson focuses on the following topics:

- Real Estate Law and Governing Bodies
- TREC and TREALA
- TREC’s Canons of Professional Ethics and Conduct

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Identify the agencies and laws that govern the practice of real estate.
- State the purpose of the Real Estate Commission (TREC).
- Explain the purpose of the Sunset Act.
- List the Canons of Professional Ethics and identify the appropriate standards of conduct.

Real Estate Law and Governing Bodies
This lesson will introduce you to the laws and Texas state statutes governing the real estate industry. Initially, we will examine the sources of law and state agencies that create and enforce real estate laws; as a licensed real estate agent, you will need to be familiar with these organizations. We will then move on to the laws that establish your
obligations, duties, and capabilities as a licensee. Subsequent lessons in this course will then examine each of the relevant statues and their various components in detail.

**What is the Practice of Real Estate?**

Real estate has many aspects and specializations such as residential, commercial, industrial, recreational, unimproved land, and farm and ranch sales and leasing. Property management, apartment locating, time share sales, and property development are all types of properties or specializations of the real estate practice. Real estate professionals who facilitate buying, selling, leasing, or managing real estate may require some of the real estate industry specializations, which may include brokerage management and ownership, inspectors, surveyors, appraisers, title and abstract, counseling, education, and financing. The real estate industry is heavily governed by statutes and professional organizations, which we will discuss throughout these courses.

**Sources of Law**

The basis of all laws starts with the constitutions, the U.S. Constitution and the State Constitutions. Within these constitutions are laws that affect not only how we practice real estate such as the fair housing laws, but also rights as property owners such as homestead and community property laws. We will talk more about fair housing in another section. These constitutions not only establish the rights of citizens but also limit the authority of the government and passes on these rights and powers to the state governments.

The principal governing bodies that directly affect the real estate industry are the Texas State Legislature and the Texas Real Estate Commission (TREC).

**Texas State Legislature**

The Texas State Legislature is a broad term that refers to the state Senate and the House of Representatives. The Texas Legislature is responsible for all laws in Texas,
which includes those laws that directly affect the real estate industry. For additional
information on the State Legislature, consider visiting their website:
http://www.capitol.state.tx.us.

Texas Real Estate Commission (TREC)
The state legislature created The Texas Real Estate Commission (TREC). TREC has
two main functions:

1. To enforce all real estate-related statues in the Texas Occupations Code,
   Chapter 1101 and 1102, also referred to as The Texas Real Estate License Act
   (TRELA)
2. To adopt and enforce new rules governing the practice of real estate, as needed
   to administer the law and protect the public

The Real Estate License Act provides that The Commission is granted the authority to
enforce all the statutes contained in the Act as well as provide for the commission to
adopt and enforce new rules. Licensed real estate professionals and licensed real
estate inspectors are responsible for adhering to the Texas Real Estate License Act,
and abide by the rules of the Texas Real Estate Commission (TREC).

The Sunset Act
A Sunset Act is a common state law, which, in Texas, requires the Sunset Commission
to evaluate all state agencies every 12 years with respect to their efficiency and the
need for their services. The Texas Real Estate Commission has been reviewed several
times since its inception under this Act and has received approval each time.

TREC and TRELA
We are primarily concerned with the Real Estate License Act and TREC’s Canon of
Professional Ethics. You should understand, however, that these two laws are actually
parts of bigger statutes and there are other sources of laws that will have an impact on
the practice of real estate such as local ordinances and those created by other
governing agencies. Other areas of law that may govern or affect the practices of real
estate include: contract law, agency law, landlord/tenant law, general property law, and
consumer protection law.

Texas Occupations Code
The Real Estate License Act (TRELA) is one section of a larger law passed by the State
Legislature called the Texas Occupations Code. The Real Estate License Act is
Chapters 1101 and 1102 of the Texas Occupations Code. Chapter 1101 pertains to
Real Estate Brokers and Salespersons and chapter 1102 pertains to Real Estate
inspectors.

Real Estate License Act (TRELA)
In essence, TRELA:

- Empowers TREC to enforce the Real Estate License Act and to make and
  enforce new rules.
- Requires that those persons who perform any real estate acts as defined in Sec.
  1101.002 (sell, exchange negotiate auction or deal in real estate) in expectation
  of compensation must obtain a state license.

The Texas Real Estate License Act was formerly called Vernon's Texas Civil Statutes,
Article 6573a, and is now known as Chapter 1101 of the Texas Occupations Code. The
legislation governs those individuals that receive compensation or commission for their
services or participation in real estate transactions. Chapter 1102 of the Texas
Occupations Code covers real estate inspectors. This Act, revised most recently, in
September of 2012, increased the initial and continued education and experience
requirements placed on real estate brokers and licensees. During sessions of the Texas
legislature, sections of the Act may be amended to establish the requirements for
acquiring a real estate license, establish broker's accountability to clients, and the public for acts performed by the broker or by the salespeople the broker sponsors.

**TREC’s Cannons of Professional Ethics and Conduct**

TREC's Canons of Professional Ethics are the ethical and professional standard for the real estate industry, published by the Secretary of State in the Texas Administrative Code. These are not laws but rules for the conduct of license holders in the practice of real estate. The Canons are made up of five individual rules written and enforced by TREC.

§531.1. **Fidelity.** A real estate broker or salesperson, while acting as an agent for another, is a fiduciary. Special obligations are imposed when such fiduciary relationships are created. They demand:

1. That the primary duty of the real estate agent is to represent the interests of the agent's client, and the agent's position, in this respect, should be clear to all parties concerned in a real estate transaction; that, however, the agent, in performing duties to the client, shall treat other parties to a transaction fairly;
2. That the real estate agent be faithful and observant to trust placed in the agent, and be scrupulous and meticulous in performing the agent's functions;
3. That the real estate agent place no personal interest above that of the agent's client.

§531.2. **Integrity.** A real estate broker or salesperson has a special obligation to exercise integrity in the discharge of the licensee's responsibilities, including employment of prudence and caution so as to avoid misrepresentation, in any wise, by acts of commission or omission.

§531.3. **Competency.** It is the obligation of a real estate agent to be knowledgeable as a real estate brokerage practitioner. The agent should:
(1) Be informed on market conditions affecting the real estate business and pledged to continuing education in the intricacies involved in marketing real estate for others;
(2) Be informed on national, state, and local issues and developments in the real estate industry; and
(3) Exercise judgment and skill in the performance of the work.

§531.18. **Consumer Information Form 1-1.**

(a) The Texas Real Estate Commission adopts by reference Consumer Information Form 1-1 approved by the Texas Real Estate Commission in 1991. This document is published by and available from the Texas Real Estate Commission, P.O. Box 12188, Austin, Texas 78711-2188, www.trec.state.tx.us.
(b) Each real estate inspector or active real estate broker licensed by the Texas Real Estate Commission shall display Consumer Information Form 1-1 in a prominent location in each place of business the broker or inspector maintains.

§531.19. **Discriminatory Practices.** No real estate licensee shall inquire about, respond to or facilitate inquiries about, or make a disclosure which indicates or is intended to indicate any preference, limitation, or discrimination based on the following: race, color, religion, sex, national origin, ancestry, familial status, or handicap of an owner, previous or current occupant, potential purchaser, lessor, or potential lessee of real property. For the purpose of this section, handicap includes a person who had, may have had, has, or may have AIDS, HIV-related illnesses, or HIV infection as defined by the Centers for Disease Control of the United States Public Health Service.

**Professional Organizations**

There are many trade organizations associated with the many aspects of real estate, including some at the national level such as the National Association of REALTORS® (NAR), which also have state and local level associations. The REALTOR® logo can only be used by those who are members of the National Association of REALTOR®. There are other associations for other specializations as well as professional institutes,
societies, and professional designations. Although these organizations are not law-making legislative bodies they have standards or educational requirements for specific designations or specializations.

**Lesson Summary**

All U.S states (including the District of Columbia) and Canadian provinces have enacted real estate license laws to govern the activities of real estate brokers and salespeople. While some details regarding these laws vary from state-to-state, many states enact similar provisions. These provisions are based on the patterns of law recommended by the License Law Committee of the National Association of REALTORS® or the Association of Real Estate License Law Officials (ARELLO).

TREC is also responsible for writing law-like entities called “rules.” TREC's rules make up a section of Texas Administrative Code (TAC) that pertains to professional ethics and practices; this section is written and enforced by TREC, but published by the Secretary of State’s Office.

The primary objectives of the Texas License Law are to:

- Protect the public from incompetent brokers and salespeople.
- Set minimum standards and qualifications for licensing brokers and salespeople.
- Maintain high ethical and moral standards among licensees.
- Protect licensed brokers and salespeople from unfair or unethical competition.

TREC is subject to the *Sunset Act* that, in Texas, states that the Sunset Commission must review all state agencies every 12 years with respect to their efficiency and the need for their services.
Lesson 2: TREL A and the Real Estate Practice

Lesson Topics
This lesson focuses on the following topics:

- TREL A and TREC General History
- The Real Estate License Act
- Subchapter A. General Provisions
- Subchapter B. Texas Real Estate Commission
- Subchapter C. Administrator and Other Personnel
- Subchapter D. Commission Powers and Duties
- Subchapter E. Public Interest Information and Complaint Procedures
- Subchapter F. Texas Real Estate Broker-Lawyer committee
- Subchapter G. Accreditation and Approval of Real Estate Educational Programs

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Explain how and when the Real Estate Commission was established.
- Identify how many members are on the Commission and their terms of service.
- List the primary purpose of the Real Estate Commission.
- List at least five Examples of who would be exempt from licensure.
- Explain the purpose of the Consumer Information form 1-1.

TREC and TREL A General History
Created in 1949 when the Texas legislature passed the Texas Real Estate License Act (TREL A) and established the Texas Real Estate Commission (TREC) to oversee the
licensing, education requirements, and ethical standards of practice for real estate sales professionals, and real estate inspectors within the State of Texas. More specifically, it administers the following legislation:

- Texas Occupations Code; The Real Estate License Act, Ch. 1101: Texas Occupations Code; Real Estate inspectors, Ch 1102.
- Texas Timeshare Act, Chapter 221, Texas Property Code

TREC regulates the activities of real estate brokers, salespeople, inspectors, and education providers who offer real estate and inspection courses. The Commission also regulates residential service companies, timeshare developers, and easement or right-of-way developers. Those who deal strictly in easements or rights-of-way are not issued a license but a certificate of registration.

TREC requires that all real estate licensee’s, brokers, salespeople, and inspectors meet and maintain specific education standards and obtain proper licensure before receiving compensation for performing acts or offering to perform acts such as negotiation, selling, purchasing, locating, leasing, or exchanging any interest in real estate. Brokers and salespeople must follow the provisions of The Real Estate License Act and TREC’s rules. The Real Estate License Act and TREC rules require that all transactions involving public interests be dutifully completed in a competent, honest, and ethical manner.

In essence, TREC acts as a public watchdog. It monitors the actions of real estate licensees to ensure compliance with the Act, maintains educational standards and records, collects licensure fees, and issues fines and penalties for violations of TREC rules and/or the Licensing Act. In addition, the Commission also handles all consumer compliments and complaints regarding licensees.

For more information on TREC, go to their website:
http://www.trec.state.tx.us/index.asp.
The Real Estate License Act

We will include excerpts from the Act as we learn about the real estate industry practices; licensing and education requirements; Commission’s powers and duties; compliance, violations and disciplinary actions; and the Commission’s handling of complaints.

The primary functions of the Real Estate Commission are to:

- Protect the public from unlawful or unscrupulous acts of licensed real estate brokers salespersons and certificate holders
- Set minimum standards and qualifications for licensing brokers and salespeople
- Protect licensed brokers and salespeople from unfair or unethical competition

Types of Licensing and Certification

In Texas, real estate salespeople, brokers, and inspectors must hold the appropriate license as specified by the statute we are about to discuss.

In essence, there are two types of real estate licenses: a broker's license and a salesperson’s license. A person who holds a salespersons license must be associated with or sponsored by a licensed broker to perform real estate practices with the expectation of compensation or receiving a commission. On the other hand, a broker can work independently and does not require any sponsorship to practice real estate within the confines of the law. A broker can be sponsored by another broker; in this case they are referred to as a broker associates. Salespersons or broker associates can work as an employee or as an independent contractor; most commonly license holders are independent contractors. Consequently, the licensing processes for a broker and a salesperson are different. Broker license eligibility requirements are greater and require at least four years of experience.

All licenses have a status of active, inactive, or expired. A person who holds an active license can practice real estate while the other two cannot. An inactive status means
that the license holder does not have a sponsoring broker or notified the Commission to have his or her license placed in an inactive status. The expired status means that the license holder did not renew his or her license.

**Subchapter A. General Provisions**

As we start learning about real estate we must first look at who is required to have a license, how to get a license, and once you get one, how to keep it. We will now take a closer look at The Real Estate License Act.

**The Real Estate License Act**

Chapter 1101

Subchapter **A. GENERAL PROVISIONS**

**The Practice of Real Estate**

**Sec. 1101-002** identifies some general definitions and the acts that require the compliance with this chapter.

A broker is defined as a person who performs any or all of the following acts for another in exchange for, or in anticipation of, receiving something of value or compensation or commission.
Practice of real estate includes but is not limited to the following acts:

- Sells, exchanges, purchases or leases real estate
- Offers, or negotiates, or attempts to negotiate the listing, sale, exchange, purchase or lease of real estate
- Auctions or attempts to, or agrees to auction real estate (the auction caller is exempt from licensing requirements)
- Deals in options, aids in locating or assists in procuring real estate.
- Controls the acceptance or deposit of rent(s) from real estate
- Provides an analysis of value of real estate, (market analysis data, not an official appraisal performed under the guidelines of the Uniformed Standards of Professional Appraisal Practices)

A salesperson is defined as a person who is associated (sponsored) with a licensed broker for the purpose of performing any of the practices of real estate as described above and by TREL. A licensed salesperson must be associated or sponsored with a broker to practice real estate on behalf of another and for compensation or a fee.

Sec. 1101-003 describes the core real estate course material and topics. It also provides that the commission may prescribe additional core real estate course(s) title and content. Below are the 11 Core Real Estate Courses;

1. Agency Law
2. Contract Law
3. Principles of Real Estate
4. Property Management
5. Real Estate Appraisal
6. Real Estate Brokerage
7. Real Estate Finance
8. Real Estate Investment
9. Real Estate Law

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10. Real Estate Marketing
11. Real Estate Math

Sec. 1101-004 depicts what constitutes acting as a broker or salesperson as; a person with the expectation of receiving valuable consideration, directly or indirectly performs or offers, attempts, or agrees to perform for another person any act described in section 1101.002. Thus, it would require a real estate license and compliance with TREL and applicable laws for the practice of real estate.

Sec. 1101-005 identifies who is exempt from the compliance of the license act and does not need a license to perform the acts or practice of real estate.

- An attorney licensed in this state (they have already acquired the license to practice law in this state)
- An attorney in fact authorized under a power of attorney to conduct a real estate transaction.
- A public official while engaged in official duties
- Members are non-broker members of the Public (usually members of the business community).
- An auctioneer licensed under Chapter 1802 while conducting the sale of real estate by auction if the auctioneer does not perform another act of a broker or salesperson;
- A person conducting a real estate transaction under a court order or the authority of a will or written trust instrument;
- A person employed by an owner in the sale of structures and land on which structures are located if the structures are erected by the owner in the course of the owner's business; for Example a sales agent for a production builder.
- An on-site manager of an apartment complex
- An owner or the owner's employee who leases the owner's improved or unimproved real estate
- Any transactions for the sale, lease or transfer of mining or mineral interests
- Any transactions for the sale, lease or transfer of cemetery lots
- Any transactions for the lease or management of a hotel or motel

Sec. 1101-006 provides the commission is subject to the Sunset Act (Chapter 325 of the Government Code). The Sunset Act is a common state law, which, in Texas, requires the Sunset Commission to evaluate all state agencies every 12 years with respect to their efficiency and the need for their continued services. The Texas Real Estate Commission has been reviewed four times under this Act and has received approval each time. Unless continued in existence as provided by that chapter, the Commission is abolished and this chapter, Chapter 1102, and Chapter 1303 of this code and Chapter 221, Property Code expire September 1, 2019.

Subchapter B. Texas Real Estate Commission

Sec. 1101.051 describes the Commission membership and eligibility for appointments. The Commission consists of a total of nine (9) members appointed by the Governor with the advice and consent two thirds of the Texas Senate. Adherence to the State License Act is enforced by the Texas Real Estate Commission comprised of the nine (9) members: six (6) are licensed brokers engaged in the brokerage business as their major occupation for five years preceding their appointment and three (3) non-broker members. The three non-broker members are usually from the state business community. These non-broker members of the public are designed to represent the public's interests. All appointments shall be made without regard to the race, color, disability, sex, religion, age, or national origin

Sec. 1101.055 addresses the member term and vacancies. Commission members serve staggered six-year terms, with the terms of three members expiring January 31 of each odd-numbered year. If a vacancy occurs during a member's term, the governor shall appoint a person to fill the unexpired term.
Subchapter C. Administrator and Other Personnel

Subchapter C primarily address the administrative functions of the commission with respect to human resource management, compliance with equal employment opportunity practices, code of ethics, and standards of conduct.

Subchapter D. Commission Powers and Duties

Sec. 1101.151 identifies the general powers and duties of the commission.

(A) The Commission shall:

(1) Administer this chapter and Chapter 1102;
(2) Adopt rules and establish standards relating to permissible forms of advertising by a license holder acting as a residential rental locator;
(3) Maintain a registry of certificate holders; and
(4) Design and adopt a seal.

(B) The Commission may:

(1) Adopt and enforce rules as necessary to administer this chapter and Chapter 1102;
(2) Establish standards of conduct and ethics for persons licensed under this chapter and Chapter 1102 to:
   (a) Fulfill the purposes of this chapter and Chapter 1102; and
   (b) Ensure compliance with this chapter and Chapter 1102; and
(3) Authorize specific employees to conduct hearings and issue final decisions in contested cases.

A residential rental locator is a person who offers for consideration to locate a unit in an apartment complex for lease to a prospective tenant. The term does not include an owner who offers to locate a unit in the owner’s complex. Residential rental locators are required to hold a license, where as the owner of an apartment complex or an employee of the owner locating tenants for his or her own property would not. And a Certificate
holder is a person who deals in right of ways and easements and is registered as “Certificate Holder” under the provisions of Subchapter K.

**Sec. 1101.152** establishes the Commission’s authority to adopt rules to charge and collect fees to cover the costs of administering these chapters. These fees include license application and renewal fees, fees associated with registrations and filing of changes in license status, business address, broker sponsorship as well as filing of applications for criminal history check, moral character determination, transcript evaluations and education or education provider approval. The licensing act also governs fee increases.

**Sec. 1101.153** provides for an additional filing fee of $200 for an original individual broker license application on top of the fee set by the Commission under section 1101.152. This fee is dispersed as follows;

- $50.00 shall be paid to the Real Estate Research Center at the Texas A&M University.
- $50.00 shall be deposited to the credit of the foundation school fund.
- $100.00 shall be deposited to the credit of the general revenue fund.

**Sec. 1101.154** provides for additional fees for the Texas Real Estate Research Center. For every renewal of a broker and salesperson license or certificate registrant a fee of $20.00 is collected in addition to the application or registration fee. This additional $20 is paid to the Real Estate Research Center at the Texas A&M University.

The real estate research center at Texas A&M University provides a wealth of information from the research conducted and Tierra Grande publication. This research benefits our real estate professionals, our industry and the general public. The educational benefits and information provided from their research is at your fingertips and worth frequent visits to their website at [http://www.verenter@TAMU.edu](http://www.verenter@TAMU.edu).
Sec. 1101.155 allows the Commission to adopt rules related to contract forms including mandated requirements for use. The forms required for use by licensees are prepared by the Texas Real Estate Broker-Lawyer committee and adopted by the Commission. These contract forms are referred to as promulgated or required for use by license holders. There are some exceptions in which the Commission may not prohibit the uses of other contract forms.

The Commission may not prohibit a license holder from using a contract form in the sale, exchange, option or lease of real property if the form is:

(1) Prepared by the property owner; or
(2) Prepared by an attorney and required by the property owner.

The Commission also requires that a listing contract form (adopted by the Commission) that includes contractual obligations between a seller of real estate and a license holder acting as an agent for the seller must include:

(1) A provision informing the parties to the contract that real estate commissions are negotiable; and
(2) A provision explaining the availability of Texas coastal natural hazards information. This is important to coastal residents due to tidal influences on real property.

Sec. 1101.156 The commission may not adopt a rule restricting advertising or competitive bidding by a person regulated by the Commission except to prohibit a false, misleading, or deceptive practice by the person.

The Commission may not include restrictions of the use of advertisement medium, restrictions on a person’s personal appearance or use of the person’s voice in an advertisement, relate to the size or duration of an advertisement or restrict the person’s
advertisement under a trade name in any rules prohibiting false, misleading or deceptive practices.

Sec. 1101.157 grants the Commission subpoena authority to subpoena witnesses for examination under oath, documents or other evidence relevant to an investigation of a violation of this chapter.

Subchapter E. Public Interest Information and Complaint Procedures

Sec. 1101.201 prescribes the requirements to prepare and provide information describing the functions and complaint procedures of the Commission to the public and appropriate state agencies.

Sec. 1101.202 establishes methods by which consumers are provided the name, mailing address and telephone number of the Commission for the purpose of directing complaints from the public. Such notice is provided in the Consumer Information form 1-1. This is required to be prominently displayed in each place of business. This form can be obtained from TREC’S website http://www.trec.state.tx.us.
The Commission shall also provide to a complainant and the licensee related to the complaint an explanation of the remedies available and additional information about state or local agencies with whom a person can file a complaint.

Sec. 1101.203 requires the Commission to maintain a prompt and efficient system for maintaining a file on each complaint and the requirements of what must be included in each file. The Commission shall periodically notify the parties as to the complaint status until final disposition, unless the notice would jeopardize an undercover investigation.

Sec. 1101.204 authorizes the Commission or Commission staff to file a complaint and conduct an investigation as necessary to enforce the chapter. The Commission shall also investigate actions and records of a license holder if a person submits a signed written complaint related to license holder and provide reasonable cause for the investigation within four years of the date of the incident (statute of limitations is four years).

Investigation of valid complaints are prioritized and handled on a risk-based assessment such as degree of immediate or potential harm to consumer, severity of allegations, number of license holders involved, complaint history, and number of violations. A license holder who is the subject to a complaint shall be provided a written notice unless deliberated by the Commission against that notification. Investigation or actions may not be initiated on the basis of an anonymous complaint.

Sec. 1101.206 provides for the Commission’s development and implementation of policies that provide the public with a reasonable opportunity to appear before the commission and to speak on any issue under the commission’s jurisdiction. The Commission shall also maintain a written plan to address how a person who does not speak English or who has a physical, mental, or developmental disability may be provided reasonable access to the commission’s programs.
Subchapter F. Texas Real Estate Broker-Lawyer Committee

The Broker-Lawyer Committee consist of 13 members, six members are brokers appointed by the Commission, six members are lawyers appointed by the State Bar Association and the 13th member is a member of the public appointed by the governor. They serve a staggered six year term with two Commission appointees and two State Bar appointees expiring every two years. The governor-appointed public member term expires every six years. The primary duties of the Broker-Lawyer committee are to draft and revise contract forms for the approval and adoption for use.

Subchapter G. Accreditation and Approval of Real Estate Educational Programs

The Commission establishes the standards for accreditation of educational programs excluding the programs and courses offered by accredited colleges and universities. The Commission also determines the approval of Continuing Education Provider applicants, maintains exam passage rate data, and may appoint a review committee to review performance of educational programs. A committee formed under this section shall review and evaluate educational program’s performance, report findings and make recommendations for improvement to the commission but may not revoke the accreditation of an educational program. The Commission may temporarily suspend the accreditation of a program as identified in Subchapter N of this chapter.

Lesson Summary

This lesson covered the sections of the Real Estate License Act that pertain to license law. It explained candidacy qualification, the different types of licenses and those situations and persons exempt from licensure. There are exceptions to the Real Estate License Act. Generally, licensed attorneys and public officials carrying out their duties are exempt from licensure requirements. Individuals selling their own homes are also exempt from licensure requirements.
The Commission consists of nine members, six brokers, and three members of the general public serving a six-year term. The Commission’s primary purpose is to protect the public from unlawful or unscrupulous acts of license holders. The legislatively given authority provides the powers and duties to the Commission to enact and enforce the laws to ensure those license holders are educated, honest, trustworthy, and of good moral character. The powers and duties of the Texas Real Estate License Act provide the Commission’s ability to enforce the laws and maintain standards, assess fees, handle complaints, and provide public interest information. The Commission has also established the Broker-Lawyer committee to draft and revise real estate contract forms and addenda. The forms approved by the Commission are designed and typically required for use by license holders to prevent the unauthorized practice of law and protect the parties to a real estate transaction.
Lesson 3: Real Estate Licensing

Lesson Topics

This lesson focuses on the following topics:

- License Applicant Eligibility
- Subchapter H. License Requirements
- Subchapter I. Examinations
- Subchapter J. License Renewal
- Subchapter K. Certificate Requirements

Lesson Learning Objectives

By the end of this lesson, you should be able to:

- Identify the eligibility requirements for a real estate license applicant.
- Explain the procedures for determining moral character, integrity, and competency.
- Identify when the exam requirements need to be met for a valid application
- List the education and experience requirements for both a salesperson license and broker license.
- Explain the meaning of a certificate holder.

License Applicant Eligibility

A prospective licensee must meet all requirements set by the Commission. Eligibility for licensure is described in Sec. 1101.354 of The Real Estate License Act, Ch. 1101; an applicant is required to be 18 years of age or older, a Texas resident, and a citizen of the United States or a lawfully admitted alien at the time the application is filed. The
Commission will judge the honesty and integrity of each individual over the course of the application process. After a person files his or her application, the Commission has 30 days to decide whether the applicant’s moral character is consistent with the Commission’s set standards. In addition, an applicant must complete the required core education courses and then pass a written final exam to receive a real estate license.

In this lesson we will learn the real estate license eligibility requirements for an individual and business entity. The following excerpt from the Real Estate License Act will identify the Commission’s role in determining if an applicant is eligible for a license. These strict requirements for moral character, integrity, competency, criminal history, and examinations are designed to ensure the public interest is protected and the practices of real estate are handled in a competent manner.

**Subchapter H. License Requirements**

**Sec.1101.351** states a person may not act or represent themselves as a broker, salesperson or rental locator unless that person receives a license evidencing that authority nor may a business entity act as a broker unless the entity holds a license issued under this chapter.

A licensed salesperson may not act or attempt to act as a broker or salesperson unless the licensed salesperson is associated with a licensed broker and is acting for that broker. The licensed salesperson must be associated or sponsored by a broker to perform the acts of real estate practice as identified in Sec 1101.002 of this chapter.

**Sec.1101.352** Applicants for a broker or salesperson license must submit an application to the Commission. Each applicant shall provide the Commission a current mailing address, email address or telephone number and must disclose whether they have:

- Entered a plea of guilty or no lo contender to a felony, or
• Been convicted of a felony and the time for appeal has elapsed or the judgment or conviction has been affirmed on appeal.

**Sec.1101.3521** stipulates the Commission shall require that applicants for a license or renewal of an unexpired license submit a set of fingerprints for the purpose of obtaining criminal history information from the Department of Public Safety and the Federal Bureau of Investigation. Failure to comply shall result in the Commission refusing to issue or renew a license from that applicant.

**Sec.1101.353** The Commission must also determine the moral character of an applicant and within 30 days after the Commission’s determination the applicant shall be notified.

**Sec.1101.354** identifies the general eligibility requirements to receive a license under this chapter; a person must:

1. At the time of application:
   - Be at least 18 years of age.
   - Be a citizen of the United States or a lawfully admitted alien and;
   - Be a resident of this state
2. Satisfy the Commission as to the applicant’s honesty, trustworthiness, and integrity
3. Demonstrate competence based on an exam
4. Complete the required courses of study, including the required core real estate courses prescribed under this chapter and
5. Complete at least
   - Three classroom hours of course work on federal, state, and local laws governing housing discrimination, housing credit discrimination and community reinvestment; or
   - Three semester hours of course work on constitutional law.
Sec.1101.355 identifies the general eligibility requirements for business entities. To be eligible for a license under this chapter:

(1) A business entity must designate one of its managing officers as its agent for purposes of this chapter; and

(2) Provide proof that the entity maintains errors and omissions insurance with a minimum annual limit of $1 million for each occurrence if the designated agent owns less than 10 percent of the business entity.

A business entity may not act as a broker unless the entity’s designated agent is a licensed broker in an active status and good standing according to the Commission’s records. A business entity that receives compensation or commissions on behalf of a license holder must be licensed as a broker under this chapter.

Sec.1101.356 identifies the broker license experience and education requirements. An applicant for a broker license must have at least four years of active experience in this state as a license holder during the 60 months preceding the date the application is filed and successfully completed at least 60 semester hours (or equivalent classroom hours - 15 classroom hours is equivalent to 1 semester hour) of postsecondary education. The post secondary education must include 18 semester hours (or equivalent classroom hours) of core real estate courses of which 2 of those semester hours must be real estate brokerage, and at least 42 hours of core or related courses accepted by the commission.

Sec.1101.358 identifies the salesperson’s license education requirements. An applicant for a salesperson license must provide satisfactory evidence to the Commission that the applicant has completed at least 12 semester hours (or equivalent classroom hours - 15 classroom hours is equivalent to 1 semester hour) of postsecondary education consisting of:
• At least four semester hours of core real estate courses on principles of real estate and
• At least two semester hours of each real estate course for agency law, contract law, contract forms and addendum’s, and real estate finance.

The Commission may also waive the education requirements if the applicant had been licensed in another state or previously licensed in this state.

Sec.1101.363 indicates the Commission shall issue an appropriate license to those who meet the requirements for a license. An inactive salespersons license may be issued to a person meeting the salesperson licensing requirements, but the salesperson cannot perform any real estate related activities that require licensure as described in Sec 1101.002 unless that salesperson is sponsored by a licensed broker who has notified the Commission as required by section 1101.367b.

A person who is issued a broker’s license can perform the acts identified in 1101.002 provided the license is in an active status and not expired.

Sec.1101.364 addresses the Commission denial of licensure of an applicant. If an applicant is denied a license, the Commission shall immediately give written notice to the applicant. The denied applicant is entitled to a hearing under Section 1101.657.

Sec.1101.366 Inactive broker license status may be requested by submitting the prescribed form to the Commission prior to the expiration of the license. A broker who wishes to change the license status from active to inactive must provide a written notice to each sponsored license holder 30 days preceding the broker applying for inactive status. Any inactive licensee cannot perform those activities regulated under this chapter.

An inactive license holder can remain in an inactive status indefinitely provided the license holder meets the renewal criteria and pays the appropriate renewal fees.
Sec.1101.367 Inactive salesperson license status may be requested by the license holder or by the sponsoring broker. When the association of a sponsoring broker and the license holder is terminated, the broker shall immediately return the salesperson license to the Commission. The Commission will change the status of an unsponsored salesperson license holder to an inactive status provided the license is not expired. The license holder can file for an active status at any time provided the license holder license has not expired, has a licensed broker sponsorship approved, and appropriate forms are submitted to TREC with the payment of the associated fees. Any inactive licensee cannot perform those activities regulated under this chapter.

Subchapter I. Examinations

Sec.1101.401 An exam is required to meet the Commission’s license applicant requirement of competency prescribed under Section 1101.354. The exam must be of sufficient scope in the judgment of the Commission to determine whether a person is competent to act as a broker or salesperson in a manner that will protect the public. The exam for a salesperson must be less exacting and less stringent that the broker exam.

An applicant must satisfy the examination requirement within one year of filing the license application. An applicant who fails an exam may apply for re-examination by filing the appropriate form to the commission along with the proper fee.

Subchapter J. License Renewal

Sec.1101.451 Licenses may be renewed for a period not to exceed two years. If a license has been expired for 90 days or less, the license may be renewed by paying a fee equal to one and one-half (1 1/2) times the required renewal fee. If the license has been expired more than 90 days but less than six months, the license may be renewed by paying a fee equal to two times the required renewal fee.
If a person’s license has been expired for six months or longer, it cannot be renewed. A person may obtain a new license by submitting to reexamination and complying with the requirements and procedures for obtaining an original license.

**Sec.1101.452** The information required for license renewal is similar to the original application requirements. The license holder must:

- Provide to the Commission proof of compliance with the continuing education requirements of Section 1101.455 if not exempt under section 1101.456 (at least 15 classroom hours)
- Disclose whether the applicant has entered a plea of guilty or nolo contendere to a felony; or
- Been convicted of felony and the time for an appeal has elapsed or the judgment or conviction has been affirmed on appeal
- Comply with the criminal history background requirements of section 1101.3521.

**Sec.1101.454** The renewal of a salesperson license for the first renewal must satisfy the educational requirements of at least 18 semester hours (or equivalent classroom hours) of core real estate courses. This requirement may not be waived by the Commission.

**Sec.1101.455** A license holder must attend at least 15 classroom hours of continuing education courses approved by the commission. This section identifies the acceptable continuing education for license holder renewal unless the license holder is exempt under Section 1101.456.

**Sec.1101.456** Exemption from continuing education requirement is provided to brokers who, before October 31,1991, qualified under former section 7A(f), The Real Estate License Act(Article 6573a, Vernon's Texas Civil Statutes), as added by Section 1.041, Chapter 553, Acts of the 72nd Legislature and paid the applicable fee.
Sec.1101.458 Additional education is required for a broker who sponsors a salesperson or supervises another license holder; they must attend at least six classroom hours of broker responsibility education courses approved by the commission. This section does not apply to those brokers who are exempt from continuing education requirements under section 1101.456.

Subchapter K. Certificate Requirements

A certificate holder is one who deals in easements or right-of-way, typically in connection with telecommunication, utility, railroad, or pipeline services. Subchapter K identifies the registration and eligibility requirements for certificate holders.

Lesson Summary

This lesson covered the issuance of salesperson licenses, broker licenses, and the Subchapter K Certificate. It also described what should happen if TREC denies an applicant’s request for licensure or certification as well as the basic steps involved in appealing such a denial.

TREC has the authority to grant licenses and certificates on an inactive basis. In the event a salesperson or certificate applicant completes all necessary requirements for licensure but has no sponsoring broker, TREC issues an inactive license. Upon acquisition of a sponsoring broker, the licensee and sponsoring broker must submit a request to TREC for the sponsoring broker to change the license holder status to active and receive the copy of the salespersons license. The broker maintains custody of the license during the broker/agent relationship. If and when that relationship ends, the broker must immediately return the license to TREC.
Lesson 4: Agents and Client Representation

Lesson Topics
This lesson focuses on the following topics:

- Brokerage Practices and Representation
- Subchapter L. Practice by License Holders
- Subchapter M. The Real Estate Recovery Trust Account

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- List the license management and broker office requirements.
- Define the terms “party” and “intermediary.”
- Explain the requirements for disclosure of representation.
- Identify when and if an intermediary broker can make appointments.
- Explain the claim limits of the Real Estate Recovery Trust Account.

Brokerage Practices and Representation
Once brokers have obtained their active licenses, they can begin their brokerage business working with and representing clients. The broker must comply with the proper handling of the license in accordance with TREL A and comply with the laws of agency (client relationships).

As a broker in the real estate brokerage business, the broker may establish the association with or sponsor other license holders to perform the practices of real estate under his or her license. Remember, in order for a salesperson license holder to legally
practice he or she must be associated or sponsored by a broker. It is that broker that is ultimately responsible for salespersons’ actions and the true representative of the client when hired for the purposes of conducting real estate business.

As a broker operates a real estate brokerage, he or she may be hired by buyers, sellers, landlords, and tenants to represent them in the sale, purchase, or lease of real property. Since a broker can represent any or all of the parties to a real estate transaction, it is extremely important that compliance with the law of agency and proper disclosure of client representation is adhered to. It should to be clear to all parties for who the agent is representing. When a broker represents both sides (buyer and seller or landlord and tenant) of a real estate transaction, he or she is acting as an intermediary. There are limitations to providing advice and opinions in some intermediary representation relationships as well as disclosure and written consent requirements. A license holder is required to treat all parties fairly and honestly, regardless of representation.

Representation is one of the most important aspects of the practice of real estate and probably the most litigated area of the business. The information that follows is an excerpt from the Real Estate License Act. Due to the importance of this subject, all license holders are require to have another 30 classroom hours on the laws of agency. You will get representation information in much greater detail in the law of agency course.

**Subchapter L. Practice by License Holders**

**Sec.1101.551** Defines the terms “intermediary” and “party” as they apply to the practice of real estate:

- Intermediary means a broker who is employed to negotiate a transaction between the parties to a transaction and for that purpose may act as an agent of the parties
- Party means a prospective buyer, seller, landlord, or tenant or an authorized representative of a buyer, seller, landlord, or tenant, including a trustee,
guardian, executor, administrator, receiver, or attorney-in-fact. The term does not include a license holder who represents a party.

Sec.1101.552 A resident broker shall maintain a fixed office in this state and that address of the office shall be designated on the broker’s license. If the broker moves and changed his or her address, the broker, no later than 10 days after the broker moves, shall submit to the Commission an application accompanied by the applicable fee to designated the broker’s new office address. A non-resident broker is exempt from the requirement to maintain a fixed office in this state.

A broker who maintains more than one place of business in this state shall obtain a branch office license for each additional office maintained by the broker.

All license holders shall provide the Commission with their current mailing address, telephone number, and email address if available. The Commission shall be notified of any changes to this information.

Sec.1101.553 All residential rental locator licenses shall be prominently displayed at the place of business in a place accessible to clients and prospective clients and the consumer information for 1-1 providing the Commission’s mailing address and phone number.

Sec.1101.554 A copy of each salespersons license shall be sent to the broker’s fixed business address of whom the salesperson is sponsored or associated with.

Sec.1101.555 When receiving offers to purchase real estate, a licensed holder shall advise each buyer, in writing, that the buyer should have an abstract covering the subject real estate examined by an attorney or obtain a title insurance policy.

Note: The promulgated contract forms that are required for use by license holders contain the appropriate verbiage to meet the requirements of this section.
Sec.1101.556 Notwithstanding other laws, a license holder is not required to inquire about, disclosure or release information relating to whether a previous or current occupant had, may have had, has or may have AIDS, and HIV-related illness, or an HIV infection as defined by the Centers for Disease Control (CDC). Nor is there a requirement for the disclosure of a death that occurred on a property by natural causes, suicide, or accident unrelated to the condition of the property.

Sec.1101.557 Acting as an agent or broker is subject to regulation of certain transactions. A broker who represents a party to a real estate transaction or who lists real estate for sale under an exclusive agreement is that party's agent and:

- May not instruct another broker to directly or indirectly violate Section 1101.652(b)(22)
- Must inform the party if the broker receives material information related to a transaction to list, buy, sell, or lease the party's real estate, including the receipt of an offer by the broker; and
- Shall at a minimum, answer the party’s questions and present any offer to or from the party.

A license holder who has the authority to bind a party to a lease or sale under a power of attorney or by a property management agreement is not in violation of this section for the sole delivery of an offer to a party.

Sec.1101.558 Representation shall be disclosed. A license holder who represents a party to a proposed real estate transaction shall disclose, orally or in writing, that representation relationship at the first contact with another party to the transaction or another license holder who represents another party to the transaction.

A license holder shall provide to a party to a real estate transaction, at the time of the first substantive dialogue with the party, the statement prescribed by Section 1101.558 Subsection (d) below; also referred to as Information about Brokerage Services. This statement is not required for residential leases for one year or less and a sale is not
being considered nor required to be provided to a party who has representation by another license holder.

**Note:** “Substantive dialogue” means a meeting or written communication that involves a substantive discussion relating to a specific property.

(d) The written statement required by Section 1101.558 must be printed in a format that uses at least 10-point type and read as follows:

**Information about Brokerage Services**

"Before working with a real estate broker, you should know that the duties of a broker depend on whom the broker represents. If you are a prospective seller or landlord (owner) or a prospective buyer or tenant (buyer), you should know that the broker who lists the property for sale or lease is the owner's agent. A broker who acts as a subagent represents the owner in cooperation with the listing broker. A broker who acts as a buyer's agent represents the buyer. A broker may act as an intermediary between the parties if the parties consent in writing. A broker can assist you in locating a property, preparing a contract or lease, or obtaining financing without representing you. A broker is obligated by law to treat you honestly.

"IF THE BROKER REPRESENTS THE OWNER: The broker becomes the owner’s agent by entering into an agreement with the owner, usually through a written listing agreement, or by agreeing to act as a subagent by accepting an offer of subagency from the listing broker. A subagent may work in a different real estate office. A listing broker or subagent can assist the buyer but does not represent the buyer and must place the interests of the owner first. The buyer should not tell the owner’s agent anything the buyer would not want the owner to know because an owner’s agent must disclose to the owner any material information known to the agent."
"IF THE BROKER REPRESENTS THE BUYER: The broker becomes the buyer's agent by entering into an agreement to represent the buyer, usually through a written buyer representation agreement. A buyer's agent can assist the owner but does not represent the owner and must place the interests of the buyer first. The owner should not tell a buyer's agent anything the owner would not want the buyer to know because a buyer's agent must disclose to the buyer any material information known to the agent.

"IF THE BROKER ACTS AS AN INTERMEDIARY: A broker may act as an intermediary between the parties if the broker complies with The Texas Real Estate License Act. The broker must obtain the written consent of each party to the transaction to act as an intermediary. The written consent must state who will pay the broker and, in conspicuous bold or underlined print, set forth the broker's obligations as an intermediary. The broker is required to treat each party honestly and fairly and to comply with The Texas Real Estate License Act. A broker who acts as an intermediary in a transaction: (1) shall treat all parties honestly; (2) may not disclose that the owner will accept a price less than the asking price unless authorized in writing to do so by the owner; (3) may not disclose that the buyer will pay a price greater than the price submitted in a written offer unless authorized in writing to do so by the buyer; and (4) may not disclose any confidential information or any information that a party specifically instructs the broker in writing not to disclose unless authorized in writing to disclose the information or required to do so by The Texas Real Estate License Act or a court order or if the information materially relates to the condition of the property. With the parties' consent, a broker acting as an intermediary between the parties may appoint a person who is licensed under The Texas Real Estate License Act and associated with the broker to communicate with and carry out instructions of one party and another person who is licensed under that Act and associated with the broker to communicate with and carry out instructions of the other party.
"If you choose to have a broker represent you, you should enter into a written agreement with the broker that clearly establishes the broker's obligations and your obligations. The agreement should state how and by whom the broker will be paid. You have the right to choose the type of representation, if any, you wish to receive. Your payment of a fee to a broker does not necessarily establish that the broker represents you. If you have any questions regarding the duties and responsibilities of the broker, you should resolve those questions before proceeding."

Sec.1101.559 A broker may act as an intermediary between parties to a real estate transaction if the broker obtains written consent from each party and the agreement states the source of any expected compensation to the broker. An intermediary shall act fairly and impartially. An appointment of an associated license holder made by an intermediary broker to communicate with, carry out the instructions of, and provide opinions and advise to that represented parties to whom that associate is appointed is a fair and impartial act.

Authorization to act as an intermediary written in a listing agreement or buyer representation agreement is sufficient to establish the appropriate written consent.

Sec.1101.560 Associated license holder appointments made by the intermediary broker must be made to both sides or parties to the real estate transaction provided the written consent of the parties is obtained and written notice of the appointments is consented to by the parties. A license holder appointed under this section may provide opinions and advice to the parties to whom the appointment is made.

Note: A broker acting as an intermediary must have at least two other license holders associate with them to make appointments in an intermediary relationship.
Subchapter M. Real Estate Recovery Trust Account

Sec.1101.601 The Commission shall maintain a real estate recovery trust account to reimburse aggrieved persons who suffer actual damages caused by an unlawful act of a license holder, certificated holder, or an employee agent of a license/certificate holder. The license or certificate must have been held at the time the act was committed.

Sec.1101.603 Each applicant for an original license must pay a fee of $10 credited by the Commission to the Recovery Trust Account and an original or renewal applicant for a certificate holder or registration will pay a $50 fee credited to the Trust Account.

Other fees or payments into the Real Estate Trust Account come from penalties for violations collected under Subchapter O. And if the Real Estate Recovery Trust Account falls below $1 million, the Commission may determine each license holder’s next renewal application must pay an additional fee equal to the lesser of $10 or a pro data share of the amount necessary to obtain a balance in the account of $1.7 million. To ensure the availability of sufficient funds to pay anticipated claims, the Commission by rule may provide for additional assessments.

Sec.1101.606 Claim for payment from the Real Estate Recovery Trust Account to an aggrieved party can be filed with the commission within two years after a court ordered judgment against a license or certificate holder is final. The aggrieved party can apply to the court that entered the judgment for an order for payment from the Real Estate Recovery Trust Account, the amount unpaid on the judgment.

Sec.1101.609 Payments made out of the Real Estate Recovery Trust Account shall be court ordered if all requirements have been satisfied.

Sec.1101.610 The amount of payment that can be made from the trust account for claims, including attorney fees and court costs are limited to:

- A total of $50,000 arising out of a single incident regardless of the number of claimants, or
A total of $100,000 against a single license or certificate holder until the amounts owed to the trust account have been reimbursed by the license/certificate holder.

**Lesson Summary**

This lesson covered disclosure and agency and how these responsibilities can change in intermediary transactions. An agent must provide either written or verbal disclosure to all potential buyers or sellers, explaining whom the agent represents. This disclosure must be presented at the beginning of the first substantive dialogue with the individuals interested in a particular transaction.

Prior to the formation of an agency relationship, however, brokers and salespeople must give potential principals a written statement describing the role of a real estate licensee in real estate transactions. By law, brokers and salespeople must use TREC’s written statement from Section 1101.558 (d) of the Real Estate License Act to make this disclosure; for convenience they can use TREC’s form OP-K, *Information about Brokerage Services*, which provides a preprinted version of this statement.

It is important that members of the public understand the role of real estate agents and brokers in a real estate transaction. Proper disclosure is the only way to ensure that all of those involved in a transaction understand each other’s roles and are clear about who represents whom. That is to say, proper disclosure helps customers and clients to understand where an agent or broker’s fiduciary duties lie.

Intermediary positions pose a unique challenge. If an agent or broker acts as an intermediary, then written disclosure must be provided about what the intermediary role entails. When an agent or broker assumes this role, he or she must have both parties agree to intermediary representation and sign a promulgated intermediary disclosure form.
The Commission maintains a monetary fund to reimburse members of the public who have been financially harmed by the unlawful or unscrupulous practices of its licensees. This reimbursement fund is referred to as the Recovery Trust Account or the Real Estate Recovery Trust Account. Payment made from the Trust Account must be court ordered and are limited to $50,000 arising out of a single incident or $100,000 per license holder unless the debt has been repaid with the accrued interest.
Lesson 5: Prohibited Practices and Disciplinary Action

Lesson Topics

This lesson focuses on the following topics:

- Subchapter N. Prohibited Practices and Disciplinary Proceedings
- Subchapter O. Administrative Penalties
- Subchapter P. Other Penalties and Enforcement provisions
- Subchapter Q. General Provisions Relating to Liability Issues

Lesson Learning Objectives

By the end of this lesson, you should be able to:

- Recognize prohibited practices by license holders.
- Identify grounds for license suspension and revocation.
- Describe the limits of the Commission’s powers for administrative penalty.
- Describe the process of disciplinary proceedings and hearings.
- Identify the limitations of liability and the civil and criminal penalties.

Subchapter N. Prohibited Practices and Disciplinary Proceedings

Sec.1101.651 A licensed broker may not pay a commission or compensation to a person directly or indirectly for performing an act of a broker unless the person is a license holder or a licensed real estate broker in another state and does not conduct any of the negotiations in this state for which the commission or compensation is paid.
A salesperson may not accept compensation for a real estate transaction from a person other than the broker with whom the salesperson is associated or sponsored by at the time the salesperson earned the commission or compensation. Nor may the salesperson pay a commission or compensation to a person except through the broker with whom the salesperson is associated with or sponsored by.

A broker acting as an intermediary or an appointed license holder under the intermediary broker relationship is prohibited from:

- Disclosing to the buyer or tenant that the seller or landlord will accept a price less than the asking price, unless otherwise instructed in a separate writing by the seller or landlord
- Disclosing to the seller or landlord that the buyer or tenant will pay a price greater than the price submitted in a written offer to the seller or landlord, unless otherwise instructed in a separate writing by the buyer or tenant;
- Disclosing any confidential information or any information a party specifically instructs the broker or salesperson in writing not to disclose, unless otherwise required to be disclosed by law, court order or information materially relates to the property condition.

Sec.1101.652 The Commission may suspend or revoke a license or take other disciplinary action authorized by this Chapter if:

(a) A license holder:
   (1) Enters a plea of guilty or nolo contendere to or is convicted of a felony or a criminal offense involving fraud, and the time for appeal has elapsed or the judgment or conviction has been affirmed on appeal, without regard to an order granting community supervision that suspends the imposition of the sentence;
(2) Procures or attempts to procure a license under this chapter for the license holder or a salesperson by fraud, misrepresentation, or deceit or by making a material misstatement of fact in an application for a license;

(3) Engages in misrepresentation, dishonesty, or fraud when selling, buying, trading, or leasing real property in the name of:
   (A) The license holder;
   (B) The license holder's spouse; or
   (C) A person related to the license holder within the first degree by consanguinity;

(4) Fails to honor, within a reasonable time, a check issued to the Commission after the Commission has sent by certified mail a request for payment to the license holder's last known business address according to Commission records;

(5) Fails or refuses to produce on request, for inspection by the Commission or a Commission representative, a document, book, or record that is in the license holder's possession and relates to a real estate transaction conducted by the license holder;

(6) Fails to provide, within a reasonable time, information requested by the Commission that relates to a formal or informal complaint to the Commission that would indicate a violation of this chapter;

(7) Fails to surrender to the owner, without just cause, a document or instrument that is requested by the owner and that is in the license holder's possession;

(8) Fails to use a contract form required by the commission under Section 1101.155;
(9) Fails to notify the Commission, not later than the 30th day after the date of a final conviction or the entry of a plea of guilty or nolo contendere, that the person has been convicted of or entered a plea of guilty or nolo contendere to a felony or a criminal offense involving fraud; or

(10) Disregards or violates this chapter.

(b) Or if the license holder, while acting as a broker or salesperson:

(1) Acts negligently or incompetently;

(2) Engages in conduct that is dishonest or in bad faith or that demonstrates untrustworthiness;

(3) Makes a material misrepresentation to a potential buyer concerning a significant defect, including a latent structural defect, known to the license holder that would be a significant factor to a reasonable and prudent buyer in making a decision to purchase real property;

(4) Fails to disclose to a potential buyer a defect described by Subdivision (3) that is known to the license holder;

(5) Makes a false promise that is likely to influence a person to enter into an agreement when the license holder is unable or does not intend to keep the promise;

(6) Pursues a continued and flagrant course of misrepresentation or makes false promises through an agent or salesperson, through advertising, or otherwise;

(7) Fails to make clear to all parties to a real estate transaction the party for whom the license holder is acting;
(8) Receives compensation from more than one party to a real estate transaction without the full knowledge and consent of all parties to the transaction;

(9) Fails within a reasonable time to properly account for or remit money that is received by the license holder and that belongs to another person;

(10) Commingles money that belongs to another person with the license holder’s own money;

(11) Pays a commission or a fee to or divides a commission or a fee with a person other than a license holder or a real estate broker or salesperson licensed in another state for compensation for services as a real estate agent;

(12) Fails to specify a definite termination date that is not subject to prior notice in a contract, other than a contract to perform property management services, in which the license holder agrees to perform services for which a license is required under this chapter;

(13) Accepts, receives, or charges an undisclosed commission, rebate, or direct profit on an expenditure made for a principal;

(14) Solicits, sells, or offers for sale real property by means of a lottery;

(15) Solicits, sells, or offers for sale real property by means of a deceptive practice;

(16) Acts in a dual capacity as broker and undisclosed principal in a real estate transaction;
(17) Guarantees or authorizes or permits a person to guarantee that future profits will result from a resale of real property;

(18) Places a sign on real property offering the real property for sale or lease without obtaining the written consent of the owner of the real property or the owner's authorized agent;

(19) Offers to sell or lease real property without the knowledge and consent of the owner of the real property or the owner's authorized agent;

(20) Offers to sell or lease real property on terms other than those authorized by the owner of the real property or the owner's authorized agent;

(21) Induces or attempts to induce a party to a contract of sale or lease to break the contract for the purpose of substituting a new contract;

(22) Negotiates or attempts to negotiate the sale, exchange, or lease of real property with an owner, landlord, buyer, or tenant with knowledge that that person is a party to an outstanding written contract that grants exclusive agency to another broker in connection with the transaction;

(23) Publishes or causes to be published an advertisement, including an advertisement by newspaper, radio, television, the Internet, or display, that misleads or is likely to deceive the public, tends to create a misleading impression, or fails to identify the person causing the advertisement to be published as a licensed broker or agent;

(24) Withholds from or inserts into a statement of account or invoice a statement that the license holder knows makes the statement of account or invoice inaccurate in a material way;
(25) Publishes or circulates an unjustified or unwarranted threat of a legal proceeding or other action;

(26) Establishes an association by employment or otherwise with a person other than a license holder if the person is expected or required to act as a license holder;

(27) Aids, abets, or conspires with another person to circumvent this chapter;

(28) Fails or refuses to provide, on request, a copy of a document relating to a real estate transaction to a person who signed the document;

(29) Fails to advise a buyer in writing before the closing of a real estate transaction that the buyer should:

(A) Have the abstract covering the real estate that is the subject of the contract examined by an attorney chosen by the buyer; or
(B) Be provided with or obtain a title insurance policy;

(30) Fails to deposit, within a reasonable time, money the license holder receives as escrow agent in a real estate transaction:

(A) In trust with a title company authorized to do business in this state; or
(B) In a custodial, trust, or escrow account maintained for that purpose in a banking institution authorized to do business in this state;

(31) Disburses money deposited in a custodial, trust, or escrow account, as provided in Subdivision (30), before the completion or termination of the real estate transaction;
(32) Discriminates against an owner, potential buyer, landlord, or potential tenant on the basis of race, color, religion, sex, disability, familial status, national origin, or ancestry, including directing a prospective buyer or tenant interested in equivalent properties to a different area based on the race, color, religion, sex, disability, familial status, national origin, or ancestry of the potential owner or tenant; or

(33) Disregards or violates this chapter.

Sec.1101.654 The Commission shall suspend or revoke a license or certificate of registration of a person who is not a licensed attorney in this state who, for direct or indirect compensation, engages in acts of unauthorized practice of law such as:

(1) Drafting any instrument or form in the sale, exchange, option or lease of real property other than one prepared by the property owner; or prepared by an attorney and required by the property owner in accordance with Section 1101.155; or

(2) Advising a person regarding the validity or legal sufficiency of an instrument or the validity of title to real property

Notwithstanding any other law, a license or certificate holder who completes a contract form for the sale, exchange, option, or lease of an interest in real property incidental to acting as a broker is not engaged in the unauthorized or illegal practice of law in this state if the form was:

(1) Adopted by the Commission for the type of transaction for which the form is used;

(2) Prepared by an attorney licensed in this state and approved by the attorney for the type of transaction for which the form is used; or

(3) Prepared by the property owner or by an attorney and required by the property owner.
Sec.1101.655 The Commission may revoke a license, approval, or certificate of registration if the Commission makes a payment from the Real Estate Recovery Trust Account to satisfy all or part of a judgment against a license or certificate holder. The Commission may probate an order of revocation. A person is not eligible for a license or certificate until the person has repaid in full the amount paid from the Recovery Trust Account plus interest at the legal rate.

Sec.1101.656 In addition to any other authority under this chapter, the Commission may suspend or revoke a license place on probation a person whose license has been suspended, or reprimand a license holder who violates this chapter or a Commission rule. The Commission may require a license holder whose license is suspended or revoked to regularly report to the Commission, limit the practices of the license holder, or require additional professional education.

Sec.1101.657 If the Commission proposes to deny, suspend, or revoke a person's license or certificate of registration, the person is entitled to a hearing conducted by the State Office of Administrative Hearings.

Sec.1101.658 A person aggrieved by a ruling, order, or decision under this subchapter is entitled to appeal to a district court in the county in which the administrative hearing was held.

Sec.1101.659 The Commission may order a refund be paid to a consumer as a result of an informal settlement in lieu of imposing administrative penalty or other sanctions. The amount of an ordered refund may not exceed the amount the consumer paid for the services of the license holder.

Sec.1101.662 In consideration of a temporary suspension of a person’s license to practice under this chapter, the Commission shall appoint a disciplinary panel consisting of three members to determine if the continued practice of this person constitutes a continued threat to the public welfare. If so, the Commission shall suspend the license.
Subchapter O. Administrative Penalty

Sec.1101.701 The Commission may impose an administrative penalty on a person who violates this chapter or combine a proceeding of administrative penalty with another proceeding to suspend or revoke a license.

Sec.1101.702 The amount of an administrative penalty may not exceed $5,000 for each violation. The amount of penalty is determined on the basis of the seriousness, nature, and extent of the violation and any history of previous violations.

Sec.1101.703 Upon investigation of a possible violation, if it has been determined that a violation has occurred, the administrator may issue a notice of violation along with the recommendation of the imposing administrative penalty, any other penalties, and the amount of the penalty.

A respondent to this notice has the right to a hearing to contest the alleged violation, the recommended penalty, or both. The respondent will have 20 days after receipt of the notice to accept the determination or in writing request a hearing.

Sec.1101.705 If a hearing is requested, an administrative law judge of the State Office of Administrative Hearings shall conduct the hearing. The administrative law judge shall issue to the Commission, based on the findings, a proposal for a decision regarding the violation and any proposed administrative penalty. The Commission's Notice of Order shall be provided to the person and include the person's right to a judicial review of the order

Sec.1101.707 Within 30 days after the Commission's order becomes final, the respondent has the option to pay the administrative penalty or file a petition for the judicial review, appealing the findings and contesting the occurrence of the violation, amount of the penalty, or both.
Sec.1101.708 If a person does not pay the ordered administrative penalty and the enforcement is not stayed, the administrator may refer the matter to the Attorney General for collection.

Sec.1101.709 Administrative penalties imposed shall accrue interest at a rate charged on loans to depository institutions by the New York Federal Reserve Bank.

Subchapter P. Other Penalties and Enforcement Provisions

Sec.1101.751 Provides for the Commission’s injunctive authority. If the commission determines that a person has violated or is about to violate this chapter, the attorney general or the county attorney or district attorney in the county in which the violation has occurred or is about to occur or in the county of the defendant’s residence may bring an action in the name of the state in the district court of the county to abate or temporarily or permanently enjoin the violation or to enforce this chapter.

Sec.1101.756 A person commits an offense if the person willfully violates or fails to comply with this chapter or a commission order is a Class A misdemeanor. A Class A misdemeanor is punishable of a fine of up to $4,000 and, and/or up to one year imprisonment.

Sec.1101.756 If the Commission deems a person is violating this chapter, chapter 1102, or a rule adopted under these chapters, the Commission after providing notice and opportunity for a hearing, may issue a cease and desist order prohibiting the person from engaging in the activity.

Subchapter Q. General Provisions Relating to Liability Issues

Sec.1101.801 Disciplinary action taken against a person under Section 1101.652 does not relieve the person from civil or criminal liability.
Sec. 1101.802 A person is not civilly or criminally liable if they comply with Section 1101.556 and make no inquiry or disclosure relating to whether a previous or current occupant of real property had, may have had, has, or may have AIDS, an HIV-related illness, or HIV infection as defined by the Centers for Disease Control and Prevention of the United States Public Health Service.

Sec. 1101.802 A licensed broker is liable to the Commission, the public, and the broker's clients for any conduct engaged in under this chapter by the broker or by a salesperson associated with or acting for the broker.

Sec. 1101.804 A license holder or nonprofit real estate board or association that provides information about real property sales prices or the terms of a sale for the purpose of facilitating the listing, selling, leasing, financing, or appraisal of real property is not liable to another person for providing that information unless the disclosure of that information is specifically prohibited by statute.

Sec. 1101.805 These provisions of liability for misrepresentation or concealment do not diminish a broker's responsibility for the acts or omissions of a salesperson associated with or sponsored by them and acting for them.

A party is not liable for a misrepresentation or a concealment of a material fact made by a license holder in a real estate transaction unless the party:

(1) Knew of the falsity of the misrepresentation or concealment; and
(2) Failed to disclose the party's knowledge of the falsity of the misrepresentation or concealment.

A license holder is not liable for a misrepresentation or a concealment of a material fact made by a party to a real estate transaction unless the license holder:

(1) Knew of the falsity of the misrepresentation or concealment; and
(2) Failed to disclose the license holder’s knowledge of the falsity of the misrepresentation or concealment.

**Lesson Summary**

This lesson covered the prohibited practices of license holders, TREC’s disciplinary authority, the administration of penalties, and the basic legal shape of hearings. We also discussed the various conditions that can lead to license suspension or revocation, as well as some of the civil and criminal penalties licensees can face. TREC requires real estate licensees to act in an ethical, competent, honest, and judicious manner throughout any real estate transaction. Licensees are expected to put their clients’ interests above their own. When TREC determines that a broker or salesperson has violated the law, it can fine the real estate licensee in addition to suspending or revoking his or her license.

When a complaint is submitted to TREC related to a license holder, TREC determines the validity of a violation and evaluates the severity of harm to the complainant as well as the history of compliance by the license holder in determining the extent of the imposed penalty or disciplinary action against the license holder for the violation. The licensee has the right to request a hearing from TREC, as well as a right to appeal TREC rulings in district courts in the same county where the complaint was filed. Aggrieved clients may also bring civil and criminal charges against licensees. TREC’s various disciplinary actions do not preclude or supersede suits brought in courts of law.
Lesson 6: Real Estate Practice Case Studies

Lesson Topic
This lesson focuses on the following topic:

- Practice of Real Estate by License Holders through Case Study Scenarios

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Identify the appropriate course of action in given case study scenarios
- Describe the lawful actions necessary for a license holder to take in case study scenarios, avoiding any grounds for disciplinary actions and license suspension or revocation.

Practice of Real Estate by License Holders through Case Study Scenarios
We have covered many specifics of the Real Estate License Act, which is Chapter 1101 of the Texas Occupations Code. To ensure a comprehensive understanding of this material, we will now integrate the information provided in this section through a series of questions delivered in case study form. Please read each case study thoroughly and consider each situation.

Case Study #1
Broker A was advertising his brokerage services in the newspaper while his license was inactive and being renewed. Broker A has held his license for five years. Is Broker A
violating any TREC rules by continuing to advertise his brokerage services during the inactive period?

**Answer**

YES. According to Section 1101.351 (b) of the Real Estate License Act, no individual may sell, lease, advertise, or exchange real estate services without an active license. If the licensee is a salesperson, then he or she may only sell, lease, advertise, or exchange real estate while acting under his or her sponsoring broker. If that sponsoring broker’s license status is "inactive," then all agents must stop providing real estate services until the broker renews his license.

**Case Study #2**

A friend of Salesperson B asked for his help when she was selling her own property. Salesperson B negotiated a contract for the sale and received compensation for the assistance. Has Salesperson B violated any portion of the Real Estate License Act?

**Answer**

YES. According to Section 1101.652 of the Real Estate License Act, a licensed real estate salesperson should only accept compensation through his or her sponsoring broker. Receiving funds directly from the principal, regardless of any relationship that may exist between the principal and the salesperson, is a direct violation of the law.

**Case Study #3**

TREC fines Agent F for representing himself as a broker when he does not hold a broker’s license. TREC received a complaint about this conduct and determined that the violation had taken place on 15 consecutive days. According to the Real Estate License Act, what is the maximum fine that TREC can administer for this violation?

**Answer**

TREC can administer a maximum fine of $75,000 for this violation. According to Sec. 1101.702, the maximum administrative fine is $5,000 per violation. For certain serious
violations—including practicing real estate without a proper license—each day that the violation continues is fined as an independent violation. A serious violation that goes on for 15 days is subject to an administrative penalty of 15 times the maximum fine, or $15,000.

Case Study #4
Broker R wants to advertise a piece of vacant land for sale. Instead of listing the property with a standard list price, Broker R puts an advertisement in the local newspaper stating that he is selling $100 lottery tickets for the property and a drawing on New Year’s Eve will determine the winner of the property. According to the Real Estate License Act, is this a legal way to advertise property for sale?

Answer
NO. Section 1101.652 (14) of the Real Estate License Act states that it is illegal to solicit property, sell property, or offer property for sale (advertise) by means of a lottery. Doing so can result in suspension or revocation of one’s license.

Case Study #5
Broker Q and her client had a contract accepted for purchase of a single family home. In order to expedite the inspection process, Broker Q strongly recommends an inspector she has worked with in the past and assures her client that the inspector will provide a thorough and comprehensive home inspection. Broker Q also states that the inspection would include a wood-boring pest inspection. Is this risky behavior for Broker Q?

Answer
YES. A broker should think hard before steering her client in the direction of any particular service provider since she cannot truly guarantee the quality or effectiveness of the service. TREC’s Canons of Professional Ethics require licensees to conduct themselves with integrity and competence, as well as to make their clients’ interests their foremost concern. Because this is so, it would be more prudent for Broker Q to
offer a list of potential inspectors to her client and allow her client to choose for himself. Broker Q might offer general advice about choosing an inspector, but she should not make or imply any judgments about the quality of the report a specific inspector would provide.
Real Property Ownership and Land Use

Lesson 7: Personal and Real Property Ownership

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- History of Land Ownership
- Characteristics of Real Estate and Land
- Land, Real Estate, and Real Property
- Ownership Rights
- Real Property vs. Personal Property

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Describe the difference between land, real estate, and real property.
- Recognize the difference between real property and personal property.
- State the definition of a fixture.
- Explain the general character of surface, subsurface, and air rights, as well as littoral and riparian rights.

Introduction
Before covering the definitions and details of modern real property and land use, we will first examine the development of these ideas. We are primarily concerned with present-
day land use and the various controls and ownership conditions that shape the contemporary views of property. To understand the modern versions of these ideas, one must understand their evolution. In this lesson, we will discuss the physical and economic characteristics that distinguish land from other commodities and also cover the distinctions between land, real estate, and real property. We will also examine the rights associated with real property and learn the difference between real property and personal property. Within this exploration, we will discuss alterations to land and property and how they can affect whether something counts as personal property or real property.

**History of Land Ownership**

In medieval Europe, the average person did not own land in the way that we think of someone owning land today. Much contemporary land ownership is what we call allodial, or complete, whereas in medieval times, a kind of abbreviated land ownership was established through a system known as *feudalism*.

Feudalism was a system of land ownership in which all the land in the kingdom was considered to be owned by the head of the state (the king or queen). The king would allow a few lords (the king’s vassals) to use some of the land in exchange for taxes and allegiance. The lords, following the same system, would allow peasants or their vassals to live on and work the land in exchange for survival. Within the feudal system, however, the lord did have responsibilities to the vassal, which included the provision of:

- A portion of land called a “fief” that was neither given nor sold to vassals, but only loaned for use to provide a return to the “owner”
- Just protection under the law
- Maintenance of the land

In brief, the lord had to protect the vassal’s land interest and guarantee the vassal’s quiet occupation. If the vassal became involved in a dispute, then the lord was obligated
to defend the vassal in order to protect his land. In return for the use of the lord’s land and his broad protection, a vassal had responsibilities to the lord. He was generally obligated to provide certain services to the lord, including military service if the lord became involved in a military campaign. These services were the means by which the vassal gained his property rights (but not yet ownership) and the protection of those rights.

**Allodial Land Ownership**

In contrast to feudal land tenure with obligations and duties to the owner, an allodial ownership system is one in which the land is owned completely without an obligation of services or duties to another. The land is owned absolutely and may be passed to heirs. This sort of complete ownership is commonly called an allodial estate or “fee simple estate” (a concept that will be discussed further in later lessons). This contemporary concept of land ownership stands in stark contrast to the reciprocal obligations and ongoing relationships under medieval feudalism.

**Characteristics of Real Estate and Land**

The following screens detail the physical and economic characteristics that set land and real estate apart from all other commodities. To help keep the physical and economic characteristics of land and real estate separate in your mind, remember this point: the most important difference between physical characteristics and economic characteristics lies in their origin. Physical characteristics occur naturally while economic characteristics are man-made.

The physical and economic characteristics we are about to discuss are relevant to all land, real estate, and real property. For now, do not worry about how these three commodities differ from each other. Instead, focus on the features that distinguish these commodities from all other commodities and personal property. Following convention, the following screens may use interchangeably the terms “real estate” and “land”; at this early stage of our discussion, this interchangeability of terms is unproblematic. But
please remember that there are important differences that we will clarify later in this lesson.

Physical Characteristics
The physical characteristics that make land or real estate a distinctive commodity are:

- Immobility
- Durability or indestructibility
- Uniqueness or non-homogeneity

We will now discuss the details of these characteristics.

Immobility
While it is true that some parts of what we usually call “land” can be removed, such as soil or plants (a process of severance, which is discussed later), a parcel has a particular geographical location that will remain constant, barring erosion or slow, geological changes. The actual land itself—the tractor lot that an individual purchases—is immovable. That is, when a person buys a piece of land he or she cannot simply load it up and take it home. Land is immovable. Thus deeds and titles are used to convey land ownership.

Durability or Indestructibility
“Physical durability” refers to the permanence of land. While its economic value and surface appearance may change, land itself is indestructible for all practical purposes. For Example, in terms of the basic character of the surface land, much of the contemporary United States looks just as it did hundreds even thousands of years ago (and it is likely to continue to look this way for many centuries to come). Despite fluctuations in culture, value, and use, the land itself tends to endure in approximately the same form over time. This durability also makes transference of land to others, such as heirs, possible.
Uniqueness or Non-Homogeneity

The physical location of a lot or parcel is an integral feature of its identity. Because land occupies a specific site that no other piece of land may also occupy, it is unique unto itself and not interchangeable with an exact substitute. Other commodities are unique. For Example, a 50 pound slab of beef may be replaced or exchanged with another 50 pound slab of beef and the exchange is indistinguishable; however, an acre of land in the desert exchanged for an acre of land in Hawaii is hardly an exact substitute, even though they are both an acre of land. If the location changes, then we are talking about a different plot of land. No two tracts of land are exactly alike because no two lots can occupy exactly the same space. Land is considered a non-fungible commodity due to its uniqueness. That is to say, each parcel of land is an object that has no precise equal or substitute.

The fact that two tracts of land are not exactly alike does not mean that they cannot have similar properties or similar values. For Example, a house located on 50 acres on a lake can be of similar price to another house on the same lake or even a 500 acre ranch located in New Mexico. It is precisely due to the fact that comparisons between properties can be made that market comparison and real estate appraising are done.

Economic Characteristics

The economic characteristics that distinguish land as a commodity are:

- Economic scarcity
- Alteration
- Fixity
- Situs

We will now discuss the details of these characteristics.
Economic Scarcity
Although good, usable land may be physically scarce in the world, this is not what the term “economic scarcity” describes. Economic scarcity is created solely by demand for land in particular areas. Like all commodities, land is most valuable when it is in short supply and in high demand, and some land is more desirable than other land.

Another way to grasp the notion of scarcity is to think about the fact that the economic scarcity of land changes over time, even if the physical amount of available land does not change. For Example, land in densely populated cities or on tropical beachfronts is scarce; however, this economic scarcity is only due to the high demand for land in that particular geographical region, not because some geological catastrophe destroyed large parcels of earth and made land physically scarce.

Technology can also affect the economic scarcity of land. For Example, new farming techniques may make food production possible on previously unusable land. This could make the previously useless land now economically scarce, even if there is the same physical quantity of land as before.

Alteration
The economic worth of land depends heavily on how it is developed, altered, and modified by building and other developments. A neighborhood that was once undesirable due to its inaccessibility or lack of amenities, but has seen improved roads, schools, and hospitals built, may now become more desirable and the prices for the homes increase. Conversely, if a sewage treatment plant is built next to a neighborhood, the owners are likely to see their homes’ values decrease. Alteration is one reason real estate prices may fluctuate.

Fixity
The investment permanence of land, also known as “fixity,” refers to the idea that the cost of both real estate and improvements to real estate take many years to recoup. Before anyone invests large amounts of money in any one parcel, they must consider
whether the land will remain useful 20 or 30 years in the future when the property is finally paid off. This level of commitment on the part of the investor is not a physical characteristic of the land; it is created with economic conventions. For this reason, real estate investments are sometimes referred to as “sunk costs” because the cost has already been expended and is gone whether you sell in five years or 20 years.

**Situs**
The importance of location in the real estate industry is now a cultural cliché; however, the aspect behind the cliché, location preference, or *situs*, is an economic preference for a particular location and not a geographic one. For residential areas, the ambiance of a neighborhood is important, and therefore parks and friendly neighbors are a factor in value. When looking for a site to build an industrial park, ambiance is not important, but access to transportation and inexpensive land to build large warehouses are. Situs is an economic preference for a certain location or characteristic that affects land and value. The preference is a social convention that creates part of the value of a particular tract, so we say that situs is an economic rather than a physical characteristic.

**Characteristics Impact the Real Estate Market**
These various characteristics have an impact on land use as well as the real estate market and ultimately the values of real property. The real estate market is impacted not only by the economic and physical characteristics of land but by many other factors such as supply and demand, demographics, employment, government controls and interest rates. The amount of supply and demand may differ between different areas or markets, which can be defined as small as neighborhoods or as large as cities or states and even national levels. These markets provide insight as to the potential value of what a property might sell for. This is referred to as the market value or the most probable price a buyer may be willing to pay for the subject property. The market price is the amount a property actually sells for or what a buyer had paid for a subject property.

The impact of supply and demand on value and the market differ. If supply is high and demand is high, the values will remain stable. As supply decreases prices will increase
and as supply increases prices will decrease. Supply and price move in opposite directions. As demand increases the prices increase and as demand decreases the prices decrease. Demand and price move in the same direction. Assessing value will be discussed in much greater detail throughout the courses.

**Land, Real Estate, and Real Property**

At first glance, the terms “land,” “real estate,” and “real property” appear to be interchangeable. The technical use of these terms in real estate practice involves subtle but important differences that licensees must understand. Each of these three terms, beginning with “land,” builds upon the previous term adding more characteristics. Previously, we discussed the physical and economic characteristics of the three commodities and the traits that set them apart from personal property. Now we must consider the characteristics of each of the commodities individually:

- **Land**—Refers to more than a tract of earth. "Land" is defined as not only the natural resources seen on the surface of the land but the minerals below the surface and the air above the surface. When a person acquires land, it is possible to acquire all that lies below and above it as well.

- **Real estate**—Encompasses everything in the definition of "land," but it adds permanent buildings and structures (known as improvements) to the definition, which basically comprises the land and everything attached to the land. Real estate is also referred to as “realty.”

- **Real property**—Property ownership includes a set of legal rights, specifically the owner's rights, which deals with the right to control the property, the right of exclusion, the right of possession, the right of disposition, and the right of enjoyment. While “real estate” refers to the land and improvements on it, “real property” refers to both the real estate and the set of rights associated with it.
General Considerations

As a practical convention, real estate licensees do not burden a conversation with the technical distinctions between the three commodities. In everyday use, these terms are interchangeable. While in the field or otherwise discussing land, real estate, or real property, it is not generally important that one differentiate between the three. In fact, we will use the three terms interchangeably in subsequent lessons. It is still important for the student to understand these basic technical distinctions for their own professional education and for the state licensing exam. Land is the land and everything naturally associated with its surface, what lies beneath it, and the air above it. Real estate is the land plus any buildings. Real property is real estate plus the rights of ownership.

Ownership Rights

There are four ownership rights associated with real property: subsurface rights, surface rights, air rights, and water rights. We defined “real property” earlier as covering real estate plus the owner’s set of rights. It is important to understand that these four different rights may be sold separately, sometimes to different persons, thus creating situations in which multiple people can have an ownership interest in the same piece of property. We will now discuss the details of these various rights.

Subsurface Rights

Subsurface rights relate to everything beneath the surface of a tract. The importance of this right lies largely in the fact that it may secure ownership of mineral deposits located under the surface of a property.

In some states, subsurface rights are sold separately from surface rights. In the event that two parties each hold an interest in a property—one holding the subsurface rights and the other holding the surface rights—the holder of subsurface rights may legally
enter the property to extract the minerals he or she has rights to, but he or she must take care to not materially disturb the surface.

**Surface Rights**

Surface rights are rights and interests with respect to the surface of the earth, including natural elements and structures built on or attached to it.

**Air Rights**

Air rights are the right to use the airspace above a property. These rights may be sold or leased independently of the tract itself.

**Water Rights**

When a property borders a body of water or a river, the right to enjoy the water is usually included in the bundle of rights. There are two types of rights associated with waterfront properties: riparian rights and littoral rights.

Riparian rights govern the use of flowing water, such as rivers and streams, that pass through or border a property. In accordance with riparian rights, a property owner does not own the water, but he or she may use the water and shares those same rights and uses with other property owners whose land also borders the water.

“Littoral rights” govern lakefront or seafront property and usually allow the property owner to use the water bordering his or her property. Littoral use does prohibit the property owner from artificially changing the water’s location.

It is important to note that water rights connect to surface rights in that a *permanent* right to enjoy a body of water surrounded by privately-owned realty usually necessitates surface ownership of waterfront property.
Real Property vs. Personal Property

Property can be thought of in two different terms; either real or personal. Recall that “real estate” is the land, including everything on, under, and above the land. Also recall that “real property” is the definition of real estate plus the set of owner’s rights associated with it. So, simply put, “personal property” is all that is not covered by real property’s definition. Therefore personal property includes objects that can be moved such as couches, tables, and clothing (here the student may recall the indestructibility and immobility of land, and note the way that these traits set real estate apart from personal property). Personal property is sometimes also called “personalty” or “chattels.”

Another difference between real property and personal property is the way in which each transfers. Ownership to a parcel of real estate is transferred by a recordable document such as a deed or will, whereas ownership to personal property usually transfers by a bill of sale. A bill of sale is a written agreement used to sell, reassign, or transfer one’s right to or interest in personal property. A deed, on the other hand, is a written instrument used specifically to transfer real property, which the owner (sometimes called the “grantor”) uses to convey ownership in real property to the buyer (or “grantee”).

In the same way that there are subtle differences between the concepts of real estate, land, and real property, there are specific technical terms used to discuss subtle differences in personal property. The term “personal property” actually refers to the theory of ownership rights in personal property (like the set of rights associated with real property). “Personalty” is effectively a synonym for “personal property” but “personalty” refers to the actual, tangible object itself, such as a chair (this distinction corresponds to the way that the terms “real estate” and “realty” identify the tangible buildings and trees associated with a parcel of land, in addition to the land itself). This technical distinction arises only rarely; however, these ideas may shed more light on the nature of real property, real estate, and land, all of which are important concepts for this course.
Severance
It is possible to turn some elements of real estate into personal property. The most common way that real estate is converted to personal property is through “severance.” Severance is the act of separating some element of the real estate from the land. For example, a tree is real estate, but if the owner cuts down the tree, literally severing it from the earth, the tree is now personal property, which can be carried off.

Fixtures
Conversely, personal property can be turned into real estate. This is accomplished by making that personal property a “fixture.” A fixture is a chattel bound to real estate and refers to an object that was once personal property but which has now been firmly attached to the land in such a way that it becomes part of the real estate. For example, a person can purchase wood, nails and paint, which are all personal property. But when the wood, nails and paint are made into a fence on the land, the former items of personal property are now real estate. The items have been transformed from movable personal property into an attached fixture on the land, i.e. real estate.

The most common way to turn personal property into real property is by permanently affixing the object(s) to real estate. Some examples of fixtures are:

- Elevators
- Central air conditioning units
- Garage door openers

Trade Fixtures
When a tenant makes a physical alteration or permanent addition to the property he or she is renting, the altered or added object usually belongs to the landlord upon expiration of the lease agreement. For example, if a tenant installs new kitchen cabinets in his or her apartment, generally speaking, these cabinets are considered fixtures, and thus revert to the landlord’s possession when the lease agreement expires.
One can see how this might impose undue hardship on a tenant who is leasing commercial property because of the large amount of money that many businesspeople have invested in items they use in the course of business and have affixed to the real estate they lease. For Example, what if a tenant is leasing a commercial retail property in a shopping mall: Are all the shelving, racks, and cash registers that the tenant installs automatically the landlord's property when the lease expires? Generally, they are not.

Objects affixed to the leased property that are owned by and necessary for the tenant's trade or business are called “trade fixtures,” and they are not subject to the same rules of transfer as fixtures in general. Trade fixtures are items that the tenant owns but has attached in some permanent way to leased (especially commercial) real estate. Trade fixtures remain the tenant's property when his or her lease expires. Examples of trade fixtures include:

- Check-out stands
- Coolers
- Display shelves
- Display racks
- Counters
- Desks

Courts usually conclude that all trade fixtures are the tenant's property, regardless of the method of installation. Nevertheless, for a tenant to retain ownership of a trade fixture, the tenant must remove the fixture by the last day of the lease. That is to say, a tenant may not leave a trade fixture on a property after the lease has expired and then later request that the landlord relinquish the item.

**Determining What Counts as a Fixture**

While the exact definition of a fixture varies slightly between states, there are some common attributes that allow us to make some general remarks about what sort of thing counts as a fixture. All licensees should acquaint themselves with state and local
regulations that help to identify fixtures for the type(s) of property with which they work. When trying to determine whether something is a fixture, we can consider the following issues: annexation, adaptation, and intention.

**Annexation**

One trait that separates fixtures from non-fixtures is the way the item is annexed, or attached, to the land. Usually, personal property can be removed without the aid of tools or heavy machinery; we can see this in the case of furniture, decorative items, utensils, wall hangings, and the like. With a comparatively minimal amount of effort, one can easily remove, shift, and replace a chattel. This is not the case with a fixture, the removal of which generally involves a great deal of effort and can require professional assistance because of its permanent nature.

Earlier, we mentioned an elevator as an Example of a fixture, and it is easy to see how annexation might be used as a criterion for identifying it as such. The installation and removal of an elevator is a lengthy and often costly endeavor, which will probably require the aid of several professionals and a few days of labor. If an owner installs an elevator on his or her property, then unless it needs to be replaced, he or she generally intends to leave it there indefinitely.

**Adaptation**

As real estate transactions become increasingly complex, so do our definitions of key terms like “fixture.” In the past, the definition of a fixture depended solely on the means of attachment, that is, annexation. Nowadays, it is important to consider the issue of adaptation as well. “Adaptation” refers to the use and modification of a particular item for a specific use in a property. If one can show that an item was custom designed for a specific use on the property, then it is likely that the item would be considered a fixture rather than a chattel.
Intention
The most important characteristic to consider when deciding whether something is a fixture is the owner’s intent for that item. Intention is inferred from the nature of the item and blends annexation and adaptation. That is to say, we can look at how the item is attached and the way in which it has been modified to suit its purpose or role in a given property. From these we can often infer whether the item was intended to be a fixture or personal property. Each case is unique and the individual parties involved in the decision must consider the method and purpose of adaptation and annexation when determining whether something is a fixture. It is often best to ask when unsure and write into a contract what will stay on the property and what is intended to be removed.

Changing Chattels into Real Estate and Vice Versa
Because a chattel can be converted to real estate, and vice versa, the difference between the two can be confusing. The following screens will provide a few more Examples and explanations to help you better understand when a thing is real estate and when a thing is personal property.

Trees and Crops
Plants pose a unique challenge when we are trying to judge whether they are real estate or personal property. Are crops, which can be harvested and sold, personal property or real estate while they are still attached to the earth? What about trees and decorative flora that one could remove - are they chattels or realty?

To decide whether plants are personal property or real property, one must generally consider their use and the duration of their existence. Trees, persistent decorative plantings (such as perennial landscape plants) and uncultivated plants are referred to as *fructus naturales* and are usually considered to be realty because of their permanence. Annually-cultivated crops are called *fructus industriales*, or “emblements,” and are generally considered to be personal property, even prior to harvesting.
Therefore, the broad general rules for making judgments about plants are as follows:

- Trees, bushes, and grasses, or *fructus naturales* that do not require annual cultivation are real estate.
- Cultivated annual crops, or emblements, are personal property.

**Minerals**

When substances are still underground, they are considered real estate. But when an owner extracts things from underground and stores them topside, the item is converted from real estate into personal property.

**Mobile Homes or Manufactured Housing**

Mobile homes are, for the most part, movable. Therefore mobile homes fall into the personal property category. If a mobile home is sold in conjunction with a parcel of land or is permanently attached, then it may be considered real estate. Some states, such as Texas, require the home to be connected to utilities and permanently attached to the land in which the owner of the home also owns through a deed or contract for deed filed in the county records as real property.

It is worth noting here that real estate licensees should be familiar with their local real estate laws before attempting to market mobile or manufactured homes. They should also make sure they are acquainted with any clauses of their state licensing laws that apply to the sale of mobile or manufactured homes, because some states impose special restrictions regarding this type of property. Mortgage lenders as well as insurance companies may have special requirements or may not offer services on mobile or manufactured houses.
Lesson Summary

This lesson covered the basic definitions and characteristics of land, real estate, real property, and personal property. It also examined the ways that personal property can be turned into real estate, and vice versa.

All land, real estate, and real property have a few characteristics in common. These characteristics are generally broken down into physical or naturally-occurring characteristics and economic or man-made characteristics. The naturally-occurring characteristics that distinguish land, realty, and real property are their immobility, durability, and uniqueness. Land is a permanent, indestructible, and non-fungible commodity; because land is an integral part of real estate, real estate generally shares many of these traits. The distinguishing economic characteristics of land, realty, and real property are scarcity, alteration, fixity, and situs.

Even though we use the terms “real estate,” “real property,” and “land” interchangeably in everyday conversation, there are important differences that separate these three commodities from each other. Land is an all-inclusive description of the natural environment for the purposes of legal ownership, which includes the Earth’s surface, the space below it, the space above it, and all things naturally attached to it, such as trees and water. “Realty” and “real estate” both identify the land and all items permanently attached to it, including manufactured items such as buildings, sidewalks, and streets. Real property encompasses everything captured by the term “real estate” but also includes the intangible benefits or rights of ownership referred to as owner’s rights.

Owner’s rights include the right to control the property, the right of exclusion, the right of possession, the right of disposition, and the right of enjoyment. In essence, real property refers to real estate and the rights to occupy and enjoy that real estate. Personal property is anything that is not real estate. As a general rule, knowing the method of attachment helps to determine the difference between real estate and personal property.
Real property ownership is divided into four rights—that is to say, there are four basic “aspects” of a property to which the owner has special rights. These rights are surface rights, subsurface rights, air rights, and water rights, any of which may be sold or leased independently of the others. For Example, one person may hold the rights to minerals located under the surface of someone else's home; similarly, a local airstrip might purchase the right to use the air space over someone's home.

It is important to note that water rights connect to surface rights in a unique way. That is to say, a permanent right to enjoy a body of water surrounded by privately-owned realty usually necessitates surface ownership of waterfront property.
Lesson 8: Home Ownership Concepts and Responsibilities

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Types of Home Ownership
- Tax Benefits for Homeowners
- Homestead
- Homeowners Insurance

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Identify the different types of housing.
- Explain the tax benefits and exemptions for homeowners.
- Identify the types of homeowner’s insurance policies.

Introduction
Now that we have a greater understanding of what real estate is, we are now going to learn about the different types of housing and ownership concepts in the residential market. This lesson will also identify some of the required responsibilities and tax benefits of home ownership.
Types of Home Ownership

When you think of residential real estate you probably think of a single family dwelling. That is the majority of the residential market but there are many types of residential properties in the different markets. Lifestyle, affordability, and location are some factors that may play a role in selecting the right type of residence.

Condos

Condominium or condo living is great for those who want freedom from exterior maintenance responsibilities with the benefits of home ownership. Condominium ownership typically provides ownership of the interior airspace within the walls of the unit and a shared interest with other owners of the common elements. The common elements are shared areas such as hallways, elevators, stairwells, pool or recreational facilities. Condominium ownership typically does not convey land and is identified with a unit number.

Co-ops

Cooperatives are very unique in that, as an owner you do not own the unit itself but shares of stock in the corporation or cooperative. The interest or ownership is in the form of a proprietary lease providing the right to occupy a particular unit in the cooperative building for the life of the cooperative. This can be a risky form of ownership; if owners default on their monthly assessments it could result in the foreclosure of the property. All the owners would lose everything in a foreclosure as this form of ownership is actually personal property: stock.

Townhouses

Townhouses or townhomes are very similar to a single family dwelling. The configuration of townhouses differ greatly; some may be stand alone or have adjoining common walls such as in row houses or brownstones. This type of housing may be similar to a condominium with a sharing of common elements but the major difference
between a condominium or townhouse is the conveyance of the land with the residence by the deed. This difference can be verified by the legal description in the deed.

**Planned Unit Developments**

Planned Unit Developments (PUD) are a subdivision or development that includes single family dwellings along with some common elements such as parks, pools, community recreational centers or golf courses. These common elements are managed by a homeowners association or property owners association in which all the residents are mandatorily required to pay a fee for these amenities and be a member of the association.

**Manufactured Homes**

Manufactured, or modular homes, mobile homes or doublewides, are prefabricated and constructed or put on site. This type of residence may be on acreage, in a park-like setting or some prefabricated modules may be used in creating a multi-family dwelling or high rise buildings.

Duplex, triplex or fourplex residences are all considered multifamily residences. The building and the land are owned just as in a single family dwelling; however, there are separate residences in the building. A duplex has two residences in the building while a triplex has three, and a fourplex has four. Buildings with more than four units fall into the commercial real estate category.

Timeshares have multiple owners of a residence, typically in a recreational environment or desirable vacation spots, who share the right to possession for a specific period of time with the other owners. This right to use these properties is typically tied to other vacation or timeshare locations that can be swapped, traded, or upgraded or have other benefits based on the purchase agreement. Each owner is assessed an annual maintenance fee in addition the cost of the timeshare.
Tax Benefits for Homeowners

Property ownership comes with both responsibilities and benefits. Most people do not pay cash for their homes but take out a mortgage or loan to finance the purchase. The financing institution or lender’s agreements on these mortgages or loans has some requirements for the borrower to pay interest on the loan as part of the monthly repayment plan and requires the homeowner to have a hazard insurance policy and pay property taxes as applicable. Some mortgages or loans may also have additional mortgage insurance depending on how much of a down payment is made on the purchase. Some properties may also require mandatory membership in an owners’ association.

Many state statutes provide for the governmental agencies at the county, city, town or districts to levy property taxes on each property owner; these taxes are known as ad valorem (Latin for according to value) taxes. These ad valorem taxes are collected from each property owner to create revenue to run the local governmental agencies and provide benefits of the community to its residences.

The lenders typically will require most borrowers to make the monthly payment of principal (loan balance amount) and interest (the cost of borrowing the money) plus an amount equal to 1/12th of their annual tax bill and 1/12th of the annual hazard insurance bill each month. These added expenses are deposited into an escrow account for the servicing agency of the loan to pay the annual taxes and insurance on behalf of the property owners. This provides the lender with some assurance that these items are paid and minimizes the risk of foreclosure in the event of a tax default foreclosure or loss from natural disasters or accidental loss of the home. These monthly payments are referred to as PITI or Principal, Interest, Taxes, and Insurance.

The taxes and interest paid on the mortgage loan may be tax deductible. This is one of the benefits of homeownership vs. renting. Mortgage insurance or owners’ association
fees are typically not tax deductible. On a home purchase, any loan origination fees and discount points paid may also be tax deductible.

A first-time homebuyer may be able to withdraw up to $10,000, penalty free, from their tax-deferred individual retirement account (IRA) to assist in the purchaser's down payment.

These tax benefits are not just limited to tax deductions but include some benefits realized when selling a principle residence with capital gains exemptions. Based on the Taxpayer Relief Act of 1997, married homeowners who file jointly are exempt from paying capital gains on profit up to $500,000 realized from the sale of their primary residence, and a single homeowner is exempt from paying capital gains up to $250,000 of realized profit from the sale of their primary residence. This exemption can be used every two years.

**Homestead**

In Texas, a homeowner has automatic state constitutional homestead rights on their owner occupied primary residence. This right is automatic and protects homeowners from claims by creditors being made against their homes, preventing any eviction by these creditors. This protection does not encompass all creditors. There are of course some exemptions such as in a mortgage where the homestead is used as security for the debt or a tax lien. There are some limits to the amount of real estate that can be homesteaded. In an urban environment, the maximum amount of land cannot exceed 10 acres. They can be multiple lots but they must be contiguous or adjoining. If it is a rural property, the maximum homestead is 200 acres for a family and 100 acres for a single person.

There is a Homestead Tax Exemption that can be filed at the appraisal district in the county in which the property is located. This homestead tax exemption will reduce the amount of ad valorem taxes paid on their homestead. Other tax exemptions for seniors
or homeowners with disabilities can file for additional tax reduction benefits. Filing a homestead exemption will reduce the taxed assessed value of the property by $15,000 or filing a senior citizens exemption will have an additional reduction of $10,000 assessed value. The tax assessed value of the homestead is what is used to calculate the taxes owed. If a home tax assessed value is $200,000 and the tax rate is 3%, the calculated taxes would be 200,000 x 3% (.03) = $6,000. With a homestead deduction on this same property, the tax assessed value would be $200,000 - $15,000 = $185,000 x 3% (.03) = 5,550. In this Example, this homeowner will save $450 annually in ad valorem taxes by filing their homestead exemption.

**Homeowners Insurance**

A home can be a major financial investment and needs to be covered from loss by natural occurrences such as hail, tornados, floods or fires or other accidental damages. This form of protection comes in the form of a homeowners’ insurance policy. As we mentioned earlier, most lenders will require a borrower to have homeowners’ insurance to protect their interest as well. Most homeowners’ insurance policies include coverage of the dwelling and outbuildings, personal property damage or loss, liability for injury and medical bill to others who are hurt on the property if the homeowner is found legally liable, and loss of use, which provides for the expenses of a place to live if the home is rendered uninhabitable and covered under the insurance policy. For additional information on homeowners insurance in Texas, visit the Texas Department of Insurance at www.tdi.state.tx.us.

Each policy, deductible and cost will differ, but most policies will cover loss or damage caused by fire or smoke, lightning, hurricanes, windstorms, hail, aircraft, vehicles, vandalism, theft, and explosions. Most policies will not cover loss or damage from flooding, earthquakes, termites, freezing pipes, wear and tear nor lack of maintenance.
Additional coverage may be added to the policy via an endorsement or rider, which may cover water damage from leaks, increase personal property coverage for art, jewelry or other personal property needing additional coverage.

Some properties may require flood insurance if the property is located in a flood plain or flood zone. The National Flood Insurance Act of 1968 subsidizes flood insurance, and requires land management and flood control programs. The cost of flood insurance is based on a detailed flood insurance rate map issued by the Federal Insurance Administration (FIA). If a home or any part of the homeowner property is located in a floodplain area, flood insurance might be required by the lender. Flood policies may exclude coverage for certain properties. For more information on the flood insurance programs and Federal Emergency Management Agency (FEMA) visit www.fema.gov.

Insurance companies use a database containing information on any claims made in the past five years by property owners on specific properties. It is standard industry practice to purge losses over five years old. The insurance companies use this database to determine the insurability of the client and specific property. The report from the database is referred to as a C.L.U.E. (Comprehensive Loss Underwriting Exchange) report. It provides dates of claims, insurance company or companies involved, the type of policy, whether loss was related to a named catastrophe (hurricane, etc.), location of the loss (on or off property), the amount paid, and cause of the loss. Consumers can request these reports on specific properties prior to purchasing and a prudent agent might request this type of report if there are any potential insurability concerns on a specific property.

**Lesson Summary**

Homeownership comes with responsibilities and financial obligations. Most home purchases are financed and may create the mortgage for repayment of the loan. The payment typically will include PITI: principal, interest, taxes and insurance.
Homeowners have tax benefits that are not available to renters. They may be able to deduct their annual loan interest and annual taxes paid on the home and some loan financing expenses such as the loan origination fee and any discount points paid in the purchase of the home. There may also be the benefits of homestead, senior citizen and disability tax exemptions from ad valorem taxes.

Homeowners’ insurance is required to protect the investment of the home purchase. Cost and coverage will differ based on the specific property and insurance company. Some properties may require additional coverage such as flood insurance or the homeowner may want additional endorsements or riders for additional coverage. A C.L.U.E. report is used to check for any claims made on a specific property in the last five years. This report is used by the insurance companies as well as consumers. Homeownership can be very rewarding with all of its benefits.
Introduction

Agency relationships are central to real estate transactions. A seller typically hires a broker to list and find a buyer for his or her property. Buyers often visit a broker’s office when shopping for real estate, and sometimes a buyer expressly hires a broker to help him or her find a property and negotiate the transaction.
An agency relationship is created when an individual authorizes another party to represent him or her and act in his or her interest. We will discuss the rules, guidelines, and ethical issues involved in agency relationships. First, let’s look at some basic definitions.

**The Agent, the Principal, and the Third Party**

**The Agent**

An agent is any individual acting as a representative for another individual in dealings with a third party. The agent is authorized by the person he or she represents to act on that person’s behalf. In the context of real estate transactions, the agent is a licensed representative of the seller, buyer, landlord, or tenant and facilitates the sale, purchase, exchange or lease of real property for others.

In the real estate industry, salespeople are often generically referred to as agents (as in the phrase “real estate agent”) and indeed often act as agents for their clients. We should remember, though, that there is a distinction between this generic term and the legal concept of agency: only certain individuals may legally act as agents in a real estate transaction. Brokers are the only Texas real estate professionals who can officially enter into an agency relationship with a buyer or seller. Any salesperson involved in a transaction then represents the broker—the salesperson cannot act as an agent. This is explained further in later lessons.

**The Principal**

The agent derives his or her power and authority from another individual—the transfer of this authority is what allows him or her to take on the role of agent. The principal is the individual who authorizes another person to act on his or her behalf. This person may also be referred to as the client.
In real estate, the principal engages the professional advice and other services of his or her agent to aid in the sale, purchase, exchange or lease of real property. The principal may be a seller, a prospective buyer, an owner wanting to lease his or her property to another person, or an individual seeking property to rent.

**The Third Party**
The *third party* is the final variable to consider when an agency relationship is formed. The third party is the individual with whom the agent and principal enter into real estate negotiations. The third party is also sometimes referred to as the *customer*. This individual may be a prospective seller, buyer, landlord, or tenant—anyone who expresses real interest in completing a contract toward the sale, purchase, or rental of real property and is both ready and able to do so.

**The Agency Relationship**
The agent works *for* the principal and works *with*, but not for, the third party.

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Principal  Agent  Third Party
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The third party negotiates with the principal through the agent. In these negotiations, the agent is obligated to represent the principal’s interests; it is not the agent’s task to look out for or act on behalf of the third party. The third party should have an agent of his or her own, whose job it is to act in the third party’s best interest.

For Example, a seller’s primary interest might be to get the full purchase price for his or her property. A broker representing that seller should attempt to get all prospective buyers to agree to the full price, without concern for what price is best or most reasonable for those prospective buyers. The seller’s agent thus cannot do things such as helping a prospective buyer to find a way to pay less than the price the seller wants. In doing so, the agent would not be acting in his or her client’s interests.
Of course, an agent cannot completely disregard all of the third party’s concerns. He or she has certain ethical and legal obligations to the third party, such as the obligation not to misrepresent a property.

**Agency**

The definition of agency is inherent in the basic definitions of agent, principal, and third party. Ultimately, agency is the fiduciary relationship between one individual (the principal) and another (the agent). In this relationship, the agent acts on behalf of the principal to negotiate with a third individual (the third party), subject to the principal’s control and consent.

This relationship is fiduciary because it is based on the principal’s trust and confidence that the agent will act dutifully and responsibly as his or her representative. A fiduciary relationship is based on the law of agency that dictates the duties owed to the principal and third party by the agent. A more in-depth discussion of the moral and ethical guidelines for fiduciary relationships appears in the next lesson.

**Forming an Agency Relationship**

Most agency relationships are formed with little formality and only the consent of both parties. It is a simple matter for the principal to select someone to act as his or her agent and for the agent to agree to the arrangement; however, the real estate professional needs to be aware of the other ways that these relationships are formed so that he or she can avoid unintentional agency relationships. Given the legal and professional obligations that come with acting as someone’s agent, this is not a relationship one wants to enter into by accident.

**Express Agreement**

Most agency relationships are formed by *express agreement*, in which a principal expressly appoints an agent to act on his or her behalf and the agent accepts this role.
This agreement does not have to be written to be valid; agency relationships that are established by oral agreements are held to the same rules and standards that govern those established by written agreements. Written agreements are generally considered the clearest and most explicit way to outline the expectations and obligations of the parties involved. Written agreements also provide a greater degree of security for all parties. In the event that problems arise over the course of an agency relationship, a written agreement acts as a record of the defined contractual terms and the expressed intentions of the agent and principal.

In the real estate profession, the listing agreement between the seller and the listing broker is the written instrument most commonly used to create an express agency relationship. The written agreement that establishes an agency relationship between a broker and a buyer is often called the buyer representation agreement.

**Note:** A broker cannot sue for commission or other compensation if the agency agreement is not in writing.

**Implied Agency**

An *implied agency* relationship is created when both parties assume consent to the relationship based solely upon inferences formed from their communication and interaction with each other. We must be careful that our words and actions do not create an implied agency relationship with someone whom we do not or cannot represent.

In real estate transactions, implied agency relationships are often created when a prospective buyer approaches a licensee, and the actions of the parties are taken to indicate that they have mutually consented to the agency. Although the actual terms and conditions of their relationship have not been explicitly laid out, the actions of the agent and principal are understood to support the idea that an agency relationship exists. This will clearly be problematic if the licensee actually represents the seller, and thus cannot act as the buyer’s agent without first obtaining the seller’s consent to do so.
Example:
A property is listed through Broker A’s office. A sign is placed on the property, which results in a call from Buyer X. The buyer soon discovers that the property, for whatever reason, is not well suited to her needs. At that point, Broker A asks the buyer what type of property she is seeking and how much she can afford to spend. This conversation gradually evolves into a discussion of her opinions regarding specific property listings. Broker A assures Buyer X that she will be able to help her find a property that is suitable for her.

In this Example, the circumstances of the conversation and the conduct of both parties led the prospective buyer to conclude that Broker A was acting as an agent on her behalf and in her best interest. In effect, Buyer X assumed that Broker A was her agent, and it was implied that she was Buyer X’s client.

Unless Broker A dispels the buyer’s assumption that A is her representative, Broker A could be held to the duties of this implied agency relationship.

Ratification
In most cases it is considered illegal for a person to represent a principal without any authorization; it is also generally against the law for an agent to act outside of the scope of his or her authority. An agency relationship can be created by ratification when an individual learns of someone acting as his or her agent, or of an established agent overreaching the scope of his or her authority, and the individual does not later deny the validity or authority of the agent’s act. His or her consent retroactively creates an agency agreement or contract—it can either create an agency relationship where none existed before, or it can extend the scope of an existing agency relationship.

Although agency and extended authority can be created by ratification, remember that the person for whom the agent is acting is under no obligation to ratify or otherwise
accept the agent’s actions. For this reason, developing an agency relationship by ratification is not recommended; it is both extremely risky and unreliable.

**Disclosure**

Because it is relatively easy for people outside of the real estate industry to become confused about when and whether a licensee is their agent, all agents are legally required to present all parties with a statement of agency disclosure. This statement reveals whether the broker is representing the buyer, the seller, both parties, or neither party. The disclosure process will be discussed in greater detail in the next lesson.

**Scope of Authority**

**Types of Agents**

A *general agent* usually has a great deal of authority to represent the principal in multiple affairs. As an Example of a general agent, we might think of a business manager who is allowed make business decisions and to enter into contracts on behalf of a company. Property managers are also usually general agents. In addition, the relationship between brokers and their affiliated licensees is usually a general agency relationship.

In purchase and sales transactions, on the other hand, the agent is usually what is called a “special agent.” This means that he or she has limited authority in the realm of a specific duty or transaction. Most of the time, agents in real estate transactions do not have the authority to sign contracts for clients or to make other major decisions on their clients’ behalf.
Types of Authority

Just as agents’ authority can differ in extent, their authority can also differ in type, as outlined in the following diagram:

Express agreements and some implied agreements grant *actual authority* to the agent. Some actions within the scope of the agent’s authority are permitted by *express actual authority*: this authority supports those acts that the principal explicitly tells the agent to carry out. Others fall under *implied actual authority*, which is the authority legitimating actions that must be completed in the process of carrying out the duties that the principal has expressly requested. While the principal did not explicitly authorize these other acts, the fact that the principal approved acts that depend on these other actions implies that the principal has consented to these other acts as well.

*Example:*

Buyer Q has hired Broker D to help her find a house. Therefore, Broker D has the express actual authority to find a house for Buyer Q. Broker D employs several salespeople who generally help the broker to find houses for clients. So, although Buyer Q did not specifically authorize this, Broker D has the implied actual authority to delegate some of the tasks involved in finding a house for her to these salespeople.
Sometimes, the actions or words of a principal can convince a third party that the agent has authority when the agent actually has no authority. In such a situation, the person who acts as an agent has *apparent authority*.

**Lesson Summary**

Agency relationships, which are central to most real estate transactions, are formed when one party, the principal, authorizes another party, the agent, to act as his or her representative. Third parties negotiate transactions with the principal through the agent, and the agent’s task is to represent the principal’s best interests.

Agency relationships are usually formed through express agreements, in which the principal expressly designates an individual to act as his or her agent. A verbal agreement may create a valid agency relationship, but a written agreement provides a clearer explanation of both parties’ interests and intentions. In addition, if the agency agreement is not in writing, a broker cannot sue for commission. An implied agency relationship may also be created by the actions and words of either party. To prevent confusion about representation, agents must present all parties with a statement of agency disclosure revealing whether the broker is representing the buyer, the seller, both parties, or neither party.

Sometimes an individual acts as an agent when not authorized to do so, or an established agent acts outside of the scope of his or her authority. In most cases it is considered illegal for a person to represent a principal without any authorization; it is also generally against the law for an agent to act outside of the scope of his or her authority. An agency relationship can be created by ratification when an individual learns of someone acting as his or her agent, or of an established agent overreaching the scope of his or her authority, and the individual does not later deny the validity or authority of the agent’s act. His or her consent retroactively creates an agency agreement or contract, though this is a risky and unreliable way of establishing agency.
An agent’s authority can vary in its extent. General agents, such as business managers, usually have a great deal of power in one or two limited areas. Most real estate professionals act as “special agents.” This means that they have a limited amount of power in one specific transaction.
Lesson 10: Duties of Agency Relationships

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Agency Disclosure
- The Agent’s Duties to the Principal
- The Principal’s Duties to the Agent
- The Agent’s Duties to the Third Party
- Compensation
- The Agent’s Liability

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- State the rules of agency disclosure.
- Describe the duties that an agent owes the principal.
- Recognize the Texas rules governing compensation of agents.
- Outline the idea of tort liability.
- Identify the circumstances under which a licensee may be held professionally liable.

Introduction
As mentioned in the previous lesson, agency relationships are considered to be fiduciary relationships, which means that the principal entrusts certain powers or authority to the agent with the understanding that the agent will act competently on the
principal’s behalf. Because of the trust and confidence placed in the agent in a fiduciary relationship, the law has established that an agent has certain obligations to the principal; these obligations are called “fiduciary duties.” In addition, the principal has duties to the agent that are, in effect, obligations to behave in a way that makes it easier for the agent to provide competent service.

Although an agent’s primary obligations are to the principal, an agent also has duties to the third party. These will be discussed later in the lesson.

**Agency Disclosure**

**Texas Disclosure Guidelines**

Licensees have the general duty to disclose agency relationships to all parties involved in a transaction. Once *substantive dialogue* occurs between an agent and a potential client or a third party, the agent must give the person a written statement that outlines Texas agency law.

Sec. 1101.558(a) of the Texas License Law defines substantive dialogue as follows:

*A meeting or written communication that involves a substantive discussion relating to specific real property.*

Substantive dialogue does not include meetings that occur at open houses. In addition, this term does not cover meetings or communications that occur after the parties have signed a contract to sell, buy or lease the property that is the subject of the meeting or communication.

So, once an agent has engaged in this kind of discussion with a client or potential client—outside the context of an open house and before the signing of a final contract—that agent is obligated to provide that person with a statement clarifying Texas agency law.
There are situations in which the agent need not supply the client with this statement. According to Sec. 1101.558(c) of the Texas License Law, the agent does not need to provide an agency disclosure statement if:

- The proposed transaction is for a residential lease for not more than one year and a sale is not being considered; or
- The license holder meets with a party who is represented by another license holder.

If the licensee is acting as someone’s agent, then the licensee must disclose that relationship to the third party (or to the third party’s agent) upon initial contact. Oral disclosure is acceptable at initial contact, but once substantive dialogue occurs, written disclosure is required.

**Statement of Agency Law**

We provide here a sample statement of agency disclosure created by the Texas Real Estate Commission (TREC). TREC does not require that licensees print and use this specific form; however, any alternative form must use the same wording; the only alterations the licensee may make to this language are the substitution of the term “buyer” for “tenant” and “seller” for “landlord,” as appropriate. This statement must be printed in no smaller than 10-point type; though not legally obligatory, a font larger than 10-point will make the statement easier for people to read.

The client, potential client or third party must sign this document to show that he or she has read and understands it; signing the statement does not in any way bind the party to the agent.

The *Information about Brokerage Services* form has been provided for educational purposes only: [http://www.trec.state.tx.us/pdf/contracts/op-k.pdf](http://www.trec.state.tx.us/pdf/contracts/op-k.pdf).
The Agent’s Duties to the Principal

We mentioned earlier that the agent owes certain fiduciary duties to his or her principal (the client). Fiduciary duties are not just ethical or moral obligations; they are required under the law of agency and there can be serious penalties for failing to carry them out. The agent owes the principal the following five duties:

1. Duty of fidelity
2. Duty of care
3. Duty of obedience
4. Duty of accounting
5. Duty to disclose facts

Duty of Fidelity

Perhaps an agent’s most important duty is that of fidelity. Chapter 531 (Rule 531.1, “Fidelity”) of the Rules of the Texas Real Estate Commission (TREC) describes an agent’s duty of fidelity as follows:

A real estate broker or salesperson, while acting as an agent for another, is a fiduciary. Special obligations are imposed when such fiduciary relationships are created. They demand:

(1) that the primary duty of the real estate agent is to represent the interests of the agent’s client, and the agent’s position, in this respect, should be clear to all parties concerned in a real estate transaction; that, however, the agent, in performing duties to the client, shall treat other parties to a transaction fairly;
(2) that the real estate agent be faithful and observant to trust placed in the agent, and be scrupulous and meticulous in performing the agent’s functions;
(3) that the real estate agent place no personal interest above that of the agent’s client. (531.1)
As laid out in TREC’s rules, the agent’s duty of fidelity stipulates that the agent must place the principal’s interests above those of all other parties, including the agent’s own interests. A key element of this duty is confidentiality, which is the agent’s obligation to keep careful watch over the information he or she receives from a client and to ensure that private information is not shared without the client’s consent.

Additionally, an agent cannot act on confidential information to obtain an unfair advantage over a principal. An agent could not, for example, inform a prospective buyer that the agent owned property that was similar to the principal's property but was priced at less than the asking price of the principal's property.

Texas law also prohibits an agent from buying or selling any piece of property in which he or she has a personal interest unless first disclosing this information and confirming the consent of the principal to follow through with the real estate transaction.

**Duty of Care**

A licensee must conduct real estate transactions with care and diligence, ensuring that he or she represents the principal to the best of his or her abilities while acting in the principal's best interests. With this understanding in place, the agent can be held professionally liable for any loss the principal suffers as a result of the agent's negligence.

Chapter 531 (Rule 531.2, “Integrity”) of TREC's Rules describes this duty as follows:

> A real estate broker or salesperson has a special obligation to exercise integrity in the discharge of the licensee’s responsibilities, including employment of prudence and caution so as to avoid misrepresentation, in any wise, by acts of commission or omission. (531.2)
Duty of Obedience

A fiduciary relationship requires that the agent act in good faith at all times, making a conscious effort to obey the principal’s instructions as set forth in the contract. This duty does not apply, however, if the principal’s instructions are illegal or unethical in any way. For Example, if an owner tells his or her broker that he or she will only sell the property to a third party of a particular race, the agent has no duty to obey this instruction. He or she should instead explain that he or she cannot carry out this request because it violates fair housing law.

This Example is not a matter of deciding whether breaking the law is in the client’s interest. It is not the agent’s task to determine a client’s interests for the client; that is a decision that the principal must make on his or her own. An agent might provide information that aids a client in choosing his or her goals, or an agent might try to persuade a principal that a certain course of action is an unwise choice. It is never up to the broker to determine—individually—what a client’s interests actually are. If an agent makes this kind of determination and acts on it without consulting the client, that agent runs the risk of acting against what the client believes to be in his or her best interest.

Duty of Accounting

If an agent holds any funds for the principal or the third party, then the status of these funds must be available to those parties at all times. The details of any financial transactions should be accurately recorded; proof of any deposits or exchanges of funds should be issued to the parties involved.

In Texas, most licensees prefer to have an independent entity, usually the title company, hold such funds in an escrow account. If a licensee elects to hold this money in trust for others, then he or she must set up a separate account for this purpose. Texas License Law forbids commingling (i.e., mixing) these funds with other funds in the licensee’s personal or business accounts. Furthermore, Texas License Law requires
these funds to be deposited into the escrow or separate account within a reasonable time. Agents (and any salespeople acting on their behalf) cannot wait any longer than the close of the second business day after the signing of a contract to make these deposits. The money will then be held in the escrow or separate account until closing, at which time the agent must release the funds to the appropriate party. In the event that the transaction does not close, the money can only be released with the written consent of all parties involved.

**Duty to Disclose Facts**

The duty to disclose factual information is central to an agent’s role in a fiduciary relationship. Just as it is an agent’s duty to keep a principal’s personal information confidential, an agent must also disclose any information about the property or customer that may affect a principal’s decisions regarding the outcome of the real estate transaction. The agent’s duty of disclosure differs slightly depending upon whether the agent is acting on behalf of the buyer or on behalf of the seller.

Providing proper factual disclosure is one of the most important tasks of the real estate licensee. Because of its ambiguous nature, disclosure often involves conflicting opinions. One individual may consider a particular fact to be nonessential information concerning a property, while another person may believe that fact to be extremely important. For this reason, the Texas legislature periodically revisits disclosure issues, striving to clarify agency obligations.

**The Principal's Duties to the Agent**

Just as the agent in a fiduciary relationship has certain obligations to the principal, the principal must also conduct himself or herself in a way that facilitates the agent’s task as a representative. The principal’s duties include the following:

- Duty to compensate the agent
- Duty to provide information
- Duty of indemnification
- Duty of availability

**Duty to Compensate the Agent**

The principal has a duty to compensate the agent for his or her expertise, as laid out in the terms of the contract. The principal must pay the agreed-upon commission to the agent when the agent completes his or her specified duties, unless all parties agree to another arrangement.

In the real estate industry, any party may pay the agent’s commission or fees, as long as full disclosure is made to all parties—that is, it is not the case that the principal is the *only* party permitted to pay the agent. If there is no other arrangement, compensation is the principal’s duty. This point will be discussed in detail later in the lesson.

An agent can agree to work for no compensation, and in these cases, the principal has no duty to compensate the agent. This kind of agency agreement creates a relationship called *gratuitous agency*. Even though no payment changes hands, the agent must still honor all of the duties of an agency relationship and the principal must honor his or her duties as well.

**Duty to Provide Information**

The principal has a duty to provide accurate responses to the agent’s requests for information; he or she must ensure that the agent and third party can rely upon his or her precision and truthfulness. The agent is usually not held responsible for any false statements made by the principal unless the agent had reason to suspect that the statements were false.
**Duty of Indemnification**
In addition to providing compensation, the principal has a responsibility to reimburse the agent for any financial losses incurred while carrying out the real estate transaction (beyond the cost of promotional efforts, which are the agent’s responsibility). This is considered a “hold harmless” clause, releasing the agent from all damages except those resulting from the agent’s own negligence or fraud.

**Duty of Availability**
The principal must make an effort to be available for all activities related to the real estate transaction, assuming requests for his or her presence are reasonable and made in timely fashion. This includes being available to show or view a property, and being available to consider offers and notices within a realistic amount of time, and in a reasonable place and manner.

**The Agent’s Duties to the Third Party**
Although the agent’s primary responsibility is to the principal, both professional ethics and the law require the agent to treat third parties fairly. Most importantly, agents have the obligation to disclose the relationship of agency. Beyond that, agents also have a duty to exercise reasonable care and skill, a duty to disclose material facts, and a duty to deal honestly and fairly with third parties.

**Duty to Exercise Reasonable Care and Skill**
Every licensee is considered to have knowledge of and expertise in real estate matters exceeding that of the layperson. Licensees’ education and experience in their field place them at an advantage in real estate transactions, and both professional ethics and the law require them to act as competent real estate professionals.
Chapter 531 (Rule 531.3, “Competency) of TREC’s Rules defines professional competency as follows:

It is the obligation of a real estate agent to be knowledgeable as a real estate brokerage practitioner. The agent should:

(1) be informed on market conditions affecting the real estate business and pledged to continuing education in the intricacies involved in marketing real estate for others;

(2) be informed on national, state and local issues and developments in the real estate industry; and

(3) exercise judgment and skill in the performance of the work. (531.3)

Because they represent themselves as competent, skilled professionals, brokers and other real estate licensees can be held liable for harm caused by their negligence or incompetence.

Licensees are NOT expected to have expert knowledge in fields other than real estate. Real estate professionals should not attempt to give advice on law, accounting, inspection, engineering, or other subjects in which they are not licensed or certified professionals. They should also be aware that dispensing such advice to a paying client may be a violation of both professional ethics and the law. Everyone in a transaction is better served if brokers and other licensees recommend that individuals who need advice in these other fields seek the counsel of qualified professionals.

**Duty to Disclose of Material Facts**

The agent must inform the third party of any *material facts* that he or she knows about the property. A material fact in a real estate transaction is any fact that is significant or essential to the transaction—that is, any piece of information that could reasonably be expected to influence a prudent individual’s decisions regarding the transaction. This duty requires the agent to disclose *latent*, or hidden, defects in the property that may not
be identified in an ordinary inspection, but which could alter the customer’s decision regarding the property.

**Example:**
If the seller is aware that the fence surrounding his listed property extends beyond the designated property boundaries and that this may lead to problems with the owners of the adjoining property, then he needs to inform potential buyers of this fact as it would probably be difficult for a buyer to discover alone. The agent must disclose this information to the prospective buyer; otherwise, the agent is intentionally concealing important information that could very likely impact the third party’s decision.

Texas Real Estate License Law identifies particular pieces of information that are not properly considered material facts. Under this law, a licensee is not required to inquire about, disclose or release information relating to whether:

- a previous or current occupant of real property had, may have had, has or may have AIDS, an HIV-related illness, or an HIV infection as defined by the Centers for Disease Control and Prevention of the United States Public Health Service; or

- a death occurred on a property by natural causes, suicide, or accident unrelated to the condition of the property. (Sec. 1101.556)

**Duty of Honesty and Fair Dealing**
All parties have the right to honesty and good faith in their interactions with licensees, regardless of whom that licensee represents. Licensees can, therefore, be held liable for any dishonest or fraudulent statements made to third parties. To avoid this liability, agents must strive to acquire and convey accurate information. Unintentional misstatements about a property are called misrepresentation, while intentional misstatements are considered fraud. Both types of conduct are extremely unprofessional and may create serious legal difficulties for an agent.
**Example:**

Salesperson A does not know that a home she has listed was formerly the site of illegal drug activity. Therefore, Salesperson A does not disclose this information to a prospective buyer. After closing, the buyer discovers this fact and states that she would not have purchased the home if she had known this information earlier.

**Would this be considered a case of fraud or misrepresentation?**

**Misrepresentation:** Salesperson A’s omission was unintentional. Thus, this is considered a case of misrepresentation, because she unintentionally concealed information from the buyer. In this situation, Salesperson A would generally not be held liable; however, the seller of the property may face liability if it is found that she or he knew about the crime on the property. If the seller told Salesperson A the truth regarding the property’s history and Salesperson A had then lied to buyers, Salesperson A could then be held liable for fraud (i.e., for intentionally concealing relevant facts).

Misrepresentation sometimes crosses paths with common sales techniques. Many salespeople rely upon exaggeration, opinions, and predictions that are not firmly based on factual evidence. For Example, a listing agent might describe a home as having “cozy charm,” but a prospective buyer sees the property as small, dark, and damp. Similarly, a salesperson might tell another buyer, “This is the best home on the market.” Are these kinds of statements to be held up as facts, and thus subject to the criteria of accurate representation?

**Consider this situation:**

Broker A tells a customer that a particular property is one of the “most charming ranch houses that she has ever seen.” When the customer goes out to view the property, however, the customer finds it is old and run-down.
Broker A’s statement that the house was “charming” was merely the broker’s opinion. This type of statement would not generally be considered a misrepresentation of material facts.

**Now consider this situation:**
Broker B shows a customer a home; the broker knows this property has a leaky roof. The customer asks if there is anything wrong with the home, and Broker B replies by saying, “You might need to do some cosmetic repairs, but nothing major.”

Broker B’s statement is fraudulent. Not only does the broker neglect to disclose the information about the roof, but she also knowingly lies to the customer about the type of repairs needed. Broker A’s statement, on the other hand, is considered “puffing;” it is an exaggeration, but it is not at odds with the known material facts regarding the property. This type of statement is not considered to be misrepresentation. Despite the fact that “puffing” statements are permissible under Texas agency law, a consumer could still claim that an agent violated the Deceptive Trade Practices Act by misleading him or her with puffing, opinions or predictions.

**Compensation**
Under the common law governing agency relationships, the principal is generally responsible for compensating the agent. Depending upon the written arrangement among the parties, it is often possible for any individual involved in a transaction to take over this duty.

Compensation can be in the form of a service fee, a commission, or a brokerage fee that is a percentage of the total money involved in the transaction. Whatever form it takes, the broker generally receives compensation when the terms of the agency relationship have been fulfilled.
In common law agency relationships, the principal is required to reimburse the agent for expenses incurred while representing the principal. In the real estate profession, however, clients usually just pay a commission or fee, and licensees pay their own expenses out of the commission.

**Eligibility for Compensation**
To be eligible for compensation the person receiving the compensation must be licensed, must have been licensed when the work was performed, and must possess a written agreement that states the terms of compensation, signed by the party who will pay the compensation.

In addition, the licensee must have informed the buyer in writing, before closing, that he or she should obtain a title insurance policy or that the abstract of title (i.e., the summary of the property’s history, including any liens or encumbrances) should be examined by the buyer’s attorney. TREC provides a “Notice to Prospective Buyers” form for agents to use in this process.

**Notice to Prospective Buyers:** [http://www.trec.state.tx.us/pdf/contracts/OP-C.pdf](http://www.trec.state.tx.us/pdf/contracts/OP-C.pdf)

**The Agent’s Liability**

**Tort Liability**

Real estate licensees can be held liable for intentional or negligent wrongdoings as well as breaches of duty. This sort of liability is called *tort*, and agents are not exempt from it.

Under tort liability, the injured party can sue the licensee for damages. For Example, if a broker fails to fulfill his or her duty to disclose a *latent defect* to a third party, then the third party can sue the broker. Similarly, if a salesperson violates a duty to the principal, perhaps by breaking confidentiality, then that principal would be able to sue the salesperson.
Possible Outcomes of Negligence or Wrongdoings

There are four basic outcomes that generally result from torts:

1. **Professional sanctions**: The licensee is subject to disciplinary action, which can include fines and the suspension or revocation of his or her real estate license.
2. **Rescission**: The principal may rescind the purchase and sales agreement.
3. **Avoidance**: The principal may legally avoid the obligation to pay commission.
4. **Legal recourse**: The injured party or parties may be able to take legal action seeking compensation for any damages suffered as a result of the agent’s conduct.

Agent’s Liability for Principal’s Actions

Generally, an agent will not be held liable for a principal's actions. If, for Example, a principal makes false statements and the agent passes these on to the third party, the agent has no liability unless the he or she suspected the information was false. Even when an agent has doubts about the information provided by a principal, he or she has no duty to inspect property or verify statements.

The “warranty of authority” is a kind of guarantee that an agent (or someone who represents herself as an agent) gives to a third party, either implicitly or explicitly. It is meant to establish that the agent has the authority to bind a principal—i.e., that the agent has the authority to makes contracts, agreements, and enter into similar arrangements on the principal’s behalf. The agent cannot be held responsible if the principal does not or cannot follow through on the agreements the agent makes on the principal's behalf. The warranty of authority only concerns the agent’s authority to act on the principal's behalf, not his or her authority to ensure that the principal *himself* acts in a certain way.
Example:
Seller E does not actually own the property he is trying to sell, but he has a counterfeit title. Broker A is not aware of this fact and has no reason to suspect the title is false. At closing, the truth is discovered. The buyer can sue the seller for this, but Broker A has no liability.

Avoiding Litigation and Disciplinary Action
To protect themselves from litigation and disciplinary action, agents should always incorporate the seller’s statements about the property into the listing agreement. This action firmly establishes that all information about the property comes from the seller, not from the agent. If information turns out to be false, it is clear that any misrepresentation or fraudulent statements are the seller’s responsibility.

In addition, the agent can take the following four steps to avoid litigation or disciplinary action:
- Perform according to the terms and conditions set out in the agency agreement.
- Promote the best interests of the client.
- Maintain confidentiality unless instructed in writing to do otherwise.
- Disclose all material facts regarding the real estate transaction.

Lesson Summary
Licensees’ first duty in agency relationships is the duty of disclosure. Licensees acting as agents are required to provide all parties to a transaction with a written statement that outlines Texas agency law. Agents are also required to disclose relevant agency relationships to third parties upon first contact. Oral disclosure is acceptable at initial contact, but written disclosure is required once substantive dialogue occurs.

Because of the fiduciary nature of agency relationships, the broker who serves as an agent owes five duties to his or her clients. Most importantly, the agent must comply
with the duty of fidelity, which means that the agent must always place the principal's interests above those of anyone else involved in the transaction, including the agent. The other four duties require the agent to:

1. Act with care and competence regarding the principal's affairs.
2. Obey the principal's instructions (as long as these are within the law).
3. Account for monies and property given to and received from the principal.
4. Disclose all known material facts about the property and transaction.

Just as the agent in a fiduciary relationship has certain obligations to the principal and third party, the principal must also honor his or her obligations to the agent. The principal's primary duties are as follows:

- The duty to compensate the agent, unless another arrangement has been agreed upon in writing.
- To provide the agent with all necessary information. The principal is responsible for ensuring that this information is accurate and complete.
- To reimburse the agent for any financial losses incurred while carrying out the real estate transaction (beyond promotional costs).
- Be available for all activities related to the real estate transaction, assuming requests are made in a reasonable and timely fashion.

Although the agent's primary responsibility is to the principal, the agent is also required to treat third parties (customers) fairly. This broad requirement of fairness imposes several additional duties on agents. As always, they have an obligation to disclose the relationship of agency. Beyond that, agents also have a duty to exercise reasonable care and skill in their professional work, a duty to disclose of material facts and a duty to deal honestly with third parties (i.e., a duty to avoid misrepresentation and fraud). The principal is generally responsible for compensating the agent. This compensation can take the form of a service fee, a commission or a brokerage fee. Whatever its form, the broker generally receives compensation when the terms of the agency relationship
have been fulfilled. In order for a broker to receive compensation, several conditions must be met:

- The broker must have been licensed when the work was performed.
- A written agreement must exist stating the terms of compensation. This statement must be signed by the party paying that commission.
- Before closing, the licensee must have informed the buyer in writing that the buyer should obtain a title insurance policy or that the abstract of title should be examined by the buyer’s attorney.

Real estate professionals can be held liable for intentional wrongdoings, negligence and breaches of duty, collectively called *torts*. If an agent commits a tort, then one or more of the following outcomes are possible:

- The agent could be subject to disciplinary action.
- The principal could rescind the purchase and sales agreement.
- The principal could be legally released from the obligation to pay commission.
- The injured party could sue for damages.

An agent is generally not held liable for his or her clients’ actions or false statements, unless the agent suspected the statements were false. To protect themselves from litigation and disciplinary action, agents should always incorporate a client’s statements into written agreements (like the listing agreement) and clearly show that all information about the property comes from the client, not from the agent. To further protect themselves, agents should always:

- Perform according to the terms and conditions set out in the agency agreement.
- Promote the best interests of the client.
- Maintain confidentiality.
- Disclose all material facts that may affect the real estate transaction.
Lesson 11: Agency Positions

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- The Seller’s Agent
- The Buyer’s Agent
- Subagency
- Intermediaries
- Brokerage Relationships and Employment Laws

Lesson Learning Objective
By the end of this lesson, you should be able to:

- Describe how the licensee’s duties apply to the four different agency positions.

Introduction
Agency relationships can only be created through the supervising broker of a brokerage. Salespeople and other affiliated licensees can act in an agent capacity, but their activities are performed in the name of the supervising broker, who is, in turn, liable for these actions. A salesperson has no authority to make contracts or receive a commission directly from the principal, and he or she receives compensation only with the full knowledge and consent of the broker. Later in the lesson, we will discuss the relationship between the supervising broker and his or her affiliated licensees.
There are four positions a broker might hold in an agency relationship. A broker can act as:

1. The seller's agent
2. The buyer's agent
3. A subagent
4. An intermediary

A licensee or salesperson may not act as an intermediary, but may act in an agent capacity (representing the broker) in any of the other positions.

**The Seller's Agent**

Most of the time, the seller’s agent will be the *listing agent* (also called the *listing broker*). Typically, sellers enter into agency relationships with brokers through a listing agreement, in which the seller expressly hires a broker to list and find a buyer for his or her property.

The agent owes five fiduciary duties to the principal. All of those duties remain in effect when an agent is representing a seller. In an agency relationship with a seller, the agent must place the seller’s interests above the agent’s own interests and above the interests of the buyer. The agent must also maintain confidentiality for the seller.

**Example:**

Seller A tells her agent, Broker B, that she would be willing to accept a lower price than that currently listed for the property. Broker B is working with a potential buyer, Buyer C, who asks the agent how low the seller is willing to go. Because this information is confidential, and because revealing this information would hurt the seller’s chances of getting the highest purchase price, Broker B cannot reveal it.
Suppose, on the other hand, that Buyer C submits an offer that is too low for the seller, and she rejects it. Then, in a conversation with the broker, Buyer C mentions that he would be willing to pay more than originally offered. Broker B, being the seller’s agent and not the buyer’s agent, has no duty of confidentiality or fidelity to the buyer, and the agent has an obligation to the principal to share this information with her.

In addition, the seller’s agent also has a duty to disclose to the seller all relevant facts that may affect the sale of the property, including:

- Appropriate asking price for the property based on typical market values
- Offers received on the property that are within the scope of the principal’s consideration
- Ability and willingness of prospective buyers to pay more than the asking price for the property
- Identity of prospective buyers if the agent or someone related to the agent is interested in purchasing the property
- Any interest the agent holds in the property or agent’s plans to form a relationship with a prospective buyer following the sale of the property (such as undertaking the role of the new owner’s property manager or as the new owner’s agent in the resell of the property for a profit)

In addition to the duties of fidelity and disclosure, the seller’s agent also owes the fiduciary duties of care, obedience, and accounting.

**Providing Services for the Client**

A seller’s agent would probably provide the following services for the seller:

- Preparing a market analysis of the property
- Creating marketing strategies
- Helping the seller decide on a listing price
Presenting all written offers
Giving advice about which price to accept
Negotiating for the seller, not the buyer
Giving market updates to the seller
Preparing the closing costs estimate
Helping the seller through the closing process
Attending the closing with the seller

Providing Services for the Third Party

Sometimes, the seller’s agent will provide helpful services to third parties. As long as these actions aim at achieving the seller’s goals, there is no breach of fidelity or conflict of interest. For example, an agent may help a prospective buyer with the process of obtaining financing because that furthers the client’s goal of selling the property. If an agent were to advise a prospective buyer on price negotiation, this would undercut the client’s goal of obtaining the best possible price. Providing this kind of help is at odds with acting as the client’s agent.

Remember that agents have duties to the third parties in agency relationships as well as to the principal. Seller’s agents must treat prospective buyers fairly; beyond this general duty of fairness, it is fine to provide third parties with services that help to achieve the principal’s goals. The seller’s agent’s loyalties lie with the seller, not with the buyer, and all services provided should reflect this fact.

The Buyer’s Agent

An agency relationship can be created between a buyer and a broker by oral or written agreement, as well as through words or conduct that imply authorization. The buyer representation agreement is the most common method of forming an agency relationship between a buyer and a broker. This agreement will be discussed in detail in the following lesson.
A seller’s agent maintains confidentiality about all matters that the agent is not legally required to disclose to the third party. The seller’s agent, for Example, should not volunteer to tell a prospective buyer about the quality of the school districts or local traffic if these facts might negatively affect the prospective buyer’s decision. The buyer’s agent, on the other hand, must seek out this sort of information. The buyer’s agent should amass as much helpful information about the property as possible, even the information that the seller’s agent is not required to disclose. The buyer’s agent should try to obtain information on all of the following subjects:

- Condition of the property and any property defects
- Characteristics of the neighborhood and surrounding areas
- Age of the property
- Length of time the property has been listed on the market
- Reasons the owner is selling the property
- Reasons other prospective buyers, if any, refused the purchase of the property
- Appropriate amount to pay for the property, regardless of the actual listing price
- Contractual terms that are not in the buyer’s best interest

In addition, the buyer’s agent is required to maintain confidentiality for the buyer. For Example, if the buyer is willing to pay more than his or her initial offer, the buyer’s agent cannot disclose this to the seller or the seller’s agent.

**Providing Services for the Client**

A buyer’s agent would probably provide the following services for the buyer:

- Showing the buyer suitable properties
- Finding information about properties, school districts, zoning, traffic problems, taxes, communities, and utilities
- Preparing a market analysis of the properties being considered
- Giving advice to the buyer about offers
Negotiating for the buyer, not the seller
Maintaining confidentiality
Helping the buyer apply for a loan
Helping the buyer through the closing process
Attending the closing with the buyer

The buyer’s agent is frequently entitled to the selling agent’s (or selling broker’s) commission. To receive this commission, the buyer’s agent must be able to prove that he or she was the procuring cause of the sale, that is, the buyer’s agent must be able to prove that his or her actions resulted in the sale.

**Subagency**

In Section 1101.002 (8) of the Texas License Law, a subagent is defined as a license holder who:

(A) represents a principal through cooperation with and the consent of a broker representing the principal; and
(B) is not sponsored by or associated with the principal’s broker.

In the real estate profession, subagency occurs most frequently when the seller authorizes the listing broker to engage someone other than the listing broker to facilitate the real estate transaction. The cooperating agent is then a subagent of the listing broker and is an agent for the principal, meaning he or she is responsible to both parties.

Agents have implied actual authority to delegate authority to a subagent in any of the following cases:

- When the act is purely mechanical
- When the agent cannot perform an act that the subagent can lawfully perform
- When it is appropriate to delegate such powers
- When the principal specially authorizes delegation

**Note:** If a primary agent employs a subagent without the principal’s authorization to do so, then the principal has no obligations to that subagent.

To accept the offer of subagency, the broker interested in cooperating with the prime agent and principal must take action. Accepting a subagency offer can involve any or all of the following steps:

1. Inquiring about the property
2. Showing the property
3. Writing an offer on the property
4. Presenting an offer on the property

In the event that a subagent intentionally misrepresents a material fact or conceals critical information in a real estate transaction, Texas License Law protects the primary agent and principal from liability unless these parties had knowledge of the misrepresentation and did not disclose this information.

**Multiple Listing Services**

A multiple listing service (MLS) is a sizeable inventory of properties in a specified area that is maintained by the real estate brokerage industry and can be viewed by all members of that multiple-listing organization.

Some brokers view the service as a unilateral offer of subagency that allows brokers to share their listings with other brokers in exchange for a portion of the commission generated from any resulting transactions. Many brokers in Texas choose to not compensate the subagents who cooperate in the transaction.
The MLS is an excellent resource for agents when they are putting together a detailed comparative market analysis (CMA) because it is a comprehensive list of properties in a particular area that is updated regularly. Consequently, it allows an agent to analyze a variety of properties currently on the market to determine appropriate listing prices for similar listings. The MLS can also help an agent to identify characteristics shared among competing listings that may influence the terms of a property’s listing agreement. Finally, because the MLS organization reaches a large number of real estate professionals, sellers benefit from many individuals having access to their property listing, just as buyers benefit from the large selection of properties available to them.

**Intermediaries**

When a broker represents only the buyer or the seller, he or she is in a relationship of single agency. An *intermediary* is an agent who represents both the buyer and the seller and is, therefore, in a position of *dual agency*. A salesperson is NOT allowed to act as an intermediary; only a broker may act in this position.

**Disclosure**

A broker in a position of dual agency must disclose the relationship to both sides of the transaction and obtain written consent to this agency relationship from all parties. Section 1101.559 (a) of the Texas License Law establishes the requirements that must be met before an agent can act as an intermediary:

A broker may act as an intermediary between parties to a real estate transaction if:

1. the broker obtains written consent from each party for the broker to act as an intermediary in the transaction; and
2. the written consent of the parties states the source of any expected compensation to the broker.
The Duties of an Intermediary Broker

It is difficult, if not impossible, for an intermediary to represent fully the interests of two parties. After all, the seller is generally interested in getting the highest possible price for a property, while the buyer wants to pay the lowest possible price. Their concerns are fundamentally in conflict, and an agent representing both of these positions has fiduciary obligations to both sides.

Because of this tension between the two sides of a real estate transaction, the intermediary broker is not required to honor the duty of fidelity. This does not mean that the agent can act to undercut the interests of either side; instead, it simply means that the agent is not required to act in the best interests of each party when those interests are directly opposed. The broker must treat both parties equally and honestly while maintaining confidentiality for both parties.

Section 1101.558 of the Texas License Law provides a statement describing agency relationships in Texas. This statement outlines the duties of an intermediary as follows:

A broker who acts as an intermediary in a transaction:

1. shall treat all parties honestly;
2. may not disclose that the owner will accept a price less than the asking price unless authorized in writing to do so by the owner;
3. may not disclose that the buyer will pay a price greater than the price submitted in a written offer unless authorized in writing to do so by the buyer; and
4. may not disclose any confidential information or any information that a party specifically instructs the broker in writing not to disclose unless authorized to do so by The Texas Real Estate License Act or a court order or if the information materially relates to the condition of the property.
Appointed Licensees

Rather than taking on the difficult job of acting as a dual agent, an intermediary broker may choose to appoint licensed associates to represent one or both of the two sides in a real estate transaction.

What is the advantage of assigning these roles to other licensees? When a broker acts as an intermediary, he or she effectively waives the right to give advice or offer opinions to either party with respect to the other party. For example, an agent cannot really give a seller truthful advice about what sort of offers to accept if that agent also represents a prospective buyer making an offer on the seller’s property. If the agent were to say that the seller should seek higher offers, then the agent would be compromising the prospective buyer’s interests, but if the agent tells the seller not to seek different offers the agent may be compromising the seller’s interests. By representing two opposed sets of interests, the agent has created a situation in which he or she can offer only very limited guidance to either party.

If licensees are appointed to represent each party then this tension no longer exists. These representatives can freely offer advice and opinions to their respective principals, as long as no confidential information is disclosed. For this reason, appointing licensees is a viable option in a situation where the two parties prefer to have more guidance from their agents.

Complications of the Dual Agency Relationship

There are many potential liabilities in a dual agency relationship. If the agent has not provided full disclosure and obtained the written consent of both principals to participate in the dual agency, serious consequences can arise. The greatest of these risks is the threat of double exposure, which occurs when an agent breaches fiduciary duties to one or both parties due to the conflicting obligations of pre-existing agency relationships with either party. Because of this danger, TREC often discourages real estate professionals from entering into dual agency relationships.
Although many real estate licensees view dual agency as a hazardous business practice, there are some compelling reasons to consider dual agency. Some real estate professionals argue that when an intermediary agent represents both parties, the real estate transaction runs more smoothly and the negotiations are more efficient due to an open line of communication and streamlined approach. For Example, when a principal’s agent works in cooperation with the representative of the third party, the agent is not in a position to verify the actions of that representative. If the agent represents both parties, he or she can be sure of the disclosures made to each party and can monitor the transaction at each level to ensure the laws of agency are upheld and both parties receive equal treatment. Essentially, intermediaries may enjoy more control over the real estate transaction, although their agency relationship is more involved and requires a more attentive approach.

**Consider the following scenario:**

A couple comes to Broker F’s office looking for a small, two-bedroom house on the north side of town. She listens to their expectations and quickly discovers that she already represents a seller who has listed a property in this area that would satisfy the couple’s desires. Her agency relationship changes with both the buyer and seller at the point when she decides to show this property to the couple, tells them that she currently represents the seller of the property, and she obtains the consent of both parties to a dual agency relationship. She is now the intermediary between the two and must treat them impartially, making certain that she never gives one party an advantage over the other. This means that she can offer only limited guidance to either party and that she has an obligation to provide the couple with the same market data used by the seller to determine the listed price so that the couple can make an informed decision about what to offer for the property. As the intermediary, her basic duties are writing the offer, presenting the offer, and managing the negotiation of the transaction in a conscientious, professional, and unbiased manner.
Brokerage Relationships and Employment Laws

Up to this point, we have primarily discussed agency relationships between brokers and clients; however, brokers and their affiliated licensees also have agency relationships. These are frequently *general agency* relationships, which means that the licensee has a great deal of authority to represent the broker.

Employees vs. Independent Contractors

A licensee can be either an employee of the broker or an independent contractor. Depending upon the licensee’s role in the brokerage, the relationship between the broker and the salesperson will differ. Most brokers choose to sponsor licensees as independent contractors, which means that the broker pays the licensee a commission rather than a wage, and the broker has little control over the day-to-day operations of the licensee’s work. The broker is still responsible for supervising the licensee’s actions and is liable for his or her wrongdoings or negligence.

The IRS sets guidelines for distinguishing employees from independent contractors. A licensee is an employee rather than an independent contractor if:

- The licensee is paid a minimum monthly salary.
- The supervising broker pays the licensee’s licensing fees.
- The company can fire a licensee for violating instructions.
- The company reserves the right to establish quotas.
- The company or supervising broker attempts to control the day-to-day work of the licensees.
- The company views the licensees as a team.

On the other hand, if a licensee is paid commissions instead of salaries, has a great deal of control over his or her working conditions, and has a contact with the supervising broker stating that the licensee is not an employee, then the IRS considers the licensee to be an independent contractor.
Discrimination in the Workplace

Federal and state laws prohibit brokers and other employers from discriminating in hiring and firing on the basis of race, color, religion, national origin, sex, age, familial status, or physical or mental disability. The Texas Commission on Human Rights enforces anti-discrimination employment laws. Anti-discrimination laws apply to all businesses with 15 or more employees.

Lesson Summary

A licensee who is serving as an agent can hold four positions: seller’s agent, buyer’s agent, subagent, or intermediary.

Most of the time, the seller’s agent will be the listing agent and the agency relationship between the seller and the agent is created by the listing agreement. The seller’s agent must place the seller’s interests above those of all other parties involved in the transaction, including the agent. Acting in the seller’s best interests requires the agent to maintain confidentiality for the seller about his or her willingness to accept a lower price than the listed price of the property. The seller’s agent should not disclose any information to the buyer about the property or the transaction other than that which is required by law. Sometimes, the seller’s agent may provide helpful services to the buyer, but these services must further the seller’s interests as well.

The buyer’s agent, on the other hand, represents the interests of the buyer in the transaction. The buyer’s agent helps the buyer negotiate and gives him or her advice. A buyer’s agent also maintains confidentiality about private information such as the buyer’s willingness to pay more than he or she has offered for a property. If the actions of the buyer’s agent result in a sale, the buyer’s agent is frequently entitled to the selling agent’s commission. To receive this commission, the buyer’s agent must be able to prove that he or she was the procuring cause of the sale—that is, that his or her actions were the cause of the sale.
A licensee acting as a subagent represents a principal through the principal’s agent, but is not associated with that agent. In the real estate profession, subagency occurs most frequently when the seller authorizes the listing broker to engage someone other than the listing broker to facilitate the real estate transaction. The cooperating agent is a subagent of the broker and is an agent of the principal seller, which means that he or she is responsible to both parties. Many real estate subagency relationships are created through multiple listing services.

An intermediary is an agent who represents both the buyer and the seller in a particular transaction—that is, he or she is in a position of dual agency. This relationship requires written disclosure to dual representation and written consent to such representation from all parties involved in the transaction. Because an intermediary is supposed to be representing the interests of both sides, he or she may give only limited guidance to either party. In addition, the intermediary must act in an unbiased way and must treat all parties fairly. An intermediary’s role, then, is to act as a facilitator to the transaction. If the parties want to receive more extensive advice, or if the intermediary does not feel comfortable in the position, the intermediary agent may appoint associated licensees to act as representatives for each party. This does not alter the agent’s position as intermediary.

Finally, agency relationships also exist between a broker and his or her affiliated licensees and salespeople. The salesperson is the general agent of the broker and has a great deal of authority to act in the broker’s name, but the broker remains liable for the salesperson’s actions. An affiliated licensee can be either an employee of the broker or an independent contractor. Depending upon the licensee’s role in the brokerage, the relationship between the broker and the salesperson will differ. In addition, it is important for brokers to know that federal and state laws prohibit discrimination in hiring and firing on the basis of race, color, religion, national origin, sex, familial status, age, or physical or mental disability. These laws affect all businesses with 15 or more employees.
Lesson 12: Agreements and Termination

Lesson Topics

This lesson focuses on the following topics:

- Introduction
- Listing Agreements
- Buyer Representation Agreements
- Termination of the Agency Relationship

Lesson Learning Objectives

By the end of this lesson, you should be able to:

- Compare and contrast the different forms of listing agreements.
- Interpret buyer representation agreements.
- State the distinctive features of an intermediary relationship.
- Describe how an agency relationship can be terminated.

Introduction

In real estate transactions, agency relationships are generally created and formalized by using a written agreement. Therefore, a full understanding of the agent’s role and functions requires a grasp of the agreements that are commonly used to bind agents and principals to one another.

The listing agreement is the written contract between the owner of real property and the agent who represents the owner in the marketing and sale of that property. This document outlines each party’s terms and conditions, including the agent’s
responsibility to represent the principal to the best of his or her ability and in accordance with the law and the principal’s responsibility to pay the stated commission to the agent for his or her expertise and service.

There are four types of listing agreements that can be used to create an agency relationship between a seller and his or her representative: an open listing, an exclusive right to sell listing, an exclusive agency listing, and a net listing. All of these agreements differ significantly from one another and offer a different package of benefits and burdens to the agent and the principal.

The agency relationship between the buyer and the broker is generally created by the buyer representation agreement. As with a listing agreement, buyer representation agreements should be in writing and should define each party’s obligations to one another. The buyer commits to working exclusively with the broker, and the broker agrees to work diligently to locate property for the buyer and to negotiate an offer in the buyer’s best interest.

In addition to knowing how to create an agency relationship, a real estate licensee must also understand the conditions and events that can terminate this relationship. Because agency relationships must be consensual, they can generally be ended at any time by either party or by mutual agreement. The principal cannot terminate an agency relationship simply to avoid paying commission to the agent. Agency relationships can also be terminated if the terms of the relationship are completed, if either party dies or becomes incapable of fulfilling her or his role in the contract, by the bankruptcy of either party, by a change in property use characteristics or zoning, by destruction of the property, by revocation of the agent’s license or by expiration of the contract.

**Listing Agreements**

The *listing agreement* is a written contract between the owner of real property and the agent representing the owner in the marketing and sale of that property. This document
outlines each party’s terms and conditions, including the agent’s responsibility to represent the principal to the best of his or her ability in accordance with the law and the principal’s responsibility to pay the stated commission to the agent for his or her expertise and service.

A listing agreement should be detailed and comprehensive so as to avoid any misunderstandings regarding the obligations and intentions of each party. At a minimum, the listing agreement should include the following information:

- An “Information about Brokerage Services” form
- An explanation of the agent’s duties to the principal and the third party
- The names of the parties involved in the transaction
- A legal description and the physical address of listed property, along with any other fixtures to be included in the sale (furniture or accessories, for example)
- The beginning and termination dates of the contract
- The terms of commission for the agent’s participation and the seller’s agreement to pay this commission when the agent completes his or her contractual duties
- The terms of the sale, including the listed price and financing options
- The remaining balance of the seller’s mortgage, if any, as of the start date of the contract
- The type of listing
- Written permission to market the property in a reasonable manner
- Written permission to keep a lockbox on the premises
- Written consent to intermediary representation, if applicable
- The appropriate fair housing language and logo
- Dated signatures from the parties involved in the transaction indicating that they have read and understood the agreement and accepted its terms and conditions

There are four types of listing agreements that an agent and a principal can make: they can agree to an open listing, an exclusive right to sell listing, an exclusive agency listing, or a net listing.
Open Listings

Open listings allow a seller to list his or her property concurrently with a number of competing brokers, or to sell the property on his or her own without facing liability for a commission payment.

Some sellers believe this type of listing works in their favor because more listings mean more prospects and the seller will not be locked into paying a commission if the property is sold as a result of the seller’s own initiative. In addition, an open listing policy releases the seller from any obligation to inform the other listing brokers when the property goes under contract or is closed. The sale of the property under such an agreement essentially cancels all outstanding listings.

Real estate licensees, on the other hand, generally avoid open listing agreements, primarily because it can be difficult to determine who is entitled to the commission payment when so many brokers are involved. Furthermore, brokers often do not feel protected in this type of agreement because a licensee who diligently advertises a property might not be rewarded for his or her efforts if another licensee secures the sale of the property. Even if the compensated agent benefits from the marketing effort of others, the commission is earned only by the individual who closes the sale.

Exclusive Right to Sell Listings

Real estate professionals generally prefer exclusive right to sell listings over other listing agreements. This type of agreement states that as long as the property is sold within the time frame stipulated in the contract, the listing broker named in the contract will receive a commission for his or her role as agent in the real estate transaction. It does not matter how the sale is secured, whether by the named listing agent, another agent, or as a result of the owner finding a buyer without the listing agent’s assistance. Regardless, a commission must be paid to the listing agent who holds exclusive rights to the commission.
When comparing these terms with those of an open listing agreement, it is clear why real estate licensees would favor this approach. From the licensee’s perspective, holding an exclusive right to a commission protects her from the possibility of dedicating time and effort to a sale only to have the commission go to another party. For this same reason, real estate professionals encourage sellers to favor exclusive right to sell listings. They argue that when an agent has a vested interest in a property, he or she is more willing to expend time, effort, and money on diligently marketing that property. Because the listing agent has a secure hold on the commission, she can spend more time and energy finding a qualified buyer. This stands in opposition to an open listing agreement, in which brokers may expend less effort promoting a property and may settle for an offer below the property’s market value, for fear that another broker may secure the sale of the property before they do and consequently receive the commission.

**Exclusive Agency Listings**

Exclusive agency listings combine elements of open listing agreements and exclusive right to sell agreements. As with open listings, exclusive agency listings release the owner from any obligation to pay a commission in the event the owner secures the sale of the property. As with an exclusive right to sell listing, the seller agrees to list the property with only one broker during a specified listing term. The distinguishing characteristic of exclusive agency listings is that the named listing broker is owed commission only if the property is sold by someone other than the owner.

This feature of the agreement can lead to problems on occasion. In an exclusive agency listing agreement, an owner may conspire with the broker’s prospective buyer to execute the sale of the property after the listing agreement expires so as to avoid the payment of a commission to the named listing broker. In this case, the listing broker can only collect commission by proving that he or she was the procuring cause of the sale. That is, the agent must demonstrate that he or she was the individual who found a ready, willing, and able buyer and whose actions put the sale into motion.
Net Listings

Net listings are listing agreements in which the seller pays any amount over the listing price set in the contract as commission. A seller may choose to enter into a net listing agreement if that seller has a set price that he or she will accept for the property and does not wish to negotiate other offers with prospective buyers. Net listings can work in conjunction with open listings, exclusive right to sell listings, and exclusive agency listings.

Consider the following scenario:

Seller X has a parcel of land that he has been trying to sell on his own for quite some time. Tired of trying to market the property but unwilling to accept the low offers he has received in the past, he calls upon Licensee Y to secure the sale of the lot for no less than $100,000. Seller X agrees that in exchange for not being bothered with the details of the real estate transaction, Licensee Y will receive as commission the difference between the actual sale price and the seller’s desired net price. Shortly thereafter, Licensee Y secures the sale of the property for $110,000, and she walks away with a 10% commission.

In many states, net listings are illegal because of the potential risk to both the seller and the licensee. Although they are permitted in Texas, many real estate licensees advise against them and they are not commonly used.

Think back to the previous Example of the parcel of land that was sold for $110,000 with a 10% commission. At first glance it may seem that a licensee would be willing to dedicate a lot of time and effort to the marketing of this property because of the opportunity to secure such a high commission rate. Though this may indeed be true in some cases, it is not guaranteed. The following two Examples suggest the ways that net listings can work to the disadvantage of either the agent or the principal.
The interaction between Seller X and Licensee Y might have worked out much differently for Licensee Y:

Again, Seller X sets a net price of $100,000 for the parcel of land, allowing Licensee Y to accept as commission any difference between this amount and the actual sale price. Licensee Y, hoping to receive a higher-than-usual commission, puts a lot of time, energy and money into promoting the property, which she lists for $110,000. After Licensee Y has spent a few hundred dollars and a number of hours on the marketing of the property, a prospective buyer makes an offer on it. The offer is for only $100,000. Because Licensee Y must honor the interests of her client, she must communicate this offer to Seller X, who is pleased that he’ll receive the desired amount for the land and accepts the offer. In this scenario, Licensee Y walks away with nothing except lost time, energy, and money.

The interaction between Seller X and Licensee Y might also have worked out differently for Seller X:

Seller X again seeks $100,000 for the sale of his property. Choosing not to disclose to Seller X that the actual market value of the property is substantially higher than his desired net amount, Licensee Y lists the property for $130,000. Shortly after putting the property on the market, a buyer agrees to buy the piece of property for the listed price of $130,000, thereby securing a 30% commission for the agent. In this situation, Licensee Y did not disclose the fair market value of the property to Seller X and can be held liable for withholding information and knowingly misleading her client.

The Texas Real Estate Commission permits net listing agreements to be made only if the principal requires or demands this kind of listing and the principal is fully aware of the current market value of the property. Details regarding TREC’s stance on net listings can be found in section 535.16 (b) of TREC’s Rules.
Buyer Representation Agreements

Buyer representation agreements, or buyer-broker agreements, are similar to listing agreements between the seller and broker. As with a listing agreement, buyer’s representation agreements should be in writing and should define each party’s obligations to one another. In this sort of agreement, the buyer commits to working exclusively with the broker and the broker agrees to work diligently to locate property for the buyer and to negotiate an offer in the buyer’s best interest. The buyer-broker agreement should be limited to a specified time period and should contain the following information:

- The names of involved parties
- The beginning date and termination date
- The general characteristics of the property search
- Both the broker’s and the client’s obligations
- A description of the agency relationship (or intermediary status, if appropriate)
- A compensation agreement
- Consent for broker to represent competing prospective buyers
- The appropriate fair housing language and logo
- The terms of a protection period after the termination of the contract calling for the client to honor the commission agreement if the client enters into a contract to purchase a property that was introduced to the client by the broker during the term of the buyer-broker agreement (as long as the broker provides list of all properties shown to the client within 10 days of contract termination)
- Dated signatures from the parties involved in the transaction, indicating that they have read and understood the agreement, and accept its terms and conditions

Termination of the Agency Relationship

Under the common law of agency relationships, an agency relationship will continue either until the parties act to terminate it or until certain events take place that bring the
work of the relationship to a close (such as the sale or purchase of a property) or that make it impossible to carry out the project(s) named in the agreement (such as the death of one party or the destruction of the property).

**Termination by the Parties’ Actions**

Because agency relationships must be consensual, either party may choose to end the relationship at any time. This can happen in three ways:

1. **Revocation: The client fires the agent:** The client (the principal) may, at any time, fire the agent. This action is called *revocation*. The client must usually give written notice of the revocation, and if the client breaches the terms of the contract, he or she may be liable for damages. For example, the principal would face legal liability if she or he ended an agency relationship simply to avoid paying commission.

2. **Renunciation: The agent quits:** The agent may, at any time, decide to leave an agency relationship. This action is called *renunciation*. The agent must usually give written notice of the renunciation, and the agent could be liable for damages if the contract is breached.

3. **Mutual agreement:** Both parties may agree to end the agency relationship at any time. It is wise to put the mutual agreement in writing.

**Termination by the Law**

The following events terminate an agency relationship by operation of law, regardless of the parties’ wishes:

- **Death, incapacity, or bankruptcy:** In most states, the death of the agent or principal terminates the agency relationship. Most states also provide for the relationship to be dissolved if either party files bankruptcy or becomes incapacitated to an extent that prevents him or her from carrying out his or her role in the agreement. Note that an agent generally has no authority to act if the
principal dies or becomes incapacitated, even if the agent has no knowledge of the event.

- **Fulfillment of purpose:** The agency relationship ends when its purpose is completed, as it would be by closing a real estate transaction.

- **Extinction of the subject matter:** If the subject matter of the relationship ceases to exist (for example, if the home that is the subject of a transaction burns down), then the agency relationship is dissolved.

- **Expiration:** The agency relationship ends upon the expiration date set in the agreement. If there is no specific expiration date established in the agreement, then a reasonable general time period can be set.

After the agency relationship has been terminated, the agent must still maintain confidentiality for the principal unless required by a subpoena or court order to disclose private information. The agent also continues to owe the principal the duty of accounting, if necessary.

**Lesson Summary**

The listing agreement is the written contract between the owner of real property and the agent who represents the owner in the marketing and sale of that property. This document outlines each party's terms and conditions, including the agent's responsibility to represent the principal to the best of his or her ability and in accordance with the law and the principal's responsibility to pay the stated commission to the agent for his or her expertise and service.

There are four types of listing agreements: open listings, exclusive right to sell listings, exclusive agency listings, and net listings. Some sellers prefer open listings, in which the seller can list his or her property concurrently with a number of competing brokers. With an open listing, the seller can also sell the property on his or her own without being liable for paying a commission. Brokers, however, generally avoid these agreements, primarily because it is difficult to determine who is entitled to the commission payment.
when so many brokers are involved. Also, brokers do not want to work diligently to find a buyer for a property without a guaranteed commission.

Most licensees prefer exclusive right to sell listings over other listing agreements. This type of agreement states that as long as the property is sold within the time frame stipulated in the contract, the listing broker named in the contract will receive a commission for his or her role as agent in the real estate transaction.

Exclusive agency listings combine elements of both open listing agreements and exclusive right to sell agreements. Under this type of agreement, the seller agrees to list the property with only one broker, but the seller does not have to pay commission if he or she sells the property independently. The distinguishing characteristic of exclusive agency listings is that the named listing broker is owed commission only if the property is sold by someone other than the owner. This fact can lead to problems if the seller conspires to avoid paying the commission by negotiating with one of the agent's prospective buyers to wait to close until after the exclusive agency listing expires.

The final type of listing agreement is the net listing, in which the seller pays as commission any amount over the listing price set in the contract. A seller may choose to enter into a net listing agreement if that seller has a set price that he or she will accept for the property and does not wish to negotiate other offers with prospective buyers. Net listings can be used in conjunction with open listings, exclusive right to sell listings, and exclusive agency listings.

The agency relationship between the buyer and the broker is generally created by the buyer representation agreement. As with a listing agreement, buyer representation agreements should be in writing and should define each party's obligations to one another. The buyer commits to working exclusively with the broker, and the broker agrees to work diligently to locate property for the buyer and to negotiate an offer in the buyer's best interest.
An agency relationship can generally be ended at any time by either party or by mutual agreement. The principal cannot terminate an agency relationship simply to avoid paying commission to the agent. Agency relationships can also be terminated if the terms of the relationship are completed, if either party dies or becomes incapable of fulfilling her or his role in the contract, by the bankruptcy of either party, by a change in property use characteristics or zoning, by destruction of the property, by revocation of the agent’s license or by expiration of the contract.
Lesson 13: Antitrust Laws and Deceptive Trade Practices

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Antitrust Laws
- Texas Deceptive Trade Practices-Consumer Protection Act

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Name the laws that prohibit deceptive trade practices.
- List at least 10 of the “laundry list” violations of the Deceptive Trade Practices-Consumer Protection Act (DTPA).

Introduction
All licensees need to be familiar with the federal and state laws that regulate trade practices. Of primary concern here are antitrust laws and the Texas Deceptive Trade Practices-Consumer Protection Act. These laws affect the real estate profession as a whole, and they have particular implications for agents.

Antitrust Laws
Real estate licensees are subject to federal antitrust laws, enforced under the Sherman Antitrust Act, that prohibit unfair trade practices in the United States. In essence,
antitrust laws prohibit businesses from establishing groups or standards that interfere with normal business competition. These laws are rooted in the idea that competition creates the largest choice of products and services for consumers, thus providing them the broadest range of price and quality. The most common antitrust violations in the real estate industry include price fixing, boycotting competitors, and allocating customers or markets.

**Price Fixing**
Price fixing is the practice of establishing prices for goods or services at a predetermined level, as opposed to allowing prices to be set by open-market competition. In real estate, a licensee provides his or her expertise and service to the principal in exchange for compensation. If brokers in a particular market conspire to set the same commission rates for all real estate licensees in that market, they are guilty of price fixing. The law states that a broker must determine the rate of compensation without the influence of any other broker. For this reason, discussion of rates among licensees from different firms is greatly discouraged, as it could easily be construed as an attempt to establish a set rate.

Similarly, professional organizations (such as multiple listing services) cannot make a broker’s participation in the organization contingent on the commission rate that he or she charges.

**Boycotting Competitors**
When two or more parties agree to abstain from dealings with other parties to limit competition, they are essentially boycotting their competitors. In real estate, this may occur if a brokerage is unfairly denied access to a particular real estate professional organization or if two or more licensees agree to withhold their patronage from certain brokers.
Allocating Customers or Markets

If two or more brokers agree to divide a market area so that each broker only covers a certain segment of that market area, the allocation of these segments is illegal because it restricts open-market competition. For example, if Brokers A, B, C, and D are the four major brokers in a city, they cannot have an agreement to exclusively represent the northern, southern, eastern, and western areas of the city, respectively. Allocation of markets does not pertain solely to geographic regions; it is also illegal to divide the market in terms of property values.

Beyond these shared principles, the details of real estate practice in regard to the legality of allocation vary from state to state and are more closely regulated and further defined at the state level. Still, many states have similar provisions based on the regulations recommended by the National Association of REALTORS®.

In Texas, real estate practices are monitored by the Texas Real Estate Commission (TREC). You can visit the TREC website at http://www.trec.state.tx.us/.

Texas Deceptive Trade Practices-Consumer Protection Act

In addition to the consumer protections granted by federal antitrust laws, the Texas Deceptive Trade Practices-Consumer Protection Act (DTPA) allows an aggrieved consumer to hold a seller of goods and services liable for damages resulting from deceptive or unfair trade practices. In the context of real estate, the consumer is the buyer, and the seller of goods is the seller of real property. When a licensee is the seller’s agent, the licensee can be considered a seller of services, and a consumer can bring action against the licensee for knowingly and intentionally deceiving the consumer in the selling or leasing of any real property. In fact, most lawsuits brought against real estate licensees cite violations of the DTPA.
Overall, the DTPA lists 25 specific violations, commonly referred to as the “laundry list.” Of these 25 violations, the following are applicable to the real estate industry:

- Representing goods as new or original if they are in fact reconditioned or used
- Representing goods as meeting a certain standard, quality, or grade or as if they are of a particular style when, in fact, they do not fit these descriptions
- Misrepresenting facts concerning the goods, services, or business of another in order to discredit that entity
- Misrepresenting facts concerning the reasons for a reduction in price of goods or services
- Representing an agreement as containing rights, remedies, or obligations that it does not contain
- Concealing or misrepresenting the need for replacement or repair services
- Misrepresenting the authority of the representative to negotiate the transaction
- Claiming that replacement or repair services have been performed when, in fact, they have not
- Failure to disclose any information at the time of the transaction that may have affected the outcome of the transaction

If the consumer can prove that the seller or the broker knowingly and intentionally committed any of these violations, the offending party can be held liable for damages. There are a number of ways for a real estate licensee to ensure that they satisfy the standards of fair and honest trade practices, and thus to protect themselves from this kind of litigation:

- Be responsible and thorough in disclosing property defects
- Encourage all parties to carry out appropriate property inspections
- Avoid offering opinions or making unwarranted exaggerations about the property
- Keep careful notes regarding the transaction process

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Disclosure
First and foremost, real estate licensees must be vigilant about the disclosures they make to the prospective buyer concerning any property. Again, the duty of disclosure is central to the agent’s role in a fiduciary relationship, even when dealing with a third party. The licensee must disclose any and all defects in a property (of which he or she is aware), including any additional information about the property that may affect the prospective buyer’s final decision.

The State of Texas requires all sellers of residential property to submit a seller’s disclosure form. TREC offers a Seller’s Disclosure of Property Condition form, but sellers are not obligated to use this specific form. As long as the disclosure includes all of the information that TREC requires, any form may be used.


Basically, the disclosure notice is an opportunity for the seller to be upfront and comprehensive about all facts and defects concerning the property. It is the real estate licensee’s responsibility to advise the seller about the necessity of the disclosure notice, although the form itself should be filled out by the seller. This form is required even when an owner sells his or her own property. The completed form should be given to the prospective buyer before he or she makes an offer to buy the property.

Recommend Inspections
It is in the best interest of all parties to have the property inspected by a professional property inspector who is not associated with the real estate licensee. The licensee can provide a list of qualified inspectors to the prospective buyer, but he or she should not be present to mediate the conversation between the inspector and the prospective buyer.
If the initial inspection reveals defects in the property and the appropriate repairs are made, the prospective buyer should be encouraged to review the property a second time to ensure that the defects have been addressed to his or her satisfaction. In the event that a prospective buyer chooses not to have a property inspected, the licensee should secure a signed written statement from the prospective buyer stating that he or she made this choice despite the licensee’s recommendation that the property be inspected.

**Avoid Opinions and Puffing**

It is important for the agent to steer clear of personal opinions when commenting on a property. If the customer believes that the agent made unwarranted exaggerations over the course of the transaction, that agent may be accused of puffing. It is the agent’s responsibility to provide known facts about the property, not his or her opinions. If a client or customer asks for an agent’s opinion, the agent should refer the individual to a specialist (for example, a property inspector, an attorney, or a plumber) who can provide unbiased and informed assistance to the consumer. The agent should, however, avoid recommending a particular specialist; if the consumer is dissatisfied with the work of that individual, the licensee could be held liable. Instead, the agent can provide the consumer with a list of qualified professionals.

**Keep Careful Notes**

Finally, the agent should always keep detailed and accurate notes throughout the real estate transaction. This is to ensure that the licensee can provide evidence regarding certain actions or events over the course of a transaction if he or she is later called upon to do so.

**DTPA Lawsuits**

When a lawsuit is filed under the DTPA, there are a number of ways the problem might be resolved. A reasonable settlement can always be made between the licensee and the consumer if the case is addressed within a set time limit. An agent may be released from liability if that agent can show that any inaccurate information he or she provided to
the consumer was obtained from another source (for Example, from governmental records or a seller’s disclosure form), and that the agent had no reasonable way of knowing that information was false. For Example, if an agent quotes the wrong square footage for a property based on inaccurate county records, the agent would be protected from liability. Also, if an agent can show that the training they received was inaccurate or mistaken (for Example, an incorrect statement appearing on the state’s real estate exam), and that he or she carried out the business of real estate relying on this information as fact, then the agent is not liable.

Recovery under the DTPA is limited to economic damages. In order for the Texas Real Estate Commission to revoke or suspend an agent’s license, that licensee’s violations of the DTPA must be coupled with violations of provisions set forth in the Texas Real Estate Licensing Act. Some of the infractions for which TREC may revoke or suspend an agent’s license—that is, violations of license law which are also violations of the DTPA—are the following:

- Material misrepresentation or failure to disclose any known or latent property defects
- Deceptive practices in the marketing, selling, or offering of real property
- False promises made to the consumer through advertising or directly through the agent
- Failure to disclose which party is compensating the agent, or that more than one party is liable for compensation without the written consent of all parties involved
- Request or acceptance of an undisclosed compensation
- Acting as agent and undisclosed principal in a transaction

**Lesson Summary**

Real estate licensees are subject to federal antitrust laws enforced under the Sherman Antitrust Act that prohibit unfair trade practices in the United States. These laws are
rooted in the idea that competition creates the largest choice of products and services for consumers, thus providing them with the broadest possible range of price and quality. The most common antitrust violations in the real estate industry include price fixing, boycotting competitors, and allocating customers or markets.

In addition to the consumer protections granted by federal antitrust laws, the Texas Deceptive Trade Practices-Consumer Protection Act (DTPA) allows an aggrieved consumer to hold a seller of goods and services liable for damages resulting from deceptive or unfair trade practices. When a licensee is the seller’s agent, the licensee can be considered the seller of services, and a consumer can bring action against the licensee for knowingly and intentionally deceiving the consumer in the selling or leasing of any real property.

To prevent lawsuits under the DTPA, real estate agents must be diligent about disclosing the known facts about a property. Agents should also recommend that buyers arrange an independent inspection of the property, avoid offering opinions or making exaggerated statements about the property (puffing), and keep careful notes and records regarding the transaction. Recovery under the DTPA is limited to economic damages, but if a licensee’s violation of the DPTA is also a violation of Texas License Law, TREC can suspend or revoke the individual’s license.
Lesson 14: Real Estate Practice

Lesson Topics
This lesson focuses on the following topics:

- Field Application of Agency Relationship Concepts
- Insight into Agency Law

Lesson Learning Objective
By the end of this lesson, you should be able to:

- Identify violations of the laws in case study scenarios.

Field Application of Agency Relationship Concepts
We have covered a lot of detailed information over a relatively short period of time. To ensure a comprehensive understanding, we will now integrate the information through a series of questions and case studies.

In the first half of the lesson, you will be presented with multiple parts of a scenario and periodic questions about what the agent should do.

Agency Dilemmas
Mr. Jones walks into Lone Star Realty and tells the receptionist that is looking to buy a house. She leads him to Ms. Smith’s desk, the firm’s top agent.

“Good afternoon! I’m Ms. Smith, the broker. I hear you are in the market for a house,” Ms. Smith says. “Tell me a little about the perfect home for you.”
Ms. Smith and Mr. Jones discuss the features that Mr. Jones wants in a home, and Mr. Jones gives Ms. Smith his general price range.

“I can think of two properties offhand that I think you’d really like.”
“Jones: Great, I’d love to see them!”

Ms. Smith is the agent for the sellers of both of the properties she plans to show Mr. Jones. She also has a general policy of refusing to act as an intermediary.

Note: Ms. Smith must disclose that she represents the sellers and give Mr. Jones an agency disclosure statement to sign. In this situation, the licensee must give the buyer the agency disclosure statement and inform him that she represents the sellers. The buyer might get confused and think that Ms. Smith represents him. Agents must be upfront and direct about whom they represent.

“Mr. Jones, before we proceed, I must let you know that I am the agent for the sellers of these two properties. What this means is that I represent their interests, and although I will be as helpful to you as I can be, I will not be representing your interests.” She pulls document from a folder and slides it across the desk to Mr. Jones. “Look over this Information about Brokerage Services form, which explains Texas agency law.”

Mr. Jones frowns slightly as he scans the form. “Hmm… oh… OK, I see.”
“Please let me know if you have any questions.”
“OK…This form describes your duties to the seller. What are your duties to me?”

Note: All agents owe the duties of care and skill, disclosure, and honesty to clients and customers alike.

Ms. Smith smiles. “So, agency law states that I owe you the duties of reasonable care and skill, disclosure of material facts and honest and fair dealing. Even though I represent the seller, I still have to treat you fairly.”
“OK, then, I'll agree to this.”

“Great! Let's go look at these two houses.”

Ms. Smith takes Mr. Jones to see the first house. “This first house is an absolute dream. I think you'll love it! It's so cozy.”

Ms. Smith knows that the driveway of this house extends onto the neighboring property. This problem is considered a latent defect because it would not be easily discovered in an inspection; however, a survey of the property would reveal this fact.

**Note:** She must disclose all latent defects that she is aware of. Remember that this problem is considered a latent defect because it would not be easily discovered in an inspection.

After a tour of the interior, Ms. Smith shows him the outside, stopping in the driveway. “Mr. Jones, I'm required by law to disclose all material facts, so you should know that the driveway of this house extends onto the neighboring property.”

“Oh, hmm. Do you think that would be expensive to fix?”

Ms. Smith suspects that the driveway would be expensive to fix; however, she is not an expert on this issue. She also knows that if she tells Mr. Jones that it may be expensive to repair, then he may not want to buy the house.

**Note:** Because Ms. Smith is not an expert, she should refrain from giving any opinion on cost of repairs to the driveway. Unless she is an expert on these matters, Ms. Smith cannot guess as to the cost of the repairs. The best option would be to suggest contacting an expert.
“I’m sorry, Mr. Jones, but I’m not a construction expert. You would need to consult a professional to get an estimate of the costs to fix this problem. If you like, I can give you a list of qualified individuals.”

“Well, I don’t know. I think this would just be too much trouble. Let’s see the next house.”

Ms. Smith drives the prospective buyer to the second house a few miles away.

“OK, this house really is great. There are no major defects. It’s in great condition, and no major repairs would be needed.”

After a thorough tour of the house, inside and out, Mr. Jones is impressed. “Wow! I really like this house! What was the listing price again?”

“$115,000.”

“Ouch, that’s steep! How low do you think the seller might be willing to go?”

Ms. Smith knows that the seller wants to sell this house quickly and is willing to go as low as $80,000.

**Note:** She must not give the buyer any advice on this matter because advising prospective buyers about price is at odds with her legal obligation to promote her client’s interests. Remember that Ms. Smith has a duty of confidentiality to her clients.

“I’m sorry, but that’s confidential information, and I can’t give you any advice on price negotiation because that would be at odds with looking out for my client’s interests. You’ll have to consult your own agent for advice.”
“You know, I think I need someone on my side to give me advice about this. I’m going to hire my own agent, and I’ll be back to buy this house!”

**Insight into Agency Law**

Here are five case studies that deal with the laws, guidelines and ethical issues regarding Texas agency law that we have covered. You will be asked consider the facts of the case to anticipate the outcome and to draw on your knowledge of agency law.

**Case Study 1**

Four months ago, Seller A listed a home with Broker B’s office, Budget Brokerage. The seller and Broker B signed a listing agreement, and they agreed to enter into an agency relationship. Broker B is a very busy person, and she assigned the task of finding a buyer for this home to Salesperson C, a new employee. Salesperson C looked over the facts about the property and she noted that the local school district is under-funded and is considered to be one of the worst school districts in the city. She mentioned this to the broker and raised a concern that this information might make it difficult to sell the home. Her broker told her not to worry because Texas law does not require a seller’s agent to disclose that sort of information to buyers.

Two weeks later, Buyer D walked into the brokerage. Salesperson C happened to be the only person in the office and after a brief talk with Buyer D, she realized that Seller A’s property would be perfect for the buyer’s needs. They immediately went to look at the property. Salesperson C mentioned several latent defects in the property but did not mention the problems with the school district. Salesperson C also showed the buyer several other properties, but the buyer decided to purchase Seller A’s home.

The closing went smoothly, with no major concerns. After closing, however, Broker B received a letter of an impending lawsuit from Buyer D. Apparently, Buyer D moved in and immediately discovered negative information about the school district. She is convinced that Salesperson C and Budget Brokerage misled her by concealing facts.
Consider this situation. Is Budget Brokerage liable?

**Answer:** It is possible that Budget Brokerage could be held liable. Texas law does not consider information such as the quality of the school district to be a material fact or a latent defect, so the agent is not required to disclose this information. This case study does not mention whether the agent gave the buyer a disclosure of agency form and the statement of agency law. The buyer in this case may not have been aware that the salesperson was not acting as her agent—and a buyer’s agent *would* be responsible for providing her client with accurate information about the community in which a property is located. If the salesperson’s actions created a situation of implied agency, then the buyer may have a case.

**Case Study 2**

Seller X relocated to another area prior to the sale of his listed property. Shortly thereafter, his agent, Broker Y, found an interested buyer. This prospective buyer, Buyer Z, was able to obtain financing quickly and the transaction quickly progressed towards closing.

Three weeks before the closing date, Buyer Z walked into the agent’s office and explained that she needed to move into the house immediately for personal reasons. If immediate possession was not possible, she said that she would withdraw her offer on Seller X’s property and move into a rental house instead.

Broker Y considered this offer briefly. Nothing in the original purchase and sales agreement allowed for this. Broker Y decided to call Seller X to get his approval, but the seller could not be reached. The buyer needed an answer right away; Broker Y decided that since Seller X wasn’t living in the house, he probably would not mind allowing the buyer to move in right away and pay rent until the day of closing. Broker Y told her it would be fine and found an attorney to draw up a contract. Buyer Z came back later that day and signed the contract, and the agent signed on behalf of Seller X.
Seller X returned the agent’s call the next morning and said that the decision was fine—of course he wouldn’t mind receiving three weeks worth of rent!

Broker Y originally acted outside of her authority, which is illegal. The principal (Seller X) later agreed to the agent’s actions. Does this approval make the agent’s actions acceptable?

**Answer:** Yes. The agent acted outside of her authority, but the seller later approved the action and thereby granted the agent authority by ratification. This particular situation worked out for both parties: the seller was able to receive three weeks of rent money when the house would have sat empty otherwise, and the buyer solved her personal situation by being able to move in immediately. It is not recommended for agents to act outside of their authority because an agent cannot predict whether a seller will agree to an action. Assuming that a client will grant ratification is risky and the agent will probably be held liable if the client does not approve of the actions.

**Case Study 3**

Seller M listed a condominium with Broker N, and they agreed to form an agency relationship. Seller M decided to list his condominium at $120,000.

Broker N had also recently put up her own condominium for sale. Both of these condominiums are located in the Happy Pines Condominium complex, and they are similar in size and layout. Broker N listed her condominium at a similar price but decided that she is willing to take lower offers.

Yesterday, Buyer O came into Broker N’s office looking to purchase a condominium and explained that his price range was $100,000 to $130,000. Broker N asked him what he was looking for and the features he described matched those of the condominiums owned by both Seller M and Broker N.
Broker N then told Buyer O that she had a lovely condominium in the Happy Pines Condominium complex with a listing price of $110,000. Buyer O asked to see the property and the broker showed the buyer her own condominium.

As they pulled into the building, Seller M happened to see Broker N and the prospective buyer in the car. Seller M asked the broker if she was showing the buyer his condominium, and the broker was forced to say no. The broker later called Seller M to explain, and Seller M fired her.

Did Broker N do anything wrong here?

**Answer:** Yes. An agent must place the principal's interests above his or her own. Broker N probably could have sold Seller M's condominium to the buyer, but she didn't even show the buyer that property. In this situation, the broker placed her own interests above her client's interests. Broker N breached the duty of fidelity that she owes to her client, Seller M.

**Case Study 4**

Broker J had been representing Buyer K for two months when he finally found a suitable property for her. Buyer K agreed to purchase this property, and presented an offer of $80,000, which was $10,000 less than the listing price. The seller (Seller L) agreed, and they proceeded towards closing.

At closing, however, the transaction fell through. It was discovered that there were several liens on the property, and the property could not be sold. Seller L was aware of the liens but had thought he would be able to clear them before the date of closing. He had kept this information hidden from his broker, Broker M.

Buyer K is very upset about this issue and wants to file a lawsuit. Which party is liable?
**Answer:** The seller is liable for concealing this information. Although agents are held responsible for their own wrongful actions and negligence, there are only certain circumstances under which they are held liable for a client’s actions, and since the seller concealed this information from the broker in this case, the broker is not responsible to the prospective buyer for undisclosed liens on the property.

In general, the agent is understood to operate under a warranty of authority. This is a kind of guarantee that an agent gives (explicitly or implicitly) to a third party, establishing that the agent has the authority to bind a principal—i.e., that the agent has the authority to make contracts, agreements, and enter into similar arrangements on the principal’s behalf. The agent cannot be held responsible if the principal does not or cannot follow through on the agreements the agent makes on the principal’s behalf. The warrant of authority concerns only the agent’s authority to act on the principal’s behalf, not his or her authority to ensure that the principal *himself* acts in a certain way.

For the purposes of this case, the seller’s broker is merely the seller’s representative and has no liability if the seller is unable to actually turn over title to the property.

**Case Study 5**

Seller S visited one of the offices of the Speedy Sales brokerage firm to list her home. Licensee A works in that office and the seller and this licensee entered into an exclusive listing agreement that authorized the licensee to publish the listing through Speedy Sales’ multiple listing service. Licensee A conducted an open house, advertised in the local paper, and took other active steps to promote the sale of the home.

Four weeks after the property went on the market, Licensee A received a call from Licensee B, who is affiliated with the same firm but works out of a different office. The two licensees had never met. Licensee B explained that he worked for Speedy Sales, had seen the seller’s property in the multiple listing service and was interested in
purchasing the property for himself. Licensee B then sent an offer to Licensee A through interoffice mail.

Licensee A spoke to her supervising broker who agreed to function as an intermediary. The broker then appointed Licensee A to serve as the seller’s agent.

When the seller’s agent, Licensee A, met with the seller to present Licensee B’s offer, she disclosed the intermediary relationship and the potential conflict of interest. Seller S consented to this arrangement in writing and agreed to the offer. Seller S then requested that Licensee A take the necessary steps to close the sale. The sale was closed, and Licensee A received a commission from the seller.

Several weeks later, Licensee A received a letter from the seller’s attorney. The attorney was of the opinion that since the buyer was a member of the same firm, Licensee A could not have acted as the agent in the sale and that she was not entitled to any listing commission. The attorney demanded that Licensee A refund the commission.

Would Licensee A have to refund the commission?

**Answer:** No. Licensee A satisfied her fiduciary duties to the seller and carefully disclosed the fact that the buyer was a member of the same firm. The seller consented in writing to the arrangement. Also, the licensee played no part in the seller’s decision to list with her or the seller’s decision as to the listing price. In this situation, the licensee performed her obligations under the listing contract and promoted the best interests of her client. She would not have to refund the commission.
Lesson 15: Definitions of Ethics and Morals

Lesson Topic
This lesson focuses on the following topic:
- Ethics and Morals

Lesson Learning Objective
By the end of this lesson, you should be able to:
- Identify the definition of ethics as used in this course.

Ethics and Morals Defined
In this lesson, we will discuss the definitions of morals and ethics while distinguishing the differences between the two concepts. We will begin with definitions of ethics and morals for use in this course.

From the Second College Edition of the American Heritage Dictionary, copyright 1982 by Houghton Mifflin Company, Boston, Massachusetts:

- ethics 3. The study of the general nature of morals and of specific moral choices to be made by the individual in his relationship with others. 4. The rules or standards governing the conduct of members of a profession (page 467).
From the *Second College Edition of The American Heritage Dictionary*, copyright 1982 by Houghton Mifflin Company, Boston, Massachusetts:

- **moral** 1. Of or concerned with the judgment principles of right and wrong in relation to human action and character. Synonym: *Ethical*. Approaches behavior from a philosophical standpoint; it stresses more objectively defined, but essentially idealistic, standards of right and wrong such as those applicable to the practices of lawyers, doctors, and businessmen (pages 813-814).

**Morals vs. Ethics**

Ethics are morals that society has converted into laws and principles; whereas, morals are the ideas of right and wrong that are inherent in each individual. The two terms are oftentimes used interchangeably, but they do not mean the same thing.

No one is perfect and all of us face difficult choices every day. The study of ethics would be easy if there were always a clear “right” and “wrong” answer in every situation; however, in many situations the answer is not that easy, and there seems to be one version of “right” contrasted with another version of “right.”

**Case Study**

A broker with ABC Real Estate goes out on a listing appointment. During the course of her discussion with the sellers, the broker discovers that the sellers are selling their home because they just cannot live next door to their neighbors anymore. According to the sellers, although the neighbors maintain their yard, the neighbors have very loud arguments at all hours of the night. The neighbors are known to abuse alcohol, which contributes to the arguments. The sellers are tired of being awakened by the arguments of their neighbors and the occasional visits from police. Is the noise from the neighbors something that should be disclosed to potential buyers? Perhaps only to buyers that the broker thinks would be bothered by the noise? Should the broker keep quiet because she owes her fiduciary duty to the sellers and knowledge about the neighbors might lower the price that the sellers would receive for the house? Is there another solution?
Due to difficult situations like these, there needs to be a system that helps make ethical decisions. The Code of Ethics plays a significant role in setting guidelines for agents to follow. The agent should follow the Code as he or she deems morally appropriate. Of course when there is legislation, court precedents, and/or common law pertaining to specific situations, then the decision may be much easier. On the other hand, there are situations where two laws are involved, and legal counsel is needed to determine how to proceed since following one law may appear to violate the second law. This course is not intended as a substitute for legal counsel.

**Lesson Summary**

This lesson defined ethics as “the rules governing the conduct of members of a profession” or “an individual’s moral conduct pertaining to other individuals” and morals as “the judgment principles of right and wrong in relation to human action and character.” Essentially, both ethics and morals should be used when dealing with real estate transactions to ensure fairness to all the parties involved.
Lesson 16: The Four Approaches to Ethical Decisions

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Ethics End-Result
- Ethics Rules and Laws
- Ethics of Social Contract
- Ethics of the Individual Conscience
- Ethical Decision-Making Model

Lesson Learning Objective
By the end of this lesson, you should be able to:

- Describe the four business ethics approaches used in this course.

Introduction
In this lesson, we will discuss four approaches to making ethical decisions and the model for applying these approaches. Later the student will be asked to apply these approaches and the model for ethical decision making. The four approaches are similar to those in a book written by Deborah H. Long entitled, Doing the Right Thing: A Real Estate Practitioner’s Guide to Ethical Decision Making, Second Edition. The four approaches we will use in this course will be based on End-Result Ethics, Rules and Laws Ethics, Social Contract Ethics, and Individual Conscience Ethics.
**Ethics End-Result**

A person who approaches an ethical decision using End-Result Ethics may draw up a list of advantages and disadvantages of a potential decision. Whichever list has the most items determines if the proposed decision is appropriate. This is a pragmatic approach and has appeal in the real estate industry since agents are very concerned with public opinion, making people happy, and closing transactions.

A downside of this approach is that obeying the law is only one item on the list, and there are consequences such as lawsuits, potential loss of real estate licensure, and potential loss of NAR membership for disobeying the law. Essentially this approach tries to find the solution that makes the most people happy.

In some cases, there are no laws involved, only personal feelings and preferences. What causes one person to be happy may cause another person pain. The following is a paraphrased case study from *Doing the Right Thing* (DRT, p. 28) to illustrate the application of this approach.

**Case Study B**

A real estate office is considering a ban on smoking within the office based on health concerns. Perhaps 80% of the office does not smoke, but the 20% who do smoke bring up concerns about potential decreased sales because without cigarettes the smokers become irritable and unproductive. The agents are also concerned about clients that smoke and whether or not smoking clients may go to a competitor who allows them to smoke. A no smoking policy has the potential to make 80% of the office happy at the expense of making 20% of the office unhappy in addition to a potential loss of clients.

An advantage of the End-Result approach to ethics is that it is a common sense approach that considers all the stakeholders within the decision process. A disadvantage is that this approach fails to define “happiness” in a consistent manner and cannot be applied to every situation. Therefore, other approaches may be necessary to reach the best potential decision.
Ethics Rules and Laws

Those opting to use the Rules and Laws approach believe that rules and laws are necessary in society because they are based on "fundamental moral truths" (DRT, p. 31), and all laws and rules should apply to everyone equally. Those who favor this approach believe that lawmakers are motivated for the good of society and are not influenced by personal interests.

The motivations of lawmakers are not always purely motivated. With this approach, another challenge is that not everyone agrees on what constitutes a fundamental moral truth. Throughout history, there have been Examples of wars being fought and persons being killed in the name of a _fundamental moral truth_.

The other challenge to the Rules and Laws approach to ethics is that even when a law or rule is well conceived, there is always an exception. Consider the case below paraphrased from _Doing the Right Thing_ (p.33).

**Case Study C**

You are a commissioner from a state regulatory board that must decide on appropriate action in the case of the mishandling of escrow funds.

It is the first time that this broker has been the recipient of a complaint. She is 24 years old and has only eight months more than the required experience to obtain her broker’s license. She comes from a real estate family, and her parents asked her to take over the brokerage business due to their failing health. While the daughter obtained her real estate education and experience to become a broker, her parents hired an interim broker to run the brokerage business. The interim broker stole $25,000 from the escrow account. The embezzlement was not discovered until several months after the young woman took over the business. At that time she and her family made complete monetary restitution to all of the clients; however, one of the clients filed a complaint to the state regulatory board.
The young broker expressed her regret that she did not have the accounts audited before she took over the managing broker position, and she is willing to accept any penalties that the state might impose. She does make one request. She asks that her name not be published in the state regulatory newsletter. She is a student at a prominent university and is being considered for a scholarship. She believes that if her name is not published, she will remain eligible for the scholarship.

The policy of the regulatory body is that, as a deterrent for violating the state real estate license law or regulatory body rules, the names of all persons found guilty of violations shall be published in the state regulatory newsletter.

Do you believe that this young broker’s name should be published in the newsletter? Why or why not?

The Rules and Laws Ethics approach is very useful, but perhaps not the most useful in every situation. Therefore, let us consider the approach entitled Social Contract Ethics by Deborah Long of Doing the Right Thing.

Ethics of Social Contract

According to Deborah Long in Doing the Right Thing (p. 32), “In contrast to rule thinkers who consider the legalities of an issue first, individuals that consider their community’s best interest when making an ethical decision are using social contract ethics.” Such individuals believe in abiding by their real estate company’s policies and procedure manual since such manuals are designed to prevent conflict and promote better working relationships between the agents of the company.

An Example of a social contract is the National Association of REALTOR® (NAR) Code of Ethics. All members of the National Association of REALTORS® (NAR) agree to abide by this Code as a condition of their membership. In complying with the Code, the members agree to hold themselves to a higher standard than the law. The social contract thinkers who agree to abide by this Code, or any similar code, “believe in
helping others and working for the common good” (DRT, p. 33). In *Doing the Right Thing* (DRT, p. 34), the following is a paraphrased case study to illustrate how this approach may be applied.

**Case Study D**

A married couple requests assistance from a broker in making an offer to purchase a home. The broker learns that the couple had been working with a broker from another company who first showed them the home. The broker asks why the couple did not go to the other broker for assistance in writing the offer. The buyers inform the broker that they no longer want to work with the current broker because he made an off-color remark when showing the house. In order to prevent a procuring cause battle, the broker asks whether or not the couple sought assistance from the broker/manager of the other company to get assistance from another broker (since their buyer agency agreement would be with the broker of the other company). The buyers state that the broker who showed them the home was the broker/manager of the company, and they no longer wanted to be associated with that broker or her company in any way.

What should the broker do?

Many states do not have laws that address procuring cause. Therefore, most brokers rely on community standards, customs, and/or arbitration by the Professional Standard Hearing Panel of their local board or association of REALTORS® in order to resolve such issues.

Also note that REALTORS® are required by Article 17 of the NAR Code of Ethics to arbitrate rather than litigate matters that involve disputes between REALTORS® of different firms (that arise in the course of their relationship as REALTORS®) regarding matters that are either contractual or non-contractual in nature. If all parties to the dispute inform the local board in writing that they choose not to arbitrate before the board, they may not have to arbitrate.
A weakness to the social contract approach is that sometimes change is difficult because of an established community belief system. For Example, buyer brokers may attempt to establish themselves in a market, but in many cases, the established real estate community will try not to cooperate with them. The established real estate community believes in the traditional way of doing business; therefore, they will be fearful and skeptical of new practices presented by buyer brokers.

Another potentially significant disadvantage to the social contract way of thinking is that some people who adopt this theory believe that the supreme authority is the state. If the state or community adopts an approach that is immoral, then all persons in the state could be at risk.

**Ethics of the Individual Conscience**

Individual Conscience Ethics uses individual and personal beliefs in order to establish a standard for decision-making. Most other philosophies are primarily concerned with focusing on the outer world such as laws and societal consequences for guidance and action. Individual Conscience Ethics “focuses on what lies within each person: conscience. A conscience can be defined as the “voice within” (DRT, p. 35). Martin Luther King, Jr. and Mahatma Gandhi are persons who practiced this approach even though it involved great personal risk.

A limitation to Individual Conscience Ethics is that it is individualized; therefore, it is hard to apply this approach when managing an office where each individual in the office has his/her own “personal ethical code” and, on some issues, those codes may clash (DRT, p. 36). In Doing the Right Thing (DRT, p. 37), the following is a paraphrased case study to illustrate how this approach may be applied.

**Case Study E**

You are the listing broker of a home in a well-kept neighborhood of medium-priced homes. The home you are listing is not along the power lines, but there is an
elementary school in the neighborhood that is located on land purchased from the power company with a close proximity to a power substation and high-voltage lines. When the school was being constructed, there were protests from parents who cited several studies that showed that children who were constantly exposed to electromagnetic fields (EMFs) developed childhood leukemia and other diseases. As a result of the parental concerns, the school board agreed to periodically test the EMF levels throughout the year, but no significant results were discovered. The school board voted to allow parents to move their children to another school within the district if they were still concerned about the potential effects of EMFs.

The owners of your listing have asked you not to mention anything about the EMF issue. You have read the results from several studies on the effects of EMFs and the results seemed conflicting and confusing. In your state, there is no law compelling you to disclose the EMF issue. You have seen evidence that the homes that are along the power lines sell for less than comparable neighborhood homes without power lines. If you disclose that children who attend the neighborhood elementary school may be exposed to a potential environmental risk, your listing will probably sell for less.

How would you handle this situation?
Ethical Decision-Making Model

Consider the following decision making model.

**Defining the Problem**
Determine:
- Facts
- Assumptions
- Affected persons
- Resources

**Applying an Ethical System**
- End results approach
- Rules and laws approach
- Social contract approach
- Individual conscience approach

**Making a Final Decision**

**Evaluating a Final Decision**

In order to use this model, it is helpful to define facts, assumptions, persons affected, resources, trial decisions and final decisions.
Defining the Problem

Facts

*Fact*: a statement or assertion of verified information about something that is the case or has happened.

**Examples** of facts in Case Study E:

- The sellers would like to sell their home (subject property).
- Their home is not close to the high voltage power lines.
- The neighborhood elementary school is located in close proximity to a power substation and high voltage lines.
- Some parents are concerned about potential long-term affects to children who are chronically exposed to electromagnetic fields (EMF) and those parents protested the construction of the school on the site purchased from the power company.
- The school board has agreed that parents who are concerned about EMFs may move their children to another school within the district.
- The EMF readings at the school have been periodically tested and none of the readings have been reported as significant thus far.
- Homes located along high voltage power lines have sold for less than comparable homes that are not near power lines.
- The sellers have requested that the listing broker not mention the EMF issue while marketing the home.

Assumptions

*Assumption*: According to the person facing the decision, anything related to the situation that is assumed to be true and from which a conclusion can be drawn.

**Examples** of assumptions in Case Study E:

- There is not a clear scientific conclusion that EMFs are harmful.
• Since homes next to high voltage lines have sold for less than other comparable homes and there has been publicity over the EMF issue in relation to the construction of the elementary school, it is possible that the subject property may sell for less rather now or later.

**Persons Affected**

*Persons affected:* All persons that will probably be affected by whatever decision is reached.

**Examples** of affected persons in Case Study E:

• The *broker* does not want to disobey the seller because of the fiduciary duties involved in agency law; however, the broker is concerned that not disclosing the EMF controversy may be dishonest. If a buyer’s child were to come down with a disease believed to be caused by EMFs, the broker would feel guilty, and the buyer might sue.

• *Sellers* may receive less for their home due to the controversy over the EMFs and the elementary school. The buyer might sue down the line if the buyer felt that he or she were coerced into buying due to the seller’s withholding of the EMF information.

• *Potential buyers* may not be familiar with the controversy. If they have children and purchase the home, they may discover the controversy after their purchase. As a result of owning the home, they may worry about health effects from EMFs if they allow their children to attend the elementary school. If they decide not to risk the possibility of EMF health risks by having their children attend another school, the buyer may be inconvenienced daily during the school year in arranging to transport their child to an elementary school that is farther away. They also may believe that they paid too much for the home considering the situation and may be concerned that they will not be able to sell the home because of the EMF controversy.

• The *broker* of the firm may not want the listing because of the controversy associated with the neighborhood and the potential for a lawsuit. The broker
may decide to accept the listing either with or without a disclosure regarding the EMF controversy.

- **Associates in the firm** may not be comfortable recommending the listing to persons who call in on ads for the subject property.
- **Peers** may refuse to show the listing because they are familiar with the controversy and feel that other neighborhoods would be less risky for buyers in terms of stability of investment and safety for children.
- **The neighborhood** may be hurt if all of their homes lose value because buyers are not comfortable buying due to the EMF controversy.

**Resources**

*Resources*: All persons, periodicals, and books that offer information on how other people have handled identical or similar situations. This may include laws, professional standards published by a regulatory body, and/or the NAR Code of Ethics.

**Examples** of potential resources for the Case Study E:

- The broker of the office may have handled similar situations in the past and can advise the agent from their experience.
- Periodicals published by the REALTOR® board or association as well as other real estate industry sources may have helpful advice on the EMF or related issues.
- An attorney may offer valuable insight and advice.
- The NAR Code of Ethics may be reviewed for insight.
- Professional Standards or Rules published by the state real estate regulatory body may be reviewed.

**Applying an Ethical System**

*Note*: All four approaches to ethical decision making can be applied to Case Study E and then weighed for their applicability to this situation.
Trial decision: A possible decision that must be more closely considered before becoming a final decision.

Final decision: The decision that is reached after careful consideration of all facts, assumptions, effects on various people and groups, available resources (both people and written), and the results of applying the four approaches to ethical decision making.

Lesson Summary

The four ethical systems applied to decision making are End-Result Ethics, Rules and Laws Ethics, Social Contract Ethics, and Individual Conscience Ethics. End-Result Ethics uses a list of pros and cons; a pragmatic decision is then made concerning the ethical dilemma at hand depending on the list. The Rules and Laws approach bases resolutions on the laws set forth by the government and other lawmaking entities. In contrast, when individuals use social contract ethics, they make decisions that place the community’s interest first; they tend to follow company procedures and guidelines. On the other hand, followers of the Individual Conscience Ethics system formulate decisions and choices based upon personal beliefs. Following the model for decision making and using the ethical approaches will help determine the best decision; this decision considers all facts, assumptions, affected parties, available resources, and results from applying the four approaches to ethical decision making.
Lesson 17: Articles in the Code of Ethics

Lesson Topics
This lesson focuses on the following topics:

- National Association of REALTORS® Code of Ethics
- The Preamble
- Articles and Standards of Practice of the Code of Ethics

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- List major categories of the Articles of the NAR Code of Ethics.
- Describe the structure of the NAR Code of Ethics and its supporting materials.
- Identify at least two aspirational concepts in the Preamble to the NAR Code of Ethics, describe the concept of general business ethics, and identify how the Code of Ethics compares and contrasts with the concept of general business ethics.
- Describe the concepts of at least two of the following Articles of the Code of Ethics: Articles 1, 2, 3, 9, 11, 12, 16, and 17.

National Association of REALTORS® Code of Ethics
REALTORS® are different from other practitioners because the National Association of REALTORS® (NAR) Code of Ethics requires a higher standard than the law requires. The Code of Ethics consists of a Preamble and 17 Articles: the first 9 Articles are "Duties to Clients and Customers," Articles 10 through 14 are "Duties to the Public," and Articles 15, 16, 17 are "Duties to REALTORS®." Some of the Articles are further clarified by Standards of Practice. A Standard of Practice gives an Example of how a particular Article has been applied. In order to file a complaint with the local REALTOR®
association or board, one must cite an Article that the complainant believes has been violated. A Standard of Practice may only be cited as support for the argument that an Article of the Code has been violated.

The NAR Code of Ethics establishes a basis for professionalism. Seeking financial success without accepting the responsibility of choosing the moral and ethical pathway will lead to failure. Remember that success can be measured by the respect clients and peers have for agents.

The National Association of REALTORS® Code of Ethics was adopted in 1913 to establish a widely held code for conducting business in a proper fashion. Over time, the Code of Ethics has evolved to keep pace with practices and business concepts that may have changed or developed throughout the Code’s life span; it must change with the legal issues and practices of the time to remain relevant and maintain its place as the industry standard. The following information presented in this course was taken from the Code of Ethics and Standards of Practice of the National Association of REALTORS®, effective January 1, 2014.

Two disclosures that precede the body of the NAR Code of Ethics follow:

1. “Where the word REALTORS® is used in this Code and Preamble, it shall be deemed to include REALTOR-ASSOCIATE®s.

2. While the Code of Ethics establishes obligations that may be higher than those mandated by law, in any instance where the Code of Ethics and the law conflict, the obligations of the law must take precedence.”

The following is the Preamble of the NAR Code of Ethics. The Preamble contains concepts to which all REALTORS® are expected to aspire.
After reading the Preamble, you will be asked to identify aspirational concepts of the Preamble.

**The Preamble**

"Under all is the land. Upon its wise utilization and widely allocated ownership depend the survival and growth of free institutions and of our civilization. REALTORS® should recognize that the interests of the nation and its citizens require the highest and best use of land and the widest distribution of land ownership. They require the creation of adequate housing, the building of functioning cities, the development of productive industries and farms, and the preservation of a healthful environment.

“Such interests impose obligations beyond those of ordinary commerce. They impose grave social responsibility and a patriotic duty to which REALTORS® should dedicate themselves and for which they should be diligent in preparing themselves. REALTORS®, therefore, are zealous to maintain and improve the standards of their calling and share with their fellow REALTORS® a common responsibility for its integrity and honor.

“In recognition and appreciation of their obligations to clients, customers, the public, and each other, REALTORS® continuously strive to become and remain informed on issues affecting real estate, and as knowledgeable professionals, they willingly share the fruit of their experience and study with others. They identify and take steps, through the enforcement of this Code of Ethics and by assisting appropriate regulatory bodies, to eliminate practices which may damage the public or which might discredit or bring dishonor to the real estate profession. REALTORS® having direct personal knowledge of conduct that may violate the Code of Ethics involving misappropriation of client or customer funds or property, willful discrimination, or fraud resulting in substantial economic harm, bring such matters to the attention of the appropriate Board or Association of REALTORS® (Amended 1-00).
“Realizing that cooperation with other real estate professionals promotes the best interests of those who utilize their services, REALTORS® urge exclusive representation of clients; they do not attempt to gain any unfair advantage over their competitors, and they refrain from making unsolicited comments about other practitioners. In instances where their opinion is sought, or where REALTORS® believe that commentary is necessary, their opinion is offered in an objective, professional manner, uninfluenced by any personal motivation or potential advantage or gain.

“The term REALTOR® has come to connote competency, fairness, and high integrity resulting from adherence to a lofty ideal of moral conduct in business relations. No inducement of profit and no instruction from clients can justify departure from this ideal.

“In the interpretation of this obligation, REALTORS® can take no safer guide than that which has been handed down through the centuries, which is embodied in the Golden Rule, “Whatsoever ye would that others should do to you, do ye even so to them.”

“Accepting this standard as their own, REALTORS® pledge to observe its spirit in all of their activities and to conduct their business in accordance with the tenets set forth below.”

**Articles and Standards of Practice of the Code of Ethics**

There are three major categories of Articles in the NAR Code of Ethics. The first nine Articles of the NAR Code of Ethics deal with “Duties to Clients and Customers.” Articles 10 through 14 apply to “Duties to the Public,” and the last three Articles consider “Duties to REALTORS®.” Application of the Articles of the NAR Code of Ethics will be addressed in the next lesson. Some of the Articles are followed by one or more Standards of Practice. A Standard of Practice illustrates how an Article has been applied to specific circumstances in the past. The purpose of a Standard of Practice is to clarify circumstances in which particular Articles have been applied in actual cases.
Review of the Articles and the Standards of Practice will be useful in working on the case studies in the next lesson.

After selected Articles, you will be asked to summarize the basic concept of that Article.

Duties to Clients and Customers

Article 1
When representing a buyer, seller, landlord, tenant, or other client as an agent, REALTORS® pledge themselves to protect and promote the interests of their client. This obligation to the client is primary, but it does not relieve REALTORS® of their obligation to treat all parties honestly. When serving a buyer, seller, landlord, tenant or other party in a non-agency capacity, REALTORS® remain obligated to treat all parties honestly (Amended 1-01).

What does Article 1 mean?
The primary duty of REALTORS® is to conduct their business in the best interest of the person(s) they represent. This includes performing fair, honest, and selfless business practices as covered under the Code of Ethics.

The temptation to rationalize or justify errors in judgment cannot be tolerated within ourselves or in those with whom we practice our profession. Article 1 establishes an equal obligation to clients and customers.

By entering into a contractual agreement to act as agents, REALTORS® are both legally and ethically obligated to the client to use their best efforts to accomplish the client’s objective, be it the sale, purchase, or lease of real property, or managing, counseling, syndicating, or other real estate related services. REALTORS® must be completely faithful to the client they have committed to serve. At the same time, a REALTOR® must also be honest with all parties to the transaction. Even if a REALTOR® is the agent of a seller, the REALTOR® still must be honest with buyers and all cooperating brokers. If the REALTOR® is the agent of a prospective purchaser, then the REALTOR® must be
honest with sellers and their agents by making his or her relationship with the buyer clearly known to all. If a REALTOR® leases property as the agent of the owner or landlord, then the REALTOR® must be honest with the lessee and any other brokers involved in the transaction. Even when a REALTOR® is not acting as an agent, the REALTOR® remains obligated to treat all parties honestly. This has particular significance to REALTORS® engaging in appraising, counseling, facilitating, and other activities where a principal-agent relationship is not involved.

**How would you summarize the basic concept(s) of Article 1?**

REALTORS® shall be faithful to their agency responsibilities to their principal in a transaction by putting the principal’s interests above their own. In addition, agents shall treat all parties in a transaction honestly.

**Standard of Practice 1-1**

REALTORS®, when acting as principals in a real estate transaction, remain obligated by the duties imposed by the Code of Ethics *(Amended 1-93).*

**Standard of Practice 1-2**

The duties the Code of Ethics imposes are applicable whether REALTORS® are acting as agents or in legally recognized non-agency capacities except that any duty imposed exclusively on agents by law or regulation shall not be imposed by this Code of Ethics on REALTORS® acting in non-agency capacities.

As used in this Code of Ethics, “client” means the person(s) or entity(ies) with whom a REALTOR® or the real estate agent’s firm has an agency or legally recognized non-agency relationship; “customer” means a party to a real estate transaction who receives information, services, or benefits but has no contractual relationship with the REALTOR® or the real estate agent’s firm; “agent” means a real estate agent (including brokers and sales associates) acting in an agency relationship as defined by state law or regulation; and “broker” means a real estate agent (including brokers and sales
associates) acting as an agent or in a legally recognized non-agency capacity (*Adopted 1-95, Amended 1-99*).

**Standard of Practice 1-3**
REALTORS®, in attempting to secure a listing, shall not deliberately mislead the owner as to the market value.

**Standard of Practice 1-4**
REALTORS®, when seeking to become a buyer/tenant representative, shall not mislead buyers or tenants as to savings or other benefits that might be realized through use of the REALTOR®’s services (*Amended 1-93*).

**Standard of Practice 1-5**
REALTORS® may represent the seller/landlord and buyer/tenant in the same transaction only after full disclosure to and with informed consent of both parties (*Adopted 1-93*).

**Standard of Practice 1-6**
REALTORS® shall submit offers and counter-offers objectively and quickly as possible (*Adopted 1-93 Amended 1-95*).

**Standard of Practice 1-7**
When acting as listing brokers, REALTORS® shall continue to submit to the seller/landlord all offers and counter-offers until closing or the execution of a lease unless the seller/landlord has waived this obligation in writing. REALTORS® shall not be obligated to continue to market the property after an offer has been accepted by the seller/landlord. REALTORS® shall recommend that sellers/landlords obtain the advice of legal counsel prior to acceptance of a subsequent offer except where the acceptance is contingent on the termination of the pre-existing purchase contract or lease (*Amended 1-93*).
Standard of Practice 1-8
REALTORS® acting as agents or brokers of buyers/tenants shall submit to buyers/tenants all offers and counter-offers until acceptance but have no obligation to continue to show properties to their clients after an offer has been accepted unless otherwise agreed in writing. REALTORS® acting as agents or brokers of buyers/tenants shall recommend that buyers/tenants obtain the advice of legal counsel if there is a question as to whether a pre-existing contract has been terminated (Adopted 1-93, Amended 1-99).

Standard of Practice 1-9
The obligation of REALTORS® to preserve confidential information (as defined by state law) provided by their clients in the course of any agency relationship or non-agency relationship recognized by law continues after termination of agency relationships or any non-agency relationships recognized by law. REALTORS® shall not knowingly, during or following the termination of professional relationships with their clients:

1. Reveal confidential information of clients.
2. Use confidential information of clients to the disadvantage of clients.
3. Use confidential information of clients for the REALTOR® advantage or the advantage of third parties unless:
   a) Clients consent after full disclosure.
   b) REALTORS® are required by court order.
   c) It is the intention of a client to commit a crime and the information is necessary to prevent the crime.
   d) It is necessary to defend a REALTOR® or the REALTOR® employees or Associates against an accusation of wrongful conduct.

Information concerning latent material defects is not considered confidential information under this Code of Ethics (Adopted 1-93, Amended 1-01).
Standard of Practice 1-10
REALTORS® shall, consistent with the terms and conditions of their real estate license and their property management agreement, competently manage the property of clients with due regard for the rights, safety and health of tenants and others lawfully on the premises *(Adopted 1-95, Amended 1-00).*

Standard of Practice 1-11
REALTORS® who are employed to maintain or manage a client’s property shall exercise due diligence and make reasonable efforts to protect it against reasonably foreseeable contingencies and losses *(Adopted 1-95).*

Standard of Practice 1-12
When entering into listing contracts, REALTORS® must advise sellers/landlords of:

- The REALTOR®’s company policies regarding cooperation and the amount(s) of any compensation that will be offered to subagents, buyer/tenant agents, and/or brokers acting in legally recognized non-agency capacities; The fact that buyer/tenant agents or brokers, even if compensated by listing brokers, or by sellers/landlords may represent the interests of buyers/tenants.
- Any potential for listing brokers to act as disclosed dual agents, e.g., buyer/tenant agents *(Adopted 1-93, Renumbered 1-98, Amended 1-99, Amended 1-03).*

Standard of Practice 1-13
When entering into buyer/tenant agreements, REALTORS® must advise potential clients of:

- The REALTOR®’s general company policies regarding cooperation and compensation; and
- Any potential for the buyer/tenant representative to act as a disclosed dual agent, e.g. listing broker, subagent, landlord’s agent, etc. *(Adopted 1-93, Renumbered 1-98, Amended 1-99).*
Standard of Practice 1-14
Fees for preparing appraisals or other valuations shall not be contingent upon the
amount of the appraisal or valuation (Adopted 1-02).

Standard of Practice 1-15
REALTORS®, in response to inquiries from buyers or cooperating brokers shall, with the
sellers’ approval, divulge the existence of offers on the property (Adopted 1-03).

Article 2
REALTORS® shall avoid exaggeration, misrepresentation, or concealment of pertinent
facts relating to the property or the transaction. REALTORS® shall not, however, be
obligated to discover latent defects in the property, to advise on matters outside the
scope of their real estate license, or to disclose facts which are confidential under the
scope of agency or non-agency relationships as defined by state law (Amended 1-00).

What does this mean?
As an elaboration of Article 1, Article 2 reiterates that REALTORS® must be open and
honest when dealing with the buyer and/or seller, shall neither conceal information that
is readily available, nor should they divulge information that is to remain confidential.

Article 2 guarantees faithful service to both clients and customers as consumers of real
estate services. Article 2 protects the consumer by ensuring that the REALTOR®
provides accurate, factual information without exaggeration. The REALTOR® must
communicate truthfully and cannot misrepresent the facts, and the REALTOR® cannot
remain silent concerning pertinent facts including adverse factors affecting the property.
As a real estate professional, the REALTOR® is obligated to discover and disclose
adverse factors apparent to someone with the REALTOR®’s level of expertise, but the
REALTOR® is not required to discover and disclose latent (hidden) defects in property
or to advise clients or customers on matters requiring specialized knowledge and
training not required by the state licensing authority or in the REALTOR®’s area of
expertise. The REALTOR® is neither expected to possess knowledge or skills generally
attributable to specialists in other fields such as architects, structural engineers, and soil experts, nor is the REALTOR® obligated to disclose facts that are confidential under the scope of agency or non-agency relationships as defined by state law. The necessity to safeguard the confidence of clients must be respected unless there is some superseding ethical obligation or legal duty.

How would you summarize the basic concept(s) of Article 2?
A REALTOR® should:

- Avoid misrepresentation
- Fully disclose the property condition
- Restrict advice to matters that are within the agent’s expertise
- Keep confidential matters confidential, such as matters related to a client’s reason for selling (if it is not related to property condition), but which might adversely affect the principal’s negotiating position

Standard of Practice 2-1
REALTORS® shall only be obligated to discover and disclose adverse factors reasonably apparent to someone with expertise in those areas required by their real estate licensing authority. Article 2 does not impose upon the REALTOR® the obligation of expertise in other professional or technical disciplines (Amended 1-96).

Standard of Practice 2-2
(Renumbered as Standard of Practice 1-12 1-98)

Standard of Practice 2-3
(Renumbered as Standard of Practice 1-13 1-98)

Standard of Practice 2-4
REALTORS® shall not be parties to the naming of a false consideration in any document, unless it is the naming of an obviously nominal consideration.
Standard of Practice 2-5
Factors defined as “non-material” by law or which are expressly referenced in law or regulation as not being subject to disclosure are considered not “pertinent” for purposes of Article 2 (Adopted 1-93).

Article 3
REALTORS® shall cooperate with other brokers except when cooperation is not in the client’s best interest. The obligation to cooperate does not include the obligation to share commissions, fees, or to otherwise compensate another broker (Amended 1-95).

What does this mean?
Article 3 forces REALTORS® to cooperate with their competitors on mutually agreed upon terms when it is in the best interest of the client. This obligation promotes harmonious teamwork by competitors to the benefit of buyers/tenants and sellers/lessors. The real estate market is best served when individuals with a variety of skills and resources work together. Cooperation optimizes the benefits available to clients and customers, as well as agents and their subagents, and it ensures sellers and lessors of the broadest possible market exposure. By cooperating with one another, brokers are able to enhance the market exposure of listed property and their ability to serve the needs of prospective purchasers and tenants.

How would you summarize the basic concept(s) of Article 3?
Unless contrary to the best interests of their principal, a REALTOR® shall cooperate with other brokers.

Standard of Practice 3-1
REALTORS®, acting as exclusive agents or brokers of sellers/landlords, establish the terms and conditions of offers to cooperate. Unless expressly indicated in offers to cooperate, cooperating brokers may not assume that the offer of cooperation includes an offer of compensation. Terms of compensation, if any, shall be ascertained by
cooperating brokers before beginning efforts to accept the offer of cooperation
*(Amended 1-99)*.

**Standard of Practice 3-2**  
REALTORS® shall, with respect to offers of compensation to another REALTOR®, timely communicate any change of compensation for cooperative services to the other REALTOR® prior to the time such REALTOR® produces an offer to purchase/lease the property. *(Amended 1-94)*

**Standard of Practice 3-3**  
Standard of Practice 3-2 does not preclude the listing broker and cooperating broker from entering into an agreement to change cooperative compensation *(Adopted 1-94)*.

**Standard of Practice 3-4**  
REALTORS®, acting as listing brokers, have an affirmative obligation to disclose the existence of dual or variable rate commission arrangements (i.e., listings where one amount of commission is payable if the listing broker's firm is the procuring cause of sale/lease and a different amount of commission is payable if the sale/lease results through the efforts of the seller/landlord or a cooperating broker). The listing broker shall, as soon as practical, disclose the existence of such arrangements to potential cooperating brokers and shall, in response to inquiries from cooperating brokers, disclose the differential that would result in a cooperative transaction or in a sale/lease that results through the efforts of the seller/landlord. If the cooperating broker is a buyer/tenant representative, the buyer/tenant representative must disclose such information to their client before the client makes an offer to purchase or lease *(Amended 1-02)*.

**Standard of Practice 3-5**  
It is the obligation of subagents to promptly disclose all pertinent facts to the principal's agent prior to as well as after a purchase or lease agreement is executed *(Amended 1-93)*.
Standard of Practice 3-6
REALTORS® shall disclose the existence of an accepted offer to any broker seeking cooperation (Adopted 5-86).

Standard of Practice 3-7
When seeking information from another REALTOR® concerning property under a management or listing agreement, REALTORS® shall disclose their REALTOR® status and whether their interest is personal or on behalf of a client and, if on behalf of a client, their representational status (Amended 1-95).

Standard of Practice 3-8
REALTORS® shall not misrepresent the availability of access to show or inspect a listed property (Amended 11-87).

Article 4
REALTORS® shall not acquire an interest in or buy or present offers from themselves, any member of their immediate families, their firms or any member thereof, or any entities in which they have any ownership interest, any real property without making their true position known to the owner’s agent or broker. In selling property they own, or in which they have any interest, REALTORS® shall reveal ownership or interest in writing to the purchaser or purchaser’s representative (Amended 1-00).

What does this mean?
Article 4 prohibits the REALTOR® from buying or presenting offers or selling property owned by the REALTOR®, or in which the REALTOR® has any interest, without making full disclosure of the ownership or interest to the buyer or seller or his or her agent or representative.

This prohibition applies not only to buying and selling by the REALTOR® but also any member of the REALTOR®’s immediate family, firm, or any entity in which the REALTOR® has any ownership interest. "Immediate family" includes "in-laws" because
in some instances, the transaction may benefit the REALTOR® in the future. A purchase or sale for the REALTOR®'s firm or any member thereof must be disclosed because it can be reasonably presumed that an individual will tend to favor the interests of business colleagues over the interests of strangers. Any entity in which the REALTOR® has any ownership interest is included to ensure that the buyer or seller or respective agents will be fully informed in advance of the REALTOR®'s position and interest in the transaction.

Article 4 protects the public by ensuring their full awareness of any direct or indirect personal interest of the REALTOR® in a real estate transaction involving property owned by the REALTOR® or property the REALTOR® is interested in acquiring. If the seller or buyer initially knows of the REALTOR®'s interest in a real estate transaction, he or she can make knowledgeable decisions, secure competent assistance, if necessary, and deal with the REALTOR® in an arm’s length transaction.

How would you summarize the basic concept(s) of Article 4?
In order to protect clients from unfair treatment, the REALTOR® must disclose, in writing, any interest he or she has in a property; this includes disclosing whether the REALTOR® is listing the property, has interest in the property, or has family members linked to the property.

Standard of Practice 4-1
For the protection of all parties, the disclosures required by Article 4 shall be in writing and provided by REALTORS® prior to the signing of any contract (Adopted 2-86).

Article 5
REALTORS® shall not undertake to provide professional services concerning a property or its value where they have a present or contemplated interest unless such interest is specifically disclosed to all affected parties.
**What does this mean?**

Article 5 protects the public by requiring REALTORS® to disclose any present or contemplated interest they may have in a property for which they are undertaking to provide professional services. These services include buying, selling, leasing, appraising, managing, counseling, and other real estate related services. Article 5 prevents REALTORS® from using their professional knowledge to gain an unfair advantage in a real estate transaction.

REALTORS® should remain aware that even indirect interests may obscure their objectivity and jeopardize the quality of their service. Such indirect interests could include interest in adjoining property, or could relate to transactions involving relatives or business associates. REALTORS® must be alert and use care in any real estate transaction that could be seen as benefiting them either directly or indirectly.

**How would you summarize the basic concept(s) of Article 5?**

REALTORS® should not use their expertise of the field in order to gain an unfair advantage over buyers or sellers in order to promote professional services. Any interest REALTORS® have in a property must be fully disclosed to all involved parties.

**Article 6**

REALTORS® shall not accept any commission, rebate, or profit on expenditures made for their client, without the client’s knowledge and consent.

When recommending real estate products or services (e.g., homeowner’s insurance, warranty programs, mortgage financing, title insurance, etc.) REALTORS® shall disclose to the client or customer to whom the recommendation is made any financial benefits or fees, other than real estate referral fees, the REALTORS® or the real estate agent’s firm may receive as a direct result of such recommendation (*Amended 1/99)*.

**What does this mean?**

Article 6 protects clients and customers from conflicts of interest by the REALTOR® by requiring advance disclosure of the REALTOR®’s connection or interest in any
organization or business entity before the REALTOR® recommends such services or products.

Many REALTORS® have interests in service firms, including contracting, roofing, brickwork, plumbing, electrical, air conditioning, title insurance, home owner's insurance, pest control, and moving. The REALTOR® is not precluded from offering such services, and it should be noted that such services may be among the best available; however, to recommend such services without first disclosing the REALTOR®'s interest, making it clear that the clients and customers are free to obtain these services elsewhere, can raise suspicion and create the appearance of impropriety.

Article 6 also prevents the REALTOR® from benefiting directly or indirectly from the providers of such goods or services without the client's prior knowledge and consent. An agent must disclose when the REALTOR® or his or her firm will receive any fee or will benefit directly from recommending a real estate service or product to a client or customer.

**How would you summarize the basic concept(s) of Article 6?**

Since REALTORS® oftentimes have access to home related services and products, REALTORS® must not mislead the buyer or seller into believing that the use of these services or products will in any way benefit them beyond its regular scope. Although the REALTOR® is free to promote these services and products, he or she must also reveal any benefits he or she will receive from the buyer or seller’s use of these services or products.

**Standard of Practice 6-1**

REALTORS® shall not recommend or suggest to a client or a customer the use of services of another organization or business entity in which they have a direct interest without disclosing such interest at the time of the recommendation or suggestion (Amended 5-88).
Article 7
In a transaction, REALTORS® shall not accept compensation from more than one party, even if permitted by law, without disclosure to all parties and the informed consent of the real estate agent’s client or clients (Amended 1-93).

What does this mean?
Article 7 imposes an ethical obligation that may go beyond the requirements of state law. A REALTOR® may never accept compensation from more than one party without the informed consent of all parties. Only through adequate prior disclosure can the parties be fully aware of any potential conflicts of interest that may affect their ability or willingness to rely on the objectivity of the REALTOR®'s advice and counsel.

How would you summarize the basic concept(s) of Article 7?
Any compensation that a REALTOR® receives from one party must be revealed to the other parties involved in the transaction.

Article 8
REALTORS® shall keep in a special account in an appropriate financial institution, separated from their own funds, monies coming into their possession in trust for other persons, such as escrows, trust funds, clients’ monies, and other like items.

What does this mean?
REALTORS®, as fiduciaries, are in positions of trust. They must keep monies coming into their possession in trust funds, separate from their own funds. Stated simply, REALTORS® must not commingle their firm's monies or their personal monies with money accepted in trust for others. Such money must be placed in a separate account to safeguard against unauthorized use.

How would you summarize the basic concept(s) of Article 8?
All monies that a REALTOR® handles must be kept separate from his or her own funds.
Article 9
REALTORS®, for the protection of all parties, shall assure whenever possible that agreements shall be in writing, and shall be in clear and understandable language expressing the specific terms, conditions, obligations, and commitments of the parties.

A copy of each agreement shall be furnished to each party upon their signing and or initialing (Amended 1-95).

What does this mean?
A REALTOR® should make sure everything is in writing to avoid complications or disagreements regarding terms of the listing. (Some states have laws requiring real estate agreements to be in writing.)

To avoid any misunderstanding and to prevent future controversy, all contractual agreements should be in writing and should set forth in detail the understanding of each of the parties. This can substantially reduce questions relating to the terms of the listing agreements, offers to purchase, financing instruments, and other agreements and commitments.

How would you summarize the basic concept of Article 9?
A REALTOR® shall endeavor to get all agreements in writing and to get agreements expressed in clear and specific language in order to avoid confusion or misunderstandings. In addition, whenever a party signs and/or initials a contract, that party should be furnished with a copy of what he or she signed or initialed.

Standard of Practice 9-1
For the protection of all parties, REALTORS® shall use reasonable care to ensure that documents pertaining to the purchase, sale, or lease of real estate are kept current through the use of written extensions or amendments (Amended 1-93).
Duties to the Public

Articles 10 through 14 are labeled as “Duties to the Public.”

Article 10

REALTORS® shall not deny equal professional service to any person for the reason of race, color, religion, sex, handicap, familial status, or national origin. REALTORS® shall not be parties to any plan or agreement to discriminate against a person or persons on the basis of race, color, religion, sex, handicap, familial status, or national origin (Amended 1-90).

REALTORS®, in their real estate employment practices, shall not discriminate against any person or persons on the basis of race, color, religion, sex, handicap, familial status, or national origin (Amended 1-00).

What does this mean?

The law prohibits discrimination in housing on the basis of race, color, religion, sex, handicap, familial status, or national origin. Article 10 illustrates the REALTOR®'s commitment to fair housing. A charge alleging that a REALTOR® has violated a fair housing law may also form the basis of a charge alleging a violation of Article 10. The REALTOR® can have nothing to do with any plan or agreement to discriminate on the basis of race, color, religion, sex, handicap, familial status, or national origin with respect to any real estate transaction.

To ensure strict compliance with fair housing laws, Boards of REALTORS® are authorized to require training in fair housing as a condition of continued membership and REALTORS® are encouraged to establish ongoing equal opportunity educational training programs for individuals in their firms. Article 10 also calls on REALTORS® to refrain from discrimination in selecting and retaining employees and independent contractors who provide real estate-related services, and the administrative and clerical staff who support them.
How would you summarize the basic concept(s) of Article 10?
A REALTOR® should be committed to the cause of fair housing; this means that there should be no discrimination based on race, color, sex, familial status, national origin, religion or handicap.

**Standard of Practice 10-1**
REALTORS® shall not volunteer information regarding the racial, religious or ethnic composition of any neighborhood and shall not engage in any activity which may result in panic selling. REALTORS® shall not print, display or circulate any statement or advertisement with respect to the selling or renting of a property that indicates any preference, limitations or discrimination based on race, color, religion, sex, handicap, familial status or national origin (Adopted 1-94).

**Standard of Practice 10-2**
As used in Article 10, “real estate employment practices” relate to employees and independent contractors providing real-estate related services and the administrative and clerical staff directly supporting those individuals (Adopted 1-00).

**Article 11**
The services which the REALTORS® provide their clients and customers shall conform to the standards of practice and competence which are reasonably expected in the specific real estate disciplines in which they engage; specifically, residential real estate brokerage, real property management, commercial and industrial real estate brokerage, real estate appraisal, real estate counseling, real estate syndication, real estate auction, and international real estate.

REALTORS® shall not undertake to provide specialized professional services concerning a type of property or service that is outside their field of competence unless they engage the assistance of one who is competent on such types of property or service, or unless the facts are fully disclosed to the client. Any persons engaged to
provide such assistance shall be so identified to the client, and their contribution to the assignment should be set forth (Amended 1-95).

What does this mean?
Article 11 explicitly describes a REALTOR®’s obligation to provide only those services that he or she can deliver competently.

For Example, if a REALTOR® acting as a residential broker with no commercial experience was asked to market a complex business property, the REALTOR® would be obligated to disclose to the client that he or she does not possess the experience and expertise to provide the requested service. In certain instances, a prospective client may value the general abilities and integrity of a particular REALTOR® and may insist on engaging in the REALTOR®’s services despite the REALTOR®’s lack of experience and competency needed to undertake the assignment. In such a case, the REALTOR® may undertake the assignment only after fully disclosing his/her lack of experience, and if the REALTOR® obtains assistance from someone competent in the field. The REALTOR® must fully inform the client as to whose assistance was utilized and the degree to which that person contributed to the assignment.

How would you summarize the basic concept(s) of Article 11?
REALTORS® shall be competent in the services they perform and shall not attempt to provide services outside their scope of expertise without getting assistance from a person who is competent in the area where the REALTOR® is lacking.

Standard of Practice 11-1
When REALTORS® prepare opinions of real property value or price, other than in pursuit of a listing or to assist a potential purchaser in formulating a purchase offer, such opinions shall include the:

- Identification of the subject property
- Date prepared
• Defined value or price
• Limiting conditions, including statements of purpose(s) and intended user(s)
• Any present or contemplated interest, including the possibility of representing the
  seller/landlord or buyers/tenants
• Basis for the opinion, including applicable market data
• If the opinion is not an appraisal, a statement to that effect *(Amended 1-01)*.

**Standard of Practice 11-2**
The obligations of the Code of Ethics in respect of real estate disciplines other than
appraisal shall be interpreted and applied in accordance with the standard of
competence and practice which clients and the public reasonably require to protect their
rights and interests considering the complexity of the transaction, the availability of
expert assistance, and, where the REALTOR® is an agent or subagent, the obligation of
a fiduciary *(Adopted 1-95)*.

**Standard of Practice 11-3**
When REALTORS® provide consultative services to clients that involve advice counsel
for a fee (not a commission), such advice shall be rendered in an objective manner and
the fee shall not be contingent on the substance of the advice or counsel given. If
brokerage or transaction services are to be provided in addition to consultative services,
a separate compensation may be paid with prior agreement between the client and
REALTORS® *(Adopted 1-96)*.

**Standard of Practice 11-4**
The competency required by Article 11 relates to services contracted for between
REALTORS® and their clients or customers; the duties expressly imposed by the Code
of Ethics; and the duties imposed by law or regulation *(Adopted 1-02)*.

**Article 12**
REALTORS® shall be careful at all times to present a true picture in their advertising
and representations to the public. REALTORS® shall also ensure that their professional
status (e.g., broker, appraiser, property manager, etc.) or status as REALTORS® is clearly identifiable in any such advertising (*Amended 1-93*).

**What does this mean?**

To avoid any confusion or miscommunication, REALTORS® should make an extra effort to ensure that the advertisements that promote a listing do not give the wrong impression to potential buyers, who may purchase the listing expecting one thing only to be disappointed.

In marketing properties, REALTORS® use advertising to inform the public about listings and to induce interest in them. REALTORS® are obligated to present a "true picture" in their advertising and in all representations to the public. A "true picture" is truthful, accurate advertising and nothing less. Descriptions that go beyond "puffing" may mislead the public. Statistics indicating a REALTOR®’s sales volume and comparisons with other firms can be impressive, but if they are inaccurate, untrue, or misleading, their use injures the public and violates Article 12.

REALTORS® must always disclose their status as real estate professionals in their advertisements. This may be accomplished by including the terms "REALTOR®," "REALTORS®", or "REALTOR-ASSOCIATE®," or by disclosing their status as a licensed broker, appraiser, property manager or other real estate professional.

In advertising listed property, REALTORS® must also disclose the name of their firm so that the public will be aware that they are dealing with the property owner's agent. Further, the REALTOR® must ensure that all brokers and salespeople affiliated with the firm include the firm’s name in their advertisements of listed properties.

When advertising unlisted property in which the REALTOR® has any ownership interest, the advertisement must disclose the interest and the existence of Board membership or real estate licensure.
How would you summarize the basic concept(s) of Article 12?
REALTORS® shall be honest in their advertising and identify their professional status in each ad.

Standard of Practice 12-1
REALTORS® shall not offer a service described as “free” and in similar terms in their advertising and in other representations provided that all terms governing availability of the offered product or service are clearly disclosed at the same time (Amended 1-97).

Standard of Practice 12-2
REALTORS® may represent their services as “free” or without cost if they expect to receive compensation from a source other than their client provided that the potential for the REALTOR® to obtain a benefit from a third party is clearly disclosed at the same time (Amended 1-97).

Standard of Practice 12-3
The offering of premiums, prizes, merchandise discounts or other inducements to list, sell, purchase, or lease is not, in itself, unethical even if receipt of the benefit is contingent on listing, selling, purchasing, or leasing through the REALTOR® making the offer. However, REALTORS® must exercise care and candor in any such advertising or other public or private representations so that any party interested in receiving or otherwise benefiting from the real estate agent’s offer will have clear, thorough, advance understanding of all the terms and conditions of the offer. The offering of any inducements to do business is subject to the limitations and restrictions of state law and the ethical obligations established by any applicable Standard of Practice (Amended 1-95).

Standard of Practice 12-4
REALTORS® shall not offer for sale/lease or advertise property without authority. When acting as listing broker or as subagent, REALTORS® shall not quote a price different from that agreed upon with the seller/landlord (Amended 1-93).
Standard of Practice 12-5
REALTORS® shall not advertise nor permit any person employed by or affiliated with them to advertise listed property without disclosing the name of the firm (Adopted 11-86).

Standard of Practice 12-6
REALTORS®, when advertising unlisted property for sale/lease in which they have an ownership interest, shall disclose their status as both owner/landlords and as REALTORS® or real estate agents (Amended 1-93).

Standard of Practice 12-7
Only REALTORS® who participated in the transaction as the listing broker or cooperating broker (selling broker) may claim to have “sold” the property. Prior to the closing a cooperating broker may post a “sold” sign only with the consent of the listing broker (Amended 1-96).

Article 13
REALTORS® shall not engage in activities that constitute the unauthorized practice of law and shall recommend that legal counsel be obtained when the interest of any party to the transaction requires it.

What does this mean?
The REALTOR® is prohibited by the law and by the Code from engaging in the unauthorized practice of law. The REALTOR® has an affirmative obligation to recommend the use of legal counsel to clients and customers when their interests require it.

If the REALTOR® is also an attorney, then Article 13 would not preclude the offering of legal services in a manner consistent with the standards of the Bar Association. REALTORS® must be mindful of their agency relationship and the duties owed to clients and to customers and must avoid all conflicts of interest.
Article 13 encourages respect for the law and protects clients and customers from well-intended but potentially misguided "legal advice" from those unqualified to provide it.

**How would you summarize the basic concept(s) of Article 13?**

REALTORS® should not practice law if they are not authorized to do so; therefore, REALTORS® should recommend that the buyer or seller obtain qualified legal counsel in order to resolve any disputes.

Article 14

If charged with unethical practice or asked to present evidence or to cooperate in any other way in any professional standards proceeding or investigation, REALTORS® shall place all pertinent facts before the proper tribunals of the Member Board or affiliated institute, society, or council in which membership is held and shall take no action to disrupt or obstruct such processes *(Amended 1-99).*

**What does this mean?**

The Code of Ethics is meaningful because it is respected and enforced. Article 14 establishes an absolute obligation to cooperate with the Board when a REALTOR® is charged with unethical practice, or when asked to present evidence in any professional standards proceeding or investigation. In either event, the REALTOR® must place all pertinent facts before a proper tribunal.

REALTORS® are required to take an active part in Code enforcement. If this were not so, then the Code would lose its relevance and influence in promoting and enforcing high standards of professional conduct.

Boards must provide due process in professional standards proceedings, as well as in the enforcement of the Board's bylaws and other rules and regulations. Due process requires as much factual support as can be reasonably ascertained to substantiate violations of the Code or arbitration awards or failure to abide by other membership obligations. With fairness established in the Board's procedures and with the facts in
hand, the Board can respect and protect the rights of all its members while strictly enforcing the Code.

If, in connection with a professional standards proceeding or an investigation, a REALTOR® is requested by the Board to answer a charge or to appear as a witness, then the REALTOR® must do so, and must take no action to disrupt or obstruct such processes.

How would you summarize the basic concept(s) of Article 14?
When a REALTOR® is charged with unethical practices, he or she must appear before the appropriate boards where he or she will have the opportunity to disclose facts pertaining to the case.

Standard of Practice 14-1
REALTORS® shall not be subject to disciplinary proceedings in more than one Board of REALTORS® or affiliated institute, society, or council in which they hold membership with respect to alleged violations of the Code of Ethics relating to the same transaction or event (Amended 1-95).

Standard of Practice 14-2
REALTORS® shall not make any unauthorized disclosure or dissemination of the allegations, findings, or decision developed in connection with an ethics hearing or appeal or in connection with an arbitration hearing or procedural review (Amended 1-92).

Standard of Practice 14-3
REALTORS® shall not obstruct the Board’s investigation or professional standards proceedings by instituting or threatening to institute actions for libel, slander, or defamation against any party to a professional standards proceeding or their witnesses based on the filing of an arbitration request, an ethics complaint, or testimony given before any tribunal (Adopted 11-87, Amended 1-99).
Standard of Practice 14-4
REALTORS® shall not intentionally impede the Board’s investigation or disciplinary proceedings by filing multiple ethics complaints based on the same event or transaction (Adopted 11-88).

Duties to REALTORS®
Articles 15 through 17 are labeled as “Duties To REALTORS®.”

Article 15
REALTORS® shall not knowingly or recklessly make false or misleading statements about competitors, their businesses, or their business practices (Amended 1-92).

What does this mean?
Article 15 logically flows from the REALTOR®’s duty established in Article 12 “to present a true picture in . . . representations.” This includes comparisons with competitors and comments or opinions offered about other real estate professionals.

Article 15 is not intended to limit or inhibit the free flow of commercial information valued by potential users regarding the many and varied services that REALTORS® provide. Article 15 requires that REALTORS® make good faith efforts to ensure that statements and representations they make, including those made in their advertising, are truthful and accurate.

REALTORS® should consider that while truthfulness is the ultimate measuring stick of Article 15, little is gained, and often much is lost, through negative, non-constructive criticism that can impair the cooperative efforts that make the service provided by REALTORS® so valuable to the public.

How would you summarize the basic concept(s) of Article 15?
REALTORS® should be truthful in all representations and statements they make about their competitors. Unless the REALTOR® is absolutely certain of a competitor's
business or business practice, the REALTOR® should not disclose any uncertain information to a buyer or seller.

**Standard of Practice 15-1**
REALTORS® shall not knowingly or recklessly file false or unfounded ethics complaints *(Adopted 1-00).*

**Article 16**
REALTORS® shall not engage in any practice or take any action inconsistent with the agency or other exclusive relationship recognized by law other REALTORS® have with clients *(Amended 1-98).*

**What does this mean?**
A REALTOR® should not interfere with the business relationships of others. Contact with other agents or sellers without authorization may be illegal under certain circumstances, so REALTORS® should ensure that all business communication is allowed under the Code.

Competition among brokers to provide appraising, brokerage, managing, leasing, syndicating, or counseling services is extremely intense until the prospective client enters into a binding agreement for such services. When an exclusive relationship is created, the competition shifts to searching for buyers or to fulfilling the agreement. At this point, Article 16 comes into play.

Once clients have selected a particular broker to serve their interests, the competition that prevailed earlier ceases and cooperation takes its place. Cooperation between REALTORS® is the general practice when it is in the best interest of the client. Generally, cooperation exists in great measure, since it benefits the clients and customers in virtually every case. REALTORS® must carefully avoid taking any action that is inconsistent with the exclusive relationship between the seller and the listing broker and avoid any action that could be construed to induce a breach of the
contractual agreement made with the client. Once the client has made a decision, he or she is entitled to the benefit of his or her bargain. This includes relief for the duration of the relationship from direct overtures of other REALTORS® seeking to interest the seller or lessor in the services they provide. This limited protection from direct solicitation does not preclude general advertising efforts by other REALTORS®, but it does prohibit efforts to induce the breach of an existing contract so that another REALTOR® can substitute himself in the place of the current listing broker.

In order to respect the exclusivity of the listing broker's relationship in an exclusive listing, other REALTORS® must be able to determine with certainty that an exclusive listing exists. If the listing broker refuses to disclose the nature (type) and duration of a listing, Article 16 recognizes the REALTOR®'s right to contact the seller or lessor directly to obtain this essential information. Under these circumstances, the REALTOR® may also discuss the terms of a future listing on the property or may enter into a listing to become effective upon the expiration of the current listing.

Article 16 also acknowledges the right of property owners whose properties are listed exclusively to contact other REALTORS® if they are not satisfied with the listing broker's performance. A REALTOR® is free to discuss the terms of a future listing on the property and may enter into a listing to become effective upon the expiration of the current listing if the discussion and contact were initiated by the property owners.

Actions inconsistent with the exclusive relationship of the listing broker can occur when a REALTOR® provides unauthorized information to a prospective purchaser or tenant. It can occur when a cooperating broker:

- Fails to obtain permission to show the property from the listing broker, but contacts the owner directly.
- Takes an offer directly to the client without the knowledge and consent of the listing broker.
- Uses the showing of a property as an opportunity to make unsolicited, derogatory, and false remarks about the listing broker.
REALTORS® are obligated to respect the agency, or other exclusive relationships recognized by law, of other REALTORS® and to work through them as long as the exclusive relationship remains in effect. Professionalism, integrity, and courtesy require this respect and buyers/tenants and sellers/lessors benefit from it.

**How would you summarize the basic concept(s) of Article 16?**

REALTORS® should not solicit a seller who is already bound by a listing contract with another REALTOR® or a buyer who is already bound by a buyer representation agreement with another REALTOR® or an owner who has an existing property management with another REALTOR®.

**Standard of Practice 16-1**

Article 16 is not intended to prohibit aggressive or innovative business practices that are otherwise ethical, nor does it prohibit disagreements with other REALTORS® involving commission, fees, compensation, or other forms of payment or expenses *(Adopted 1-93, Amended 1-95).*

**Standard of Practice 16-2**

Article 16 does not preclude REALTORS® from making general announcements to prospective clients describing their services and terms of their availability even though some recipients may have entered into agency agreements or other exclusive relationships with another REALTOR®. A general telephone canvas, general mailing or distribution addressed to all prospective clients in a given geographical area or in a given profession, business, club, organization, other classification of group is deemed “general” for the purpose of this standard. Article 16 is intended to recognize as unethical two basic types of solicitations:

- First, telephones or personal solicitations of property owners who have been identified by a real estate sign, multiple listing compilations or other information service as having exclusively listed their property with another REALTOR®.
• Second, mail or other forms of written solicitations of prospective clients whose properties are exclusively listed with another REALTOR® when such solicitations are not part of a general mailing but directed specifically to property owners identified through compilations of current listings, “for sale” or “for rent” signs, or other sources of information required by Article 3 and Multiple Listing Service rules to be made available to other REALTORS® under offers of sub-agency or cooperation (Amended 1-93).

**Standard of Practice 16-3**

Article 16 does not preclude REALTORS® from contacting the client of another broker for the purpose of offer to provide, or entering into a contract to provide, a different type of real estate service unrelated to the type of service currently being provided (e.g., property management as opposed to brokerage). However, information received through a Multiple Listing Service or any other of cooperation may not be used to target clients of other REALTORS® to whom such offers to provide services may be made (Amended 1-93).

**Standard of Practice 16-4**

REALTORS® shall not solicit a listing which is currently listed exclusively with another broker. However, if the listing broker, when asked by a REALTOR®, refuses to disclose the expiration date and nature of such listing; i.e., an exclusive right to sell, an exclusive agency, open listing, or other form of contractual agreement between the listing broker and the client, the REALTOR® may contact the owner to secure such information and may discuss the terms upon which the REALTOR® might take a future listing or, alternatively, may take a listing to become effective upon expiration of any existing exclusive listing (Adopted 1-94).

**Standard of Practice 16-5**

REALTORS® shall not solicit buyer/tenant agency agreement from buyers/tenants who are subject to exclusive buyer/tenant agency agreements. However, if asked by a REALTOR®, the broker refuses to disclose the expiration date of the exclusive
buyer/tenant agency agreement, the REALTOR® may contact the buyer/tenant to secure such information and may discuss the terms upon which the REALTOR® might enter into a future buyer/tenant agency agreement or, alternatively, may enter into a buyer/tenant agency agreement to become effective upon expiration of any existing buyer/tenant agency agreement (Adopted 1-94, Amended 1-98).

**Standard of Practice 16-6**

When REALTORS® are contacted by the client of another REALTOR® regarding the creation of an exclusive relationship to provide the same type of service, and REALTORS® have not directly or indirectly initiated such discussions, they may discuss the terms upon which they might enter into a future agency agreement or, alternatively, may enter into an agency agreement which becomes effective upon expiration of any existing exclusive agreement (Amended 1-98).

**Standard of Practice 16-7**

The fact that a client has retained a REALTOR® as an agent or in another exclusive relationship in one or more past transactions does not preclude other REALTORS® from seeking such former client’s future business (Amended 1-98).

**Standard of Practice 16-8**

The fact that an exclusive agreement has been entered into with a REALTOR® shall not preclude or inhibit any other REALTOR® from entering into a similar agreement after the expiration of the prior agreement (Amended 1-98).

**Standard of Practice 16-9**

REALTORS®, prior to entering into an agency agreement or other exclusive relationship, have an affirmative obligation to make reasonable efforts to determine whether the client is subject to a current, valid exclusive agreement to provide the same type of real estate service (Amended 1-98).
Standard of Practice 16-10
REALTORS®, acting as agents of, or in another relationship with, buyers or tenants, shall disclose that relationship to the seller/landlord’s agent or broker at first contact and shall provide written confirmation of that disclosure to the seller/landlord’s agent or broker not later than execution of a purchase agreement or lease (Amended 1-98).

Standard of Practice 16-11
On unlisted property, REALTORS® acting as buyer/tenant agents or brokers shall disclose that relationship to the seller/landlord at first contact for that client and shall provide written confirmation of such disclosure to the seller/landlord not later than execution of any purchase or lease agreement. REALTORS® shall make any request for anticipated compensation from the seller/landlord at first contact (Amended 1-98).

Standard of Practice 16-12
REALTORS®, acting as agents or brokers for sellers/landlords or as subagents of listing brokers, shall disclose that relationship to buyers/tenants as soon as practicable and shall provide written confirmation of such disclosure to the buyers/tenants not later than execution of any purchase agreement (Amended 1-98).

Standard of Practice 16-13
All dealings concerning property exclusively listed, or with buyer/tenants who are subject to an exclusive agreement shall be carried on with the client’s agent, and not with the client, except with the consent of the client’s agent or broker or except where such dealings are initiated by the client (Adopted 1-93, Amended 1-98).

Before providing substantive services (such as writing a purchase offer or presenting a CMA) to prospective purchasers, sellers, tenants or landlords ("prospects"), REALTORS® shall ask prospects whether they are a party to any exclusive representation agreement. REALTORS® shall not knowingly provide substantive services concerning a prospective transaction to prospects who are parties to exclusive
representation agreements, except with the consent of the prospects’ exclusive representatives or at the direction of prospects *(Amended 1-03).*

**Standard of Practice 16-14**

REALTORS® are free to enter into contractual relationships or to negotiate with sellers/landlords, buyers/tenants or others who are not subject to an exclusive agreement but shall not knowingly obligate them to pay more than one commission except with their informed consent *(Amended 1-98).*

**Standard of Practice 16-15**

In cooperative transactions, REALTORS® shall compensate cooperating REALTORS® (principal brokers) and shall not compensate nor offer to compensate, directly or indirectly, any of the sales agents employed by or affiliated with other REALTORS® without the prior expressed knowledge and consent of the cooperating broker.

**Standard of Practice 16-16**

REALTORS®, acting as subagents or buyer/tenant agents, shall not use the terms of an offer to purchase/lease to attempt to modify the listing broker’s offer of compensation to subagents or buyer’s agents or brokers nor make the submission of an executed offer to purchase/lease contingent on the listing broker’s agreement to modify the offer of compensation *(Amended 1-98).*

**Standard of Practice 16-17**

REALTORS® acting as subagents or buyer/tenant agents or brokers, shall not attempt to extend a listing broker’s offer of cooperation and/or compensation to other brokers without the consent of the listing broker *(Amended 1-98).*

**Standard of Practice 16-18**

REALTORS® shall not use information obtained from listing brokers through offers to cooperate made through multiple listing services or through other offers of cooperation
to refer listing brokers' clients to other brokers or to create buyer/tenant relationships with listing brokers' clients, unless such use is authorized by listing brokers (Amended 1-02).

**Standard of Practice 16-19**
Signs giving notice of property for sale, rent, lease, or exchange shall not be placed on property without consent of the seller/landlord (Amended 1-93).

**Standard of Practice 16-20**
REALTORS®, prior to or after terminating their relationship with their current firm, shall not induce clients of their current firm to cancel exclusive contractual agreements between the client and that firm. This does not preclude REALTORS® (principals) from establishing agreements with their associated agents governing assignability of exclusive agreements (Adopted 1-98).

**Article 17**
In the event of contractual disputes or specific non-contractual disputes as defined in Standard of Practice 17-4 between REALTORS® (principals) associated with different firms, arising out of their relationship as REALTORS®, the REALTORS® shall submit the dispute to arbitration in accordance with the regulations of their Board or Boards rather than litigate the matter.

In the event clients of REALTORS® wish to arbitrate contractual disputes arising out of real estate transactions, REALTORS® shall arbitrate those disputes in accordance with the regulations of their Board, provided the clients agree to be bound by the decision.

The obligation to participate in arbitration contemplated by this Article includes the obligation of REALTORS® (principals) to cause their firms to arbitrate and be bound by any award (Amended 1-01).
What does this mean?
Generally, arbitration is used to settle disputes between REALTOR® principals of two different real estate firms concerning entitlement to a commission or to a cooperating brokers’ compensation. Entitlement is determined by the "procuring cause.” In most instances, the decision awards the disputed amount to one party or the other. In certain cases, if not precluded by state law, the disputed amount may be divided between the parties if the arbitrators determine that both parties contributed, without interruption, to the transaction.

Article 17 also requires a REALTOR® to arbitrate disputes with clients if the client requests the arbitration and agrees to be bound by the decision. The Code of Ethics and Arbitration Manual advises Boards and State Associations to determine whether:

- State law authorizes prior agreements to arbitrate future disputes in advance of a dispute or only after the dispute occurs.
- State law recognizes binding arbitration at all. In the latter case, Boards can only offer arbitration and cannot require REALTORS® and REALTOR-ASSOCIATE®s to participate in it.

The Code of Ethics and Arbitration Manual also specifies three circumstances under which REALTORS® must submit to arbitration:

1. A dispute between REALTOR® principals of different firms
2. A dispute between REALTORS® (other than principals) or REALTOR-ASSOCIATE®s in different firms, provided the REALTOR® principals join in the arbitration.
3. A dispute between REALTOR® principals and their clients when the client or REALTOR® invokes the arbitration and the client agrees to be bound by the decision.
The Manual also specifies three circumstances under which the REALTOR®'s participation in arbitration is voluntary:

1. A dispute between REALTOR® principals and REALTORS® and REALTOR-ASSOCIATE®'s (non-principals) who are or were affiliated with the same firm, provided each party voluntarily agrees to the arbitration in writing. This applies to disputes arising when the parties are, or were, affiliated with the same firm, irrespective of the time the request is made for such arbitration.

2. A dispute between a REALTOR® principal with a non-member broker, provided each party agrees in writing to be bound by the decision. It is the member's choice whether the member will submit to arbitration with a non-member broker who is not an MLS Participant. A non-member broker, who is not an MLS Participant, is not entitled to invoke the arbitration facilities of a Board of REALTORS®.

3. A dispute between a REALTOR® principal and a customer if a written contractual relationship has been created by the REALTOR® principal between a customer and a client, and provided all parties to the dispute (i.e., the customer and the REALTOR®) agree in writing to arbitrate the dispute.

REALTORS® and REALTOR-ASSOCIATE®'s who participate in the Board's MLS or otherwise access MLS information through any Board in which they do not hold membership, have the same rights and responsibilities as any Board member relative to the Code of Ethics.

How would you summarize the basic concept(s) of Article 17?

REALTORS® must arbitrate rather than litigate matters that involve disputes between REALTORS® of different firms that arise in the course of their relationship as REALTORS® regarding matters that are either contractual or non-contractual in nature.
**Standard of Practice 17-1**
The filing of litigation and refusal to withdraw from it by REALTORS® in an arbitrary matter constitutes a refusal to arbitrate (*Adopted 2-86*).

**Standard of Practice 17-2**
Article 17 does not require REALTORS® to arbitrate in those circumstances when all parties to the dispute advise the Board in writing they choose not to arbitrate before the Board (*Amended 1-93*).

**Standard of Practice 17-3**
REALTORS®, when acting solely as principals in a real estate transaction, are not obligated to arbitrate disputes with other REALTORS® absent a specific written agreement to the contrary (*Adopted 1-96*).

**Standard of Practice 17-4**
Specific non-contractual disputes that are subject to arbitration pursuant to Article 17 are:

- Where a listing broker has compensated a cooperating broker and another cooperating broker subsequently claims to be the procuring cause of the sale or lease. In such cases, the complainant may name the first cooperating broker as respondent and arbitration may proceed without the listing broker being named as a respondent. Alternately, if the complaint is brought against the listing broker, the listing broker may name the first cooperating broker as a third-party respondent. In either instance, the decision of the hearing panel as to procuring cause shall be conclusive with respect to all current or subsequent claims of the parties for compensation arising out of the underlying cooperative transaction (*Adopted 1-97*).

- Where a buyer or tenant representative is compensated by the seller or landlord, and or by the listing broker, and as a result, reduces the commission owed by the seller or landlord and subsequent to such actions, another cooperating broker claims to be the procuring cause of sale or lease. In such cases, the complainant
may name the first cooperating broker as respondent and arbitration may proceed without the listing broker being named as a respondent. Alternatively, if the complaint is brought against the listing broker, the listing broker may name the first cooperating broker as a third-party respondent. In either instance, the decision of the hearing panel as to procuring cause shall be conclusive with respect to all current or subsequent claims of the parties for compensation arising out of the underlying cooperative transaction (Adopted 1-97).

**Standard of Practice 17-4**

Specific non-contractual disputes that are subject to arbitration pursuant to Article 17 are:

- Where a buyer or tenant representative is compensated by the buyer or tenant and, as a result, the listing broker reduces the commission owed by the seller or landlord and, subsequent to such actions, another cooperating broker claims to be the procuring cause of sale or lease. In such cases the complainant may name the first cooperating broker as respondent and arbitration may proceed without the listing broker being named as a respondent. Alternatively, if the complaint is brought against the listing broker, the listing broker may name the first cooperating broker as a third-party respondent. In either instance, the decision of the hearing panel as to procuring cause shall be conclusive with respect to all current or subsequent claims of the parties for compensation arising out of the underlying cooperative transaction (Adopted 1-97).

- Where two or more listing brokers claim entitlement to compensation pursuant to open listings with a seller or landlord who agrees to participate in arbitration (or who requests arbitration) and who agrees to be bound by the decision. In cases where one of the listing brokers has been compensated by the seller or landlord, the other listing broker, as complainant, may name the first listing broker as respondent and arbitration may proceed between the brokers (Adopted 1-97).
Explanatory Notes

The reader should be aware of the following policies, which have been approved by the Board of Directors of the National Association:

In filing a charge of an alleged violation of the Code of Ethics by a REALTOR®, the charge must read as an alleged violation of one or more Articles of the Code. Standards of Practice may be cited in support of the charge.

The Standard of Practice serves to clarify the ethical obligations imposed by the various Articles and supplement, and do not substitute for, the Case Interpretations of the Code of Ethics. Contact your local Board or Association for more information. Modifications to existing Standards of Practice and additional new Standards of Practice are approved from time to time. Readers are cautioned to ensure that the most recent publications are utilized.

Lesson Summary

This lesson covers the Code of Ethics by discussing the Preamble and the various Articles and Standards of Practice that are applied. The Preamble addresses aspirational concepts that include serving the best interests of our nation, utilizing the land for its highest and best use, performing duties with honor and integrity, staying current and informed on current real estate related events and issues, and the Golden Rule.

Essentially, it is vital that the agent act responsibly, ethically, and fairly by disclosing all relevant information concerning property conditions and the agent’s interest and involvement in the property; this works towards the best interest of the client. The agent not only needs to treat all clients fairly and honestly, but must treat their competitors in the same manner. The agent needs to make truthful and valid representations in all facets concerning a property, sales transaction, competitor, agent involvement, and compensation. The Code of Ethics helps to set requirements expected by NAR in order
to regulate equal and fair treatment of all people involved in the real estate industry. Below is a brief overview of each Article in the Code of Ethics:

Article 1 requires REALTORS® to be faithful to their clients by treating them honestly and by placing their client’s interests above their own.

Article 2 requires REALTORS® to fully disclose the condition of a property; they must avoid misrepresentation, restrict advice on matters that are not in their area of expertise, and respect a client’s confidentiality (so long as it does not violate any laws).

Article 3 requires REALTORS® to cooperate with other brokers unless it is not in the best interest of the client.

Article 4 protects clients from unfair treatment by ensuring that REALTORS® disclose any interest (in writing) that they may have in a property prior to any agreements.

Article 5 states that REALTORS® should not use their expertise of the field to gain unfair advantage over their clients. Any interest that REALTORS® have in a property must be fully disclosed to the client.

Article 6 discusses the REALTORS® responsibility to fully inform a buyer or seller of the true nature of a product or service he or she is promoting. This means that the REALTOR® may not mislead the buyer into thinking that purchasing these services or products will, in any way, benefit them beyond its regular scope.

Article 7 requires that REALTORS® reveal any compensation that they may receive from another party to all parties involved in the transaction.

Article 8 requires that REALTORS® must keep their personal funds separate from any monies they handle in transactions.
Article 9 asserts that REALTORS® should get all agreements in writing, and these agreements must be written in clear and concise language and all appropriate signatures or initials must be in place.

Article 10 stipulates that REALTORS® must adhere to the fair housing laws.

Article 11 states that REALTORS® should not offer services that are beyond their range of expertise without attaining assistance from a more competent person in that particular field.

Article 12 requires REALTORS® to be honest in their advertising; they must state their professional status in every advertisement.

Article 13 asserts that REALTORS® should not practice law unless they are authorized to do so. REALTORS® should recommend that buyers or sellers obtain qualified legal counsel to settle disputes.

Article 14 requires REALTORS® to appear before the appropriate boards when charged with unethical practices.

Article 15 entails REALTORS® to be truthful in all comments and depictions they make about their competitors.

Article 16 disallows the solicitation of sellers or buyers who are bound to an agreement with another REALTOR®.

Article 17 states REALTORS® should resolve disputes through arbitration.
Lesson 18: Using the Model for Ethical Decision Making

Lesson Topics

This lesson focuses on the following topics:

- Ethical Decision-Making Model
- Ethical Decision-Making Model Case Studies

Lesson Learning Objective

By the end of this lesson, you should be able to:

- Identify possible violations of the NAR Code of Ethics in given case study scenarios.

Ethical Decision-Making Model

The Decision-Making Model will be used in order to break down the different steps that need to be taken in order to arrive at a decision. By examining each case study, the student will be able to define the problem by explaining the facts, assumptions, affected persons and resources associated with each case. Then, after each of the ethical systems is applied to the case, the student should have a grasp of the different possible decisions that can be discerned and be able to decide which ethical approach best fits each situation.
Ethical Decision-Making Model

**Defining the Problem**
Determine:
- Facts
- Assumptions
- Affected persons
- Resources

**Applying an Ethical System**
- End results approach
- Rules and laws approach
- Social contract approach
- Individual conscience approach

**Making a Trial Decision for testing**

**Making a Final Decision**

**Evaluating a Final Decision**
Ethical Decision-Making Model Case Studies

Using the model for ethical decision making from earlier, analyze Case Study 5-1. For the purpose of this course, use the NAR Code of Ethics for the Social Contract approach.

Case Study 5-1

As a favor, a broker listed his friend’s home despite the fact that it was a residential property, and his expertise was in commercial real estate. Additionally, the friend’s home was located in an area of town that the broker was unfamiliar with; therefore, the broker had apprehensions about the listing. As a precaution, the broker insisted that the seller have the house appraised, but the seller insisted that he was in good hands and encouraged the broker to list the house at $150,000, a price that the seller believed to be fair market value for the area. The broker reluctantly listed the house at that price, and the house was quickly snatched up by a young couple.

Less than six months later, the broker received a call from the slightly perturbed seller. The seller told the broker that he had run into the young couple at a restaurant, and they had mentioned that they were in the process of transferring to another town and had received an offer for the house, $175,000, but refused because they had been told that they could do much better. This upset the seller because he felt that the broker did not do all he could to get the highest price for his property.

Think about your answers to the following questions.

What facts are presented in this case study?
The broker’s expertise was in commercial real estate.
• The seller said that he wanted the broker to list his home even though the broker informed the seller that residential real estate was outside his expertise and that he was unfamiliar with the area of town where the home was located.
• The broker insisted that the seller have the house appraised.
• The seller insisted that he felt confident in the Broker’s abilities.
• The seller said that he believed $150,000 to be an appropriate fair market value at which to list his home.
• The broker listed the home for sale at $150,000.
• A young couple purchased the home soon after it went on the market.
• Later, the young couple told the seller that they were selling the home because of a job transfer and that they had already received an offer for $175,000 but had turned it down because they thought “they could do much better.”
• The broker’s friend (the seller) is now upset with him.

What assumptions apply to this case study?
• The seller did not want to listen to the broker’s disclaimers because the seller thought both he and the broker knew what they were doing.
• Perhaps since the seller was a friend, the broker agreed to a lower commission than the seller would have been asked to pay by real estate professionals more knowledgeable in residential real estate and who were familiar with the neighborhood where the house was located.
• If the seller was getting a bargain in the commission, perhaps the broker should not have made (or perhaps agreed to) that offer, but should have referred his friend to a more appropriate agent.
• The young couple could have made significant improvements to the house in six months.
• The market could have improved dramatically in six months.

Name the persons and/or groups affected by a decision made on this case?
The broker probably does not want to lose his friendship with his friend and does not want any trouble because he tried to do a friend a favor.

The seller probably received less for his house than he could have if there had been an appraisal or an agent who was competent in residential real estate and familiar with the neighborhood where the house was located.

Peers may be hurt if the firm suffers because of the expense of a lawsuit.

The neighborhood may be hurt by the sale that was probably below market value and may count against the value of the other homes if it is deemed comparable by an appraiser. At this point, there may be no course of action that will help the neighborhood.

What resources (persons or written) may be useful in reaching a decision on this case?

- NAR Code of Ethics
- The real estate firm’s attorney
- The local board or association
- Real estate publications that may contain comments on similar cases
- An appraiser

Applying the Approaches

Applying the *end results approach* to this case, what decision might you reach?

With this approach, the goal is to make as many people happy as possible. If there is a reason to believe that the home was worth significantly less when the broker listed it than it was six months after the sale, then the broker could hire an appraiser to perform an appraisal as though the “clock was turned back” and give a value for the home at the time of the listing. Then the broker could offer to pay the seller the difference of the appraisal and the list price less the cost of closing costs and the cost of the appraisal that the broker wanted the seller to pay for in the first place. This could possibly pacify the seller. Another possibility is to offer to refund (to the seller) the broker’s portion of the commission. Another possibility is to write the seller a letter outlining the facts,
including the broker’s efforts to make a full disclosure by insisting that the seller get an appraisal. Perhaps the Seller would cool off when he reviewed the facts.

**Applying the *rules and law approach*, what decision might you reach?**

The decision resulting from the *rules and law approach* would depend on the laws of each state. For Example, if the license law presumes that if you take the required education and pass the exam, you are competent to practice all types of real estate, then perhaps the broker has not violated a law in taking a listing outside his expertise. The broker was honest with the seller in taking this listing, and the broker fully informed the seller of his lack of knowledge of residential real estate and his unfamiliarity with the neighborhood. The seller also turned down the idea of securing an expert, the appraiser, on the value of home. The seller set the list price. If there is an affirmative duty in the real estate license law of the broker’s state to always inform the seller of the market value of a property before listing it, then the broker is guilty of failing to determine the market value prior to listing the property. This failure could result in a disciplinary action from the state regulatory agency and/or a possible lawsuit.

**Applying the *Social Contract Approach* and using the NAR Code of Ethics for your “social contract,” what Article(s) have been violated, if any? What decision might you reach?**

An appropriate conclusion under this approach is that the broker did not violate the NAR Code of Ethics. The broker’s obligation under Article 1 is to protect and promote the interests of the client. He had made known his lack of knowledge about the area, the market value of the property, and insisted that the seller have the property appraised. Because of these disclosures and recommendations, the broker is not in violation of Article 1. In addition, the broker did exactly what was required under the second paragraph of Article 11 in advising the seller that residential real estate was not his area of expertise and that the seller should hire an appraiser to assist in pricing the property.
Applying the *Personal Conscience Approach*, what might be the resulting decision?

Each person’s answer to this approach may be different. One possible result of this approach is the broker regretting that he did not do one of the following: 1) refuse to take the listing, 2) decide to take the listing but pay for the appraisal himself or 3) explain to the seller that the broker could refer the listing to an experienced and knowledgeable agent in residential real estate who was familiar with the neighborhood and then work closely with that agent to make sure that the seller got good service. If the broker felt that he had let the seller down, he might offer to refund his share of the commission and/or to order an appraisal for a value at the time the listing was taken and then compensate the seller for the untapped value of the home.

From your application of the four approaches, what approach should be weighed most heavily in this case?

This depends on each person who uses this model, the office in which they work, the laws of the state where they are licensed, the social contract under which they work, and their own conscience. If the broker violated any laws in his state, his attorney may advise him to do what is necessary to make the seller happy and keep him from bringing legal action through a lawsuit and/or filing a complaint with the regulatory board.

What might be an appropriate decision for this case study? Is the broker at fault? Is the seller?

Obviously it would have been better if the broker had not taken the listing. The only good news here is that the broker does not appear to have violated the NAR Code of Ethics, which is often a standard more stringent than the law. Probably both the seller and the broker are at fault. The seller is at fault for insisting that the broker list the home even after the broker’s disclosure of incompetence in the residential area. The broker is at fault for neither refusing the listing nor turning it into a referral nor taking the listing only after paying for the appraisal himself. Mediation is a dispute resolution process that strives for a “win-win” solution to preserve relationships. Potential sources of mediators
are the local board, alternative dispute resolution centers, and attorneys trained in mediation. Perhaps the best solution would be for the broker to suggest that he and the seller go to mediation to settle the dispute. Mediation through the local board is discussed further in the next lesson.

Case Study 5-2

Last year, a seller received word that her uncle had passed away and had bequeathed his property to her. The seller suddenly had this beautiful stretch of land practically fall into her lap—a massive house in the middle of a dozen acres of land bordered by the Pacific Ocean. Unfortunately for the seller, the property was in southern California, but the Seller lives in Louisiana and therefore, has never had an opportunity to take full advantage of the land.

Torn between doing the sensible thing and having a great stretch of land, the seller decided to sell the property and make full use of the monetary value instead. The seller called around and was pointed toward a REALTOR®. The Seller asked the REALTOR® to look at the land and suggest a list price, which he did and came back with a price of $80,000. This seemed far below what the seller had expected, but she reluctantly agreed to the price.

Within a month the REALTOR® had called with an offer. He, the REALTOR®, would buy the property for the price listed, less his commission. The seller sensed that she was being taken advantage of and suggested that he have the property appraised, to which the REALTOR® got upset and demanded his commission for a job well done.

Think about your answers to the following questions.

What facts are presented in this case study?
- The seller inherited a piece of property in California with a large house and a dozen acres bordering the Pacific Ocean.
• The seller lives in Louisiana and does not want to move to California.
• The seller decided to sell the property she inherited.
• The seller selected the REALTOR® to list the property after calling around.
• The list price that the REALTOR® suggested was $80,000.
• The seller reluctantly agreed to the list price of $80,000.
• Within a month of when he listed the property, the REALTOR® offered to buy the property for $80,000 less his commission.
• The seller suggested that the property be appraised.
• The REALTOR® rejected the idea of an appraisal and demanded his commission since he produced a ready, willing, and able buyer who was willing to purchase the property at list price.

What assumptions apply to this case study?
• After the REALTOR® saw the property, he wanted to buy it so he suggested a below market list price that he could afford.
• The REALTOR® suggested a list price that was below market value.
• After the REALTOR® made the offer to purchase the property, the REALTOR® was upset when the seller suggested that they get an appraisal.
• The REALTOR® may have made no effort to market the property.
• If the REALTOR® had marketed the property at the $80,000 list price to the public, it probably would have sold within days to someone other than the REALTOR®.

Name the persons and/or groups affected by a decision made on this case?
• The REALTOR® would be affected because his reputation may suffer if he is found to have put his own interests above those of his client. Also, if found guilty of failing to protect the interests of his client, he may suffer disciplinary action from the local Board, and he may lose his license.
• If the REALTOR® is found guilty, then the REALTOR®’s broker will probably be dragged into court with the REALTOR® and his reputation may suffer in the community.
The seller will suffer because of the inconvenience and expense of definitively determining whether or not the REALTOR® was trying to take advantage. This factual determination is necessary to protect the seller against the REALTOR®’s demand for a commission. The facts will also aid the seller in taking other legal actions against the REALTOR® if the seller deems it necessary to do so.

- The REALTOR®’s peers may be hurt by bad publicity about the firm.
- The real estate industry may suffer because the REALTOR®’s actions were unprofessional and reflect poorly on the industry in general.

What resources (persons or written) may be useful in reaching a decision on this case?
- An appraiser
- California real estate laws
- The NAR Code of Ethics
- An attorney in California
- Real estate publications that may contain comments on similar cases.

Applying the Approaches

Applying the end results approach to this case, what decision might you reach?
In order to make the most people happy in this situation and after consulting with his broker, the REALTOR® may decide to withdraw his demand for a commission and offer, at no charge (no referral commission), to refer the seller to a reputable firm to handle the sale of the ocean front property. This would save the seller the expense and inconvenience of having to hire an attorney in California and should result in a sale at fair market value. If the seller agrees to this solution, then the REALTOR® may not have to face a lawsuit, a complaint to the state regulatory board, and a complaint to the local association.

Applying the rules and law approach, what decision might you reach?
Since it appears that the REALTOR® attempted to place his interests above those of his client, the REALTOR® would be in violation of the principles of agency law by breaching
his fiduciary duty of loyalty to his client. The consequence for such a breach varies from state to state according to state law. The seller would have the right to pursue appropriate penalties under the agency laws and/or real estate license laws of California. The REALTOR\textsuperscript{®} would also be in violation of any state law that may require that the agent inform a seller of fair market value before listing a property and/or making an offer on a property.

**Applying the social contract approach and using the NAR Code of Ethics for your “social contract,” what Article(s) have been violated, if any? What decision might you reach?**

The REALTOR\textsuperscript{®} violated Article 1 of the NAR Code of Ethics. The REALTOR\textsuperscript{®}'s obligation was to protect and promote the interests of his client. When he became a principal in the transaction, he was pursuing his own interest, possibly at the expense of the client. He could not continue to act as the seller’s agent, except with full disclosure to the seller and with the seller’s knowledgeable consent. The REALTOR\textsuperscript{®}'s comment that the seller had no choice but to view the REALTOR\textsuperscript{®} as her agent and to compensate him, even though the REALTOR\textsuperscript{®} had become a principal, was not accurate. The REALTOR\textsuperscript{®}'s anger was not only unprofessional; but also, acted as a clue to the seller that there was a lack of disclosure.

**Applying the personal conscience approach, what might be the resulting decision?**

This approach depends on the REALTOR\textsuperscript{®}'s conscience. The REALTOR\textsuperscript{®} may feel that he did the right thing by offering to purchase the seller’s property promptly. The REALTOR\textsuperscript{®} knew that he had the capacity to purchase the property and there would be no impediments to a swift closing. A swift and hassle-free closing would be beneficial to the seller. The REALTOR\textsuperscript{®}, upon more reflection, might decide that it was wrong to try to purchase the property for less than market value, and he might make an offer to give the seller the amount of the commission as an apology for his actions in addition to giving the seller the names of three good area REALTORS\textsuperscript{®} who the seller could
interview by phone and from whom the seller could select an agent that would do a good job in selling the property.

From your application of the four approaches, what approach should be weighed most heavily in this case?
The answer will vary from person to person. The seller was probably very angry after the REALTOR®’s reaction to the suggestion of an appraisal. Therefore, it might be a good idea for the REALTOR®’s broker to try to contact the seller and negotiate with the seller for a private settlement and/or suggest mediation as a way to settle the dispute. This would save everyone the expense and inconvenience of going to court.

Case Study 5-3
The broker always made it a point of following her checklist when filling out property data sheets, as she did when evaluating the seller’s house. As she studied each room in the house meticulously, she noticed that there were hardwood floors in the game room where every other room had carpeting. When the broker asked the seller if there was hardwood flooring under the wall-to-wall carpeting throughout the house, the seller hesitated before finally answering yes. The broker made note of this and included “hardwood flooring” on the property data form.

Weeks later she received a call from the new owner. He told the broker that he had bought the house under the impression that there were hardwood floors throughout, yet when he removed the carpeting in the bedrooms and living room all he found was plywood sub-flooring. Despite her disappointment, the broker realized that the new owner had every right to be angry.

Think about your answers to the following questions.

What facts are presented in this case study?
- The broker followed her standard listing procedure of filling out a property data sheet on the home she listed.
The broker was observant that the room without carpet had hardwood floors. 

The broker asked the seller if there were hardwood floors under the carpeted floors in the other rooms.

The seller hesitated before answering the broker’s question affirmatively about hardwood floors.

The new owner purchased the home.

The new owner discovered that there was not hardwood flooring under the carpet.

The new owner was angry when he discovered that the carpeted rooms had plywood sub-flooring rather than hardwood flooring under the carpet.

What assumptions apply to this case study?

- The broker assumed the seller was being truthful.
- The buyer assumed that the property condition disclosure was accurate.
- Possibly, the seller assumed that it was okay to embellish the truth.
- Possibly, the seller did not know what was under the carpet and hardwood flooring sounded reasonable; therefore, she confirmed that there was hardwood flooring underneath the carpet.
- The seller could have hesitated in order to remember what was under the carpet, and then, she did not accurately recall the flooring under the carpet.

Name the persons and/or groups affected by a decision made on this case?

- The broker could be affected because her reputation could suffer if she was found guilty of any wrongdoing. Also, if found guilty of violating the NAR Code of Ethics, she could suffer disciplinary actions from the Professional Standards Hearing Panel of the local board. If found guilty of violating the license law of her state, she could lose her license or suffer other penalties.

- The buyer could suffer monetarily if he has to pay for new flooring rather than the cost of refinishing the existing hardwood flooring that the house was represented to have.
The seller may suffer for the cost of new hardwood flooring and any attorney's fees and/or court costs associated with a claim in this case.

The real estate Industry could be affected if the buyer remains angry and tells all of his friends and associates about his bad experience.

What resources (persons or written) may be useful in reaching a decision on this case?

- NAR Code of Ethics
- The real estate firm’s attorney
- State law on property disclosure
- Real estate publications containing comments on similar cases

Applying the Approaches

Applying the end-results approach to this case, what decision might you reach?

If the seller made a good profit on the sale of the house, and if the seller has not reinvested the money in another home, then the seller is a source of money for the misrepresentation made by the seller regarding the hardwood flooring. If the seller is feeling guilty, it might be possible to talk the seller into reimbursing the buyer for the difference between the cost of refinishing existing hardwood floors, which the buyer seemed willing to expend, and the cost of installing new hardwood floors in the rooms that had carpeting. This would make everyone, but the seller, happy.

Applying the rules and law approach, what decision might you reach?

The answer to this would depend on state law, common law, and court precedents in terms of the legal interpretation of responsibility for property condition foreclosure. A factor against the broker is that she completed the property data sheet that detailed property condition. If the seller, in her handwriting, had completed a Seller’s Disclosure Form that included a notation of hardwood floors under the carpeting, then the responsibility might be more clearly linked to the seller, unless the broker “coached” the seller on the form. It is possible that some state law requires that the broker verify and/or substantiate the information given by the seller. State law may not allow a
buyer’s agent to rely on a seller’s or seller’s agent’s information and require that the buyer’s agent verify and/or substantiate that information.

**Applying the social contract approach** and using the NAR Code of Ethics for your “social contract,” what Article(s) have been violated, if any? What decision might you reach?

One might review Article 2 of the NAR Code of Ethics, but it appears that neither Article 2 nor any other Article was violated. The broker accurately conveyed to the buyer information given to her by the seller. There was no reason to believe that hardwood floors were not present as the seller stated. This case makes clear that the REALTOR® has a right to rely on the representations of the seller unless there is reason to believe that the seller’s information is inaccurate. The seller’s hesitation in answering the hardwood-flooring question is probably not enough in and of itself to cause the broker to believe the seller’s statement to be false.

**Applying the personal conscience approach, what might be the resulting decision?**

The broker may feel personally responsible since she noticed the seller’s hesitation in answering her question regarding the hardwood flooring, and the broker did not ask additional questions to discover the reason for the seller’s hesitation. The broker also did not pull back the carpet in a corner to verify the type of flooring below the carpet. If the broker felt that she was responsible, she might offer to split with the seller, the cost of installing hardwood flooring for the buyer.

**From your application of the four approaches, what approach should be weighed most heavily in this case?**

Of course the answer to this question will vary from person to person and from state to state depending on the property disclosure laws of the state. A critical issue is whether or not the seller was intentionally misrepresenting the flooring material. It is important that all sellers are encouraged to disclose all property condition accurately to avoid these types of disputes. If there is an undisclosed problem with property condition, in all
probability the buyer will discover it either before or after the transaction closes, and there will be consequences to the seller and possibly to the broker for failing to disclose the property condition known by the seller.

**What might be an appropriate decision for this case study? Is the seller at fault? Is the broker?**

The selection of an appropriate decision will vary from person to person and state to state and would probably somewhat depend on the seller’s situation. If it could be determined that the seller knowingly lied about the flooring, then the seller is probably responsible to the buyer for all the monetary damages suffered by the buyer in the matter of the flooring. If the seller did not make any profit on the sale of the property, recovering monetary damages from the seller may be difficult. If the seller did not intentionally lie, but simply thought she was agreeing with the “knowledgeable” broker about the flooring, then the responsibility might be shared by broker and the seller. Mediation may be the first step in resolving this situation.

**Case Study 5-4**

Henry is unhappy with his present experience with trying to sell his house. REALTOR® A doesn’t seem to be working very hard to represent his needs; since agreeing to a 90-day exclusive with REALTOR® A, the property has only been shown four times during the three months. With the seller ready to move into his new house, he does not need this headache. With REALTOR® A’s time almost up, the seller wants to find a REALTOR® who will better meet his needs.

The seller is told about REALTOR® B and gives her a call. Henry tells REALTOR® B about REALTOR® A’s ineptitude, prompting REALTOR® B to inquire about when REALTOR® A’s listing expires. She decides to call REALTOR® A, which takes many phone messages and e-mails before REALTOR® A finally responds with a curt and unprofessional response, still refusing to discuss the terms of her business relationship with the seller. REALTOR® B informs REALTOR® A that she can easily get the information from the seller, but REALTOR® A still does not budge.
After meeting with Henry, REALTOR® B happily agrees to assume the role of agent when REALTOR® A’s listing expires. Four weeks later, the house was sold.

Think about your answers to the following questions.

**What facts are presented in this case study?**

- The seller signed a 90-day listing agreement with REALTOR® A to sell his home.
- During the listing agreement with REALTOR® A, the home was only shown four times, and there are only two weeks left in the listing term.
- Henry is not happy with his current REALTOR® A.
- Henry has purchased another home and wants to be rid of the headache of his current home.
- Henry wants a REALTOR® who will be more responsive to his needs.
- Henry contacts REALTOR® B and tells her about his experience with REALTOR® A.
- REALTOR® B is finally able to contact REALTOR® A and asks about her business relationship with the seller.
- REALTOR® A refuses to answer any questions about the listing agreement.
- REALTOR® B informs REALTOR® A that she can easily get the information from the seller.
- REALTOR® B meets with Henry and agrees to list the property as soon as his current listing with REALTOR® A expires.
- REALTOR® B lists the property right after the seller’s agreement with REALTOR® A expires.
- Four weeks after REALTOR® B lists the property, the house is sold.

**What assumptions apply to this case study?**

- REALTOR® A was not communicating well with the seller regarding her efforts to sell the property.
- Perhaps REALTOR® A had not made much effort to market the seller’s property.
REALTOR® B did not initiate the contact with the seller. Rather, Henry contacted REALTOR® B because he was unhappy with REALTOR® A’s performance.

**Name the persons and/or groups affected by a decision made on this case?**

- The **seller**, who wants good service from a listing broker, may be affected by any decision because he is the one who initiated contact with REALTOR® B while he had an existing listing agreement with REALTOR® A.
- REALTOR® A is affected because she might have been able to sell the property if she had been able to renew the listing agreement.
- REALTOR® B is affected by a decision in this case because her commission for actually selling the property might be affected.
- The **general public** would be affected if they had no right to contact another agent if they became unhappy with their current broker.
- The **real estate industry** would be adversely affected if the public felt that they had no recourse against a lazy broker.

**What resources (persons or written) may be useful in reaching a decision on this case?**

- NAR Code of Ethics
- REALTOR® B’s broker
- REALTOR® A’s broker
- State law on agency and/or state law regarding contact with a seller while under an existing employment contract with another broker
- Real estate publications that may contain comments on similar cases

**Applying the Approaches**

**Applying the end results approach to this case, what decision might you reach?**

REALTOR® A is the only person unhappy with REALTOR® B getting the listing and selling the house. Therefore, using this approach, there should be no action taken against the seller or REALTOR® B.
Applying the *rules and law approach*, what decision might you reach?
There may be some states that have laws that do not allow the type of seller contact and/or discussion that REALTOR® B conducted. Please check state law before conducting the activities described in this case study.

Applying the *social contract approach* and using the NAR Code of Ethics for your “social contract,” what Article(s) have been violated, if any? What decision might you reach?
Article 16 is the article that applies to this case. The key Standard of Practice is Standard of Practice 16-4. This Standard of Practice sets out the correct procedure in this situation and shows that REALTOR® B is not in violation of the Code. She followed the exact procedure required by Standard of Practice 16-4. She first contacted REALTOR® A to determine the nature and expiration date of the listing. When REALTOR® A refused to give her the information, REALTOR® B then contacted the seller to secure such information. REALTOR® B’s obligation was to first contact REALTOR® A to secure information about the nature and expiration date of the listing. She fulfilled that obligation in this case.

REALTOR® A did not violate the Code. She had a choice; she could disclose or not disclose the information concerning the listing to REALTOR® B. Once REALTOR® A chose not to disclose the information, REALTOR® B was free to go directly to Henry and obtain the information and discuss the terms of a future listing as well as to enter into an agreement that would become effective upon expiration of the current listing. REALTOR® A has no obligation to disclose the information; however, the consequence of not disclosing the information is that REALTOR® B has a right to contact the seller directly to secure the information.
Questions may arise regarding the ability to discuss a listing if the client contacts the REALTOR® directly. This is covered by Standard of Practice 16-6, which allows the REALTOR® to discuss listing a property currently listed with another broker if the client initiates the discussion, and the REALTOR® has not directly or indirectly initiated such discussion.
Applying the *personal conscience approach*, what might be the resulting decision?

Since this approach is an individual one, it is hard to determine a definitive answer. Since most people agree that the responsibility of an agent is to serve the public in matters related to real estate, it is hard to fault REALTOR® B. She did not initiate the contact with the seller. If Henry had perceived that REALTOR® A was doing a good job, he would probably have renewed his listing agreement with her. Since he did not believe that REALTOR® A was doing a good job of serving his interests, he contacted REALTOR® B who successfully sold his home. Therefore, most people conclude that REALTOR® B acted appropriately.

From your application of the four approaches, what approach should be weighed most heavily in this case?

Unless there is a state law preventing the actions by REALTOR® B, all approaches seem to indicate that she acted appropriately.

What might be an appropriate decision for this case study? Did REALTOR® B behave appropriately?

Yes, she did act appropriately unless she violated a law in her state.

**Case Study 5-5**

A listing broker published an offer of cooperation and compensation in MLS for one of her listings, with a list price of $200,000, with an offer of compensation at X%. Broker A, struck by the X% compensation on such a high-priced property, showed the property and assisted a buyer in writing an offer on the property. When Broker A delivered the offer to the listing broker, she informed him that in order to keep the seller happy, she had to reduce the commission, which in turn lowered the value of Broker A’s co-op fee by 1%. Needless to say, he was not pleased.

Think about your answers to the following questions.
What facts are presented in this case study?

- The listing broker published a commission offer to cooperating brokers in the MLS.
- The list price of the property was $200,000.
- Broker A showed the property to the buyer.
- When Broker A brought the listing broker the offer from the buyer, the listing broker informed Broker A that the overall commission had been lowered and consequently the commission that would be paid to him had been lowered by 1%.

What assumptions apply to this case study?

- Broker A appears to have been attracted to showing the listing because of the commission being offered through the listing broker’s company.
- The intent of the listing broker advertising an attractive commission in the MLS was to attract more brokers to show the property.
- The listing broker could have changed the commission to the cooperating broker in the MLS computer as soon as the change of the total commission occurred.
- It seems doubtful that the listing broker changed the commission in the MLS computer as soon as the change in commission occurred.
- Usually during the preparation of an offer, there is communication between the listing broker and the broker working with the buyer. If this communication did occur, the listing broker could have communicated the change in commission prior to Broker A presenting an offer.
- If Broker A is representing the buyer, Broker A should be placing the buyer’s interests above his personal interests, and the amount of commission being paid to Broker A should not be a deciding factor in what he decides to show the buyer.
- If Broker A is a cooperating broker, then the commission paid to Broker A should not in any way jeopardize this transaction and the dispute should be taken up with the listing broker and her company as an issue separate from the seller being able to sell their home to the buyer.
• If Broker A works exclusively with the buyer, then the commission paid to Broker A should not in any way jeopardize this transaction, and the dispute should be taken up with the listing broker and her company as an issue separate from the buyer being able to purchase the home that she wants.

• Although the transaction itself could give Broker A leverage to collect the commission that the listing broker advertised, her agency duties to either the buyer or the seller prevent her from jeopardizing the transaction to assure that she collects her commission.

Name the persons and/or groups affected by a decision made on this case?

• The listing broker could have to give up some of her personal commission if she did not change the commission offer to cooperating brokers in a timely manner.

• Broker A might lose 1% of the commission that was advertised for the cooperating broker.

• If Broker A uses the transaction as leverage to collect the full commission that the listing broker advertised, the buyer might lose the opportunity to purchase the home.

• If Broker A uses the transaction as leverage to collect the full commission that the listing broker advertised, the seller may suffer if the transaction does not close because of the controversy.

• The real estate industry can suffer. If brokers begin spending their energy worrying whether or not they will get compensated as advertised in MLS, it takes away from energy that they could spend concentrating on their duties to buyers and sellers.

What resources (persons or written) may be useful in reaching a decision on this case?

• NAR Code of Ethics

• The listing broker’s broker

• Broker A’s broker
- State law, if any, regarding representation of and communication of compensation by one broker to a cooperating broker and/or false advertising
- Real estate publications that may contain comments on similar cases

**Applying the Approaches**

**Applying the *End-Results Approach* to this case, what decision might you reach?**

The end result goal is to close the transaction and make sure that brokers are paid appropriately. In order to accomplish this goal, Broker A should not do anything to jeopardize the closing of the transaction and should take action against the listing broker and her company as a separate issue from the closing of the transaction.

**Applying the *Rules and Law approach*, what decision might you reach?**

As long as the agency duties are fulfilled, there may not be any state law that addresses the issue of how brokers compensate cooperating brokers. The listing broker could be accused of false advertising and that is illegal in many states; each state’s laws concerning this issue should be checked.

**Applying the *Social Contract Approach* and using the NAR Code of Ethics for your “social contract,” what Article(s) have been violated, if any? What decision might you reach?**

The analysis of this case is based on Article 3; however, it should be noted that it is further explained in the Standard of Practice 3-2, which requires the timely communication of any change in an offer of compensation *before* an offer to purchase is produced by the other REALTOR®.

The listing broker is in violation of Article 3 as interpreted by Standard of Practice 3-2 but keep in mind that the violation is of the Article and not the Standard of Practice. The listing broker should have communicated the change to the offer of compensation before Broker A produced the offer to purchase. If this were an MLS listing, the listing broker could have changed the offer of compensation in the MLS computer before Broker A produced the offer to purchase.
If Broker A files an arbitration claim against the listing broker for the 1% difference, the arbitration panel will likely rule in Broker A’s favor if he can prove that the offer of compensation in MLS was X% on the day the offer to purchase was produced. To prove the offer of compensation was X%, Broker A should print a copy of the MLS data sheet on the day the offer to purchase was produced.

**Applying the Personal Conscience Approach, what might be the resulting decision?**

It is difficult to know how the personal conscience of the listing broker or Broker A might contribute to this analysis, but here are some possibilities. The listing broker may feel as though she should have communicated the change in commission in a timely manner and may offer to pay Broker A the 1% out of her own commission or get her broker to help her pay Broker A the 1%. On the other hand, the listing broker may believe that Broker A is too greedy and that he should be happy with the reduced commission.

Broker A may believe that he deserves the commission as advertised because he showed the home in good faith at the advertised commission, and the change in commission was not communicated in a timely manner. On the other hand, Broker A may not feel that it is worth the hassle of pursuing the matter and that could use his energies more productively by working with other buyers and sellers.

**From your application of the four approaches, what approach should be weighed most heavily in this case?**

The *Social Contract Approach* would probably be most appropriate for this case. With this approach, the transaction would close as scheduled, making the buyer and seller happy. If Broker A is a REALTOR®, he is required to arbitrate commission disputes first. Broker A should file a request for arbitration with the local board or association of REALTORS®. The arbitration request will be reviewed by the Grievance Committee, and if found to have merit, the matter will be arbitrated by the Professional Standards Hearing Panel. The listing broker might learn a lesson, and Broker A may get the rest of his commission.
What might be an appropriate decision for this case study?
An appropriate decision may be for Broker A to file a request for arbitration with the local board or association of REALTORS®.

Lesson Summary
This lesson uses the model for ethical decision-making to help the student better understand the steps required in formulating an ethical resolution to a problem. Given case studies, this lesson illustrates step-by-step the process of breaking down each scenario according to the model. First, the problem must be identified; the problem includes facts, assumptions, affected persons, and resources. Secondly, each ethical approach must be applied, which leads to making a final decision and evaluating that decision. This model shows resolutions from each ethical approach’s perspective, thus letting the student become more informed as to the various possible outcomes and decisions that can be made as well as shows the student how to use the model effectively.
Lesson 19: Basics of the Professional Standards Enforcement Process through the Local REALTOR® Board or Association

Lesson Topics
This lesson focuses on the following topics:
- Ethics Complaints
- Arbitration
- Mediation

Lesson Learning Objective
By the end of this lesson, you should be able to:
- Describe the professional standards enforcement process of a local board or association.

Ethics Complaints
There are two basic types of cases that may be heard through the local board or association. Since local boards and associations have a duty to enforce the NAR Code of Ethics, the first type of case deals with issues of ethics in relation to possible violations to the NAR Code. The second type of case is a request for arbitration related to a money dispute between two REALTORS® usually from different firms.

Anyone may file an ethics complaint. In other words, a buyer, seller, REALTOR® (member of NAR) or a member of the general public may contact the board or association and complete the required paperwork to file an ethics complaint.
The first issue to be decided is whether or not there is a possible violation of the Code. This decision is made by the Grievance Committee, which acts as a screening committee for complaints. The members of the Grievance Committee are appointed, and it is their duty to decide whether or not there has been a possible violation of the NAR Code of Ethics, assuming initially that the allegations given in the complaint are true as stated. If the Grievance Committee agrees that there may have been a violation of the NAR Code, then they recommend the case to the Professional Standards Hearing Panel.

The Professional Standards Hearing Panel is comprised of members of the Professional Standards Committee, and their function is to provide “due process” by hearing sworn testimony, witnesses, and evidence. After conducting the hearing, the Panel decides if clear, strong, and convincing evidence has been presented to prove the allegation of a violation of the NAR Code. If they agree that the Code of Ethics has been violated, then it is the Hearing Panel’s duty to impose a sanction on the violator (respondent). The Panel’s authority is limited to selecting penalties from the list of disciplinary actions. The last item on the list may only be imposed if it is imposed on all cases where a violation is found. The potential disciplinary actions are:

- Letter of Warning
- Letter of Reprimand
- Education
- Fine not to exceed $5,000
- Probation for one year or less
- Suspension from board membership for not less than 30 days nor for more than a year
- Expulsion from board membership for a period of one to three years
- Suspension or termination of MLS privileges.
- Administrative processing fee (if found in violation) not to exceed $500 ("court costs")
Arbitration

The arbitration process begins with a request for arbitration that is reviewed by the Grievance Committee to determine whether or not the matter is arbitrable. In other words, the Grievance Committee screens arbitration requests and decides if there is some basis for which a money award could be granted if the allegation in the arbitration request is found true.

Using Article 17 of the Code of Ethics and the state arbitration statute (if any), arbitration is conducted by the Professional Standards Hearing Panel (consists of members of the Professional Standard Committee). If a money award is awarded to a party in the dispute and the money is not paid voluntarily, the arbitration award can be taken to court and enforced through judicial processes.

Another approach is for the Board to adopt a procedure whereby the potential money award (usually the amount of the commission) would be collected prior to the beginning of the arbitration process. The money would be deposited and held by the Board during the arbitration hearing and possible legal challenges that may follow the arbitration hearing.

Mediation

As of January 1, 2002, mediation is a voluntary dispute resolution process that is to be offered by local boards and associations. In this type of mediation, the local board or association appoints a mediator who assists the disputing parties to come to a mutually acceptable resolution of the dispute. This process is an alternative to having the Arbitration Hearing Panel impose a decision to resolve the dispute. The local board or association establishes a policy as to when mediation can occur, but it generally occurs prior to or after the Grievance Committee reviews the allegations. In order to resolve a dispute using mediation, the parties must come to an agreement, spell out the
agreement in writing, and then sign the agreement. If the dispute is settled by mediation, then no arbitration hearing will be held.

**Lesson Summary**

Local real estate boards and associations handle two specific types of cases, those concerning violations of the NAR Code of Ethics and those dealing with arbitration (related to money disputes). If an agent feels that another agent is in violation of the Code, then he or she must address this violation in front of the Grievance Committee, who then decides if an infringement has occurred. Arbitration also begins with the Grievance Committee, who then decides if there is a basis for a monetary award. On the other hand, mediation acts as an alternative to arbitration; this is a voluntary dispute resolution process where a mediator is appointed in order to help the disputing parties come to an acceptable resolution.
Lesson 20: More Risk Management in Action to Improve Business

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Unethical Conduct
- Antitrust Laws and Violations
- Ethical and Professional Business Practices
- Ethics in Summary

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Differentiate between intentional fraud, negligent misrepresentation, and negligence.
- List the three violations of antitrust laws: price fixing, group boycotts, and market allocations.
- Describe how the existence of and adherence to the NAR Code of Ethics is good for the real estate profession.

Introduction
Despite the standards and guidelines that the NAR Code of Ethics sets for REALTORS® to adhere to, there are still possible situations where a REALTOR® or firm acts unethically. This lesson covers the different types of unethical conduct, which includes intentional fraud, negligent misrepresentation, and negligence. Firms can act unethically
by violating antitrust laws by participating in group boycotts, price fixing, and market allocation. REALTORS® must at all times adhere to a strict code of ethics, which requires them to be knowledgeable and well-informed concerning the laws and procedures governing the real estate industry in order to provide the best service possible to their clients and customers.

**Unethical Conduct**

Here are some Examples of unethical conduct in real estate:

- Intentional fraud
- Negligent misrepresentation
- Negligence

**Intentional Fraud**

*Intentional fraud* generally includes both affirmative misrepresentations and affirmative concealment, when the person making the misrepresentation is aware of the true facts. A real estate agent who willfully deceives another person with intent to induce him or her to alter his or her position to his or her injury or risk, is liable for any damages suffered.

Any of the following constitutes intentional fraud:

- The suggestion that something is a fact, when it is not true, by someone who does not believe it is true.
- The assertion that is something is a fact, when it is not true, by someone who has grounds to believe that it is untrue.
- The suppression of a fact, by one who is bound to disclose it, or who gives information of other facts that are likely to mislead for want of communication of that fact.
A promise made without any intent of performing it.

**Elrich v. Menezes (Cal. 1999)**
The Elrich family purchased a home from the builder, Mr. Menezes. The home was to be the Elrich family “dream” home, but instead became a nightmare. After moving in, the Elrich family discovered numerous defects and serious structural errors that Mr. Menezes did not inform them about. None of the 20 load-bearing walls were installed correctly. Within months the roof had begun to collapse, three decks were in danger of "catastrophic collapse," and a foundation required to support 12,000 pounds could only support about 2,000 pounds. In addition, the house leaked from “every conceivable location.” The Elrich family was able to successfully sue for fraud and misrepresentation.

**Negligent Misrepresentation**

*Negligent misrepresentation* generally means an affirmative statement that is not true is made by a person who did not know that the statement was false, but who either had no reasonable basis for believing its truth, or who should have known of its falsity, due to some other duty to investigate its falsity.

**Easton V. Strassburger (Cal. 1984)**
Easton, the plaintiff, purchased a single-family residence from Strassburger for $170,000 in 1976. Valley Realty (Valley) was the listing broker in the transaction. Three years prior to the sale to Easton, there had been two landslides on the property. Strassburger had taken corrective action to prevent further subsidence of the soil but did not inform Valley of the soil problems nor of the corrective action taken. Valley’s agents inspected the property several times during the listing period, and according to the appellate court, there was evidence that Valley’s agents "were aware of certain 'red flags' which should have indicated to them that there were soils problems." Earth movements and landslides that occurred soon after Easton occupied the property virtually destroyed its value. Easton filed suit against Strassburger, Valley and others. He successfully found Valley guilty of negligent misrepresentation.
**Negligence**

*Negligence* generally means failing to perform some duty that a person is required to perform under the law, or failing to perform such a duty in accordance with industry standards.

**Padgett v. Pharett (Cal. 1997)**

In 1991, the Padgett family entered into a real estate contract from the Stone Point development for $207,500. The standard real estate contract specified the sellers were to provide copies of the governing documents of the development and its homeowners' association, the Stone Point-Sweetwater Homeowners' Association, to buyers. These documents included the covenants, conditions and restrictions (CC&R's), bylaws, and financial data. Sellers were also required to disclose, in writing, any known pending litigation affecting the property. Despite this, the buyers' and sellers' real estate agents and brokers failed to disclose to the defendants that there was a pending lawsuit between the development's homeowners' association and the developer concerning alleged construction defects in the common areas of the property. The Padgetts were able to successfully sue for negligence against their real estate brokers and the sellers' real estate brokers.

**Antitrust Laws and Violations**

Antitrust laws preserve free enterprise by making private conspiracies to minimize competition illegal. In antitrust law, it is important to distinguish between a single firm and a group of competitors; an otherwise legal activity may be illegal if other competing firms join the activity. Even though many sales agents operate as independent contractors under their broker, for purposes of the antitrust laws, a real estate brokerage firm is usually considered one entity. Price fixing, boycotting, market allocation, and tying arrangements are common violations of antitrust laws.
**Price Fixing**

*Price fixing* is a typical Example of the individual versus group distinction. An individual firm may certainly set the prices it charges its clients; however, once that same firm agrees with a competing firm to set the same prices, the activity becomes illegal under the antitrust laws.

Price agreements between brokers are another issue. An agreement between competing real estate brokers to fix the prices each will charge a third party violates state and federal antitrust laws; the prohibition is not limited to the commission to be charged sellers. Depending on the circumstances, it could include splits to be offered to cooperating brokers or it could include referral fees to be paid. Pricing decisions should be made individually or within the firm.

**Group Boycotts**

An illegal group boycott may occur when competitors collectively exert pressure for the purpose of eliminating competition by refusing to deal with or by withholding services from another firm. Again, there is a distinction between group and individual action. The collective action is prohibited by the antitrust laws. Although each individual office has a legal right to choose its clients and business associates, decisions not to buy from or sell to individuals should not be made lightly. Aside from concerns about discrimination or other improper motives, real estate firms must also take into account their fiduciary responsibilities to clients. Is refusing to deal with a competing firm in the best interest of the client? Has this been discussed with the client? In almost every case, the brokers will find that dealing with all brokerage firms on an equal basis will benefit their clients.

The antitrust laws prohibit a group of brokers from collectively deciding not to deal with a third party to eliminate competition. This is especially true if the group of boycotting brokers is attempting to put competitive pressure on a broker to increase prices or curtail an aggressive marketing plan.
Market Allocation

Antitrust laws prohibit competing firms from dividing their markets to insulate themselves from each other's competition. For Example, one real estate firm may not agree with another real estate firm's decision not to list or sell property in each other's areas; such agreements restrict open competition. Firms should be free to list and sell real property in any area they wish; therefore, the brokers should sell their services on their merits rather than on the basis of a pre-determined agreement with competing firms.

Many offices are familiar with the term farming, whereby an office assigns different sales associates to intensively market in certain areas. Typical farming practices are acceptable as long as the division is made within a firm and not between two different firms. Since the real estate firm is really one entity for purposes of the antitrust laws, it may devise methods to cover a certain territory for more effective marketing.

Market allocation is a little different when customers are divided among competitors; it is illegal for competitors to divide or allocate the customers to whom they sell. One firm should never agree with another firm to abstain from servicing the other real estate firm's former client if approached by the client.

If a seller has an exclusive listing agreement with another broker, then such an exclusive should be respected. This means that no agent should interfere with the existing contract or agency relationship by requesting the client to breach an existing contract. Of course, agents should follow applicable MLS Rules or Code of Ethics provisions when contacting a current client of another agent. Competing agents should not agree to "leave the client alone" after a listing has expired and there is no legal obligation to any broker.

Tying Arrangements

Under certain circumstances, it may be illegal to refuse to sell a product or service unless the customer decides to purchase another product or attain another service. The
analysis of a tying arrangement may involve difficult factual questions such as whether the product is two products or packaged as one. Additionally, illegal tying arrangements involve a seller of the tying product (usually the more desired product or service) who has substantial or dominant market power in the tying product. This determination may involve a complicated economic analysis.

This means the buyer cannot receive the product he or she wants (the tying product) without first purchasing a different product (known as a positive tie) or by promising to not buy the tying product from another seller (known as a negative tie). In order for the tying arrangement to be illegal, the seller must have adequate economic power relating to the tying product in order to affect free competition for the tied product.

In the real estate industry, some courts have applied tying law to "list backs" where a sale of property is conditioned upon the agent obtaining the listing for a future sale.

Although it may appear that one could apply tying laws to many transactions where the seller insists on certain companies (such as title or escrow companies or specific lenders), this is not necessarily the case. As mentioned before, the seller has to have "market dominance," and therefore, this area would seem to be limited to larger developers. Each case is subject to a rather difficult analysis pertaining to this question.

Ethical and Professional Business Practices

REALTORS® Duties

The amount of information a REALTOR® may have varies at different states of the REALTOR®'s professional life. The REALTOR® should strive to:

- Become informed as rapidly and thoroughly as possible about laws, proposed legislation, government regulations, public policies, and current market conditions.
- Seek reliable information on matters that depend, in whole or in part, upon information or knowledge the REALTOR® may provide to clients and customers.

REALTORS® will find it difficult to advise clients and customers properly if they do not know the requirements and limitations imposed by laws upon a property or its owner. REALTORS® must provide accurate information, but they must refrain from the unauthorized practice of law. REALTORS® should avoid engaging in activities where they lack sufficient knowledge or when the activity is beyond the scope of their licensure.

It is important to admit the lack of pertinent knowledge and recommend that information be sought from those who are adequately informed. REALTORS® cannot be fully informed on all matters at all times, but must always be honest and forthright and should constantly increase their knowledge and expertise consistent with the reasonable expectations of clients and customers.

With so many issues affecting the practice of real estate and the rights of property owners, it is recommended that REALTORS® be informed and contribute responsibly to debate and decision as best they can.

**Criticism**

A REALTOR® is not precluded from responding to a request for an opinion as to a competitor's general business practices or a particular real estate transaction. If it appropriate to respond, the REALTOR® should provide the opinion with strict professional integrity and courtesy (i.e., provide objective, reliable information in a professional manner). This requires careful language and analytical approach based on facts. REALTORS® can always refrain from comment if they choose.

Uninvited criticism is counterproductive, impairs cooperative efforts, and diminishes the public's appreciation for the valuable services provided by REALTORS®. Stress the
value and merit of your own work rather than criticizing or making derogatory comments about the efforts of other REALTORS®.

**Participation in Law Enforcement, Regulations and Code of Ethics**

If the REALTOR® becomes aware of any damaging practice to the public that would discredit the real estate profession, the Preamble encourages the REALTOR® to bring such actions to the attention of the State Real Estate Commission.

Such reports should not be prompted by personal whim, preference, or spite, but should be a manifestation of respect for the law and the Code of Ethics. Reports should never be made for the purpose of stunting a competitor who provides new or different services. Any challenge to a competitor's practice must be based solely upon an unbiased and disinterested analysis of the practice or service itself and whether it damages the public or brings discredit upon the real estate profession.

REALTORS® should be aware that they must arbitrate certain business disputes with other members rather than resorting to litigation; however, the obligation to arbitrate does not necessitate the need to report any potential violations of the law to the governmental agency charged with regulating the practices of brokers and salespeople in the state.

REALTORS® who have direct personal knowledge of conduct that may violate the Code of Ethics, involving misappropriation of client or customer funds or property, willful discrimination or fraud resulting in substantial economic harm, should bring such matters to the attention of the appropriate Board or Association of REALTORS®.

**Exclusive Representation**

REALTORS® should urge the exclusive listing of property unless it is contrary to the best interest of the owner. This prevents dissension and misunderstanding, therefore assuring better service to the owners and lessors.
The exclusive listing includes both exclusive right to sell and exclusive agency agreements, which benefit sellers and lessors since they establish a clear line of responsibility on the part of the seller or lessor and the listing broker. Listing brokers know they will not be paid unless they meet the specific terms and conditions of the listing; they realize that payment will be received if they perform accordingly. Sellers and lessors know they will incur an obligation to pay only one commission and are assured that property will be shown only to bona-fide, pre-qualified prospective buyers or tenants. Such certainties, established by the exclusive listing agreement, minimize dissension and misunderstanding and sellers and lessors are assured of the best efforts of listing brokers and cooperating brokers.

**Sharing Knowledge and Experience**

This concept encourages a high standard rarely established by business and professional groups. As a general rule, business competitors do not share the lessons of their experience with each other for the benefit of the public. Rather, such experience is zealously guarded lest it fall into the hands of competitors. But REALTORS®, although intensely competitive with each other, cooperate with each other in the best interest of clients and customers. In cooperative transactions, it is desirable that the combined professional abilities and talents as well as the shared commitment to high standards of conduct prevail. This cooperation benefits clients and customers.

Programs offered by the Boards provide opportunities to share information on: public policy, politics, and legislation affecting private ownership of real property and the practice of real estate technology to improve service and maintain competency, methods of financing real estate transactions, and the standards of professional conduct. They also provide opportunities to share information on better methods of selling, buying, leasing, managing, counseling, appraising, developing, and syndicating.

REALTORS® should share their knowledge and expertise with other REALTORS® for the benefit of their clients and customers.
If disagreements did not arise between members, then there would be little need for ethics or arbitration hearings. REALTORS® should strive to minimize the likelihood of disagreements through professional practice by adhering to the Code of Ethics, understanding and respecting the law, and practicing general competence in all transactions undertaken. A REALTOR® cannot guarantee that disagreements will never arise, but should always seek to avoid even the appearance of impropriety.

Unfair advantage can be avoided by caring, consideration, and communication. REALTORS® who care for the interests of every individual involved in a real estate transaction and consider all points of view are not apt to take any unfair advantage. Good relationships and good results in real estate matters are commensurate with good communication between principals, agents, and cooperating brokers.

The phrase "unfair advantage" is not intended to discourage aggressive competition. Rather, it is intended to discourage the misrepresentation of law or fact, misleading clients and customers with respect to the competence, honesty, or loyalty of other REALTORS®, resorting to technicalities to justify questionable actions and attempts to induce a breach of contract. Ultimately, unfairness works to the disadvantage of clients and customers since it limits their power of choice, exposes them to possible litigation, and deprives them of the full benefits of an open and cooperative relationship.

Advantages of Adhering to the NAR Code of Ethics

The NAR Code of Ethics is a code designed to establish a public and professional consensus against which the practice and conduct of REALTORS® and REALTOR-ASSOCIATE®s may be judged. It is designed to protect the public also helps to protect fellow agents from practices that are harmful to the industry.

There are many reasons why a real estate agent may want to be familiar with the professional conduct required by the NAR Code of Ethics. Not only does adherence to a high level of professional conduct avoid legal exposure and liability, it also increases the public's awareness of real estate agents as professionals and results in better service to
the real estate agent’s clients and customers. Decreasing legal liability exposure while increasing the level of professionalism and services offered to clients can result in a successful business for the real estate agent.

**Ethics in Summary**

To be ethical is a daily struggle because there are many hard choices that each person faces in their professional and their personal lives. This course has presented four approaches to ethics, a model for ethical decision-making, and introduced the NAR Code of Ethics as the real estate industry ethical code. Hopefully, these tools will help you make good and well-reasoned choices in your business. Being ethical is an important part of a business plan. When clients and customers are treated in a professional and ethical manner, those clients and customers are much more likely to respond positively to your request for referrals. In addition to referrals, your percentage of repeat business should be substantial if you follow up on past sales and if your clients believe that you treated them in an ethical and professional manner. Good ethics are the key to a long and successful real estate career.

**Lesson Summary**

There are multiple forms of unethical conduct; however, some major ones include: intentional fraud, negligent misrepresentation, and negligence. An agent has committed intentional fraud when he or she knowingly misrepresents or misinforms a client of information that the agent blatantly knows is untrue. Negligent misrepresentation occurs when an agent discloses information that he or she suspects is untrue but does not take the time to verify its validity. An agent acts negligently when he or she fails to perform a duty that he or she is required to do under law.
Antitrust laws help protect the public from any unfair practices by entities conspiring to minimize competition. Price fixing, boycotting, and market allocation are among the most common violations of antitrust laws.

In order for an agent to be successful in the real estate industry, he or she must be aware of the actions that need to be taken to ensure success. Agents need to be informed of the laws and guidelines that apply to the industry, as well as adhere closely to the Code of Ethics. Whenever possible, the agent should urge the client to enter into an exclusive representation agreement because this establishes a relationship between the client and agent, which identifies the necessary responsibilities necessary of both parties.
Lesson 21: Real Estate Practice

Lesson Topics
This lesson focuses on the following topics:

- Insight into the Code of Ethics
- Field Applications of the Code of Ethics

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Identify violations of the codes of ethics in given case study scenarios.
- Explain an ethical course of action in given case study scenarios.

Insight into the Code of Ethics
We have covered many specifics over a relatively short period. To ensure a comprehensive understanding, we will integrate the information provided through questions and case studies. The first half of this lesson presents questions and answers. The second half presents brief case studies that illustrate ethical principles and ideas.

Question 1: Why are antitrust laws important?

Answer 1
Antitrust laws protect free enterprise; they make price fixing, boycotting, market allocations and tying arrangements illegal in order to promote free and fair competition between firms. This serves to not only protect firms from illegal actions but protects the
consumer from corrupt firms. Antitrust laws make private conspiracies to minimize competition illegal.

**Question 2:** When does a tying arrangement become illegal?

**Answer 2**
A tying arrangement occurs when a buyer cannot receive the product that he or she wishes to buy without first buying a different product. This activity becomes illegal when the seller has substantial economic power relating to the tying product, which affects free competition for that product.

**Question 3:** Why should REALTORS® be informed on the current events and issues in their industry?

**Answer 3**
REALTORS® will find it hard to help clients and customers if they are not acquainted with the current information, requirements, and limitations imposed by their industry or by law. It is essential that REALTORS® be able to provide accurate and substantial information to clients; a lack of knowledge will hinder a REALTORS® relationship with his or her clients, and an exaggeration of the facts will expose the REALTOR® to potential lawsuits.

**Question 4:** How is an exclusive listing agreement beneficial?

**Answer 4**
The exclusive listing agreement benefits the REALTOR®, the seller, and the buyer because it sets forth the terms and conditions of the relationship. Any future complications that arise can be solved by referring to the contract. This allows all parties to know their role in the relationship and eliminates any confusion as to compensation, deadlines, etc.
Question 5: How does knowing how to apply the various methods of ethical decision help a decision maker?

Answer 5
By understanding the different methods of ethical decision making, a decision maker can evaluate a decision from various points of views and pick a decision that will best benefit the parties involved in each case. The decision maker can use the model to identify the facts, the assumptions, and the resources involved in each case as well as see how each decision affects each aspect of the model. The decision maker can then make the appropriate decision depending on which method yields the best outcome.

Question 6: Is a REALTOR® allowed to disclose confidential information given to him by a client?

Answer 6
According to Standard Practice 1-9, a REALTOR® can withhold confidential information so long as it does not violate any laws. A REALTOR® must disclose any information if the client gives consent of the disclosure, if there is a court order requiring the disclosure, if the information prevents a crime or if the information is needed to defend a REALTOR® or any associates accused of wrongful conduct.

Field Applications of the Code of Ethics

Case Study 1
REALTOR® A shows a property to three different buyers: Buyer A, Buyer B, and Buyer C. All three prospective buyers liked the property; however, Buyer A could not afford the listed price of the home, Buyer B needed a home closer to an elementary school and Buyer C wanted a home closer to work. Upon hearing this, REALTOR® A disclosed to each buyer that if he or she purchased the property from him and purchased some additional services through him, he could reduce the price of the home. What Articles of the Code of Ethics does REALTOR® A violate and how?
REALTORS® should never promise prospective buyers that purchasing a property or acquiring their services will, in any way, affect the sale of a property. Article 1, Standard Practice 1-4 specifically states, “REALTORS®, when seeking to become a buyer/tenant representative, shall not mislead buyers or tenants as to savings or other benefits that might be realized through use of the REALTOR®’s services.” This means that REALTORS® should not mislead a buyer into thinking that using his or her services will benefit the buyer beyond the normal scope.

According to Article 6 of the Code, REALTORS® must disclose any compensation or benefits they will receive as a result of the buyer’s purchase or usage of specific products or services. A REALTOR® can recommend these services; however, he or she cannot delude the customer into thinking that using these services or product will, in any way, affect the price of the sale or the services rendered by the REALTOR®.

Case Study 2
College Student A is looking for a one bedroom apartment and approaches REALTOR® A to help him find one that fits his needs. He explains to REALTOR® A that since he is a college student, he cannot afford to spend a lot for an apartment; however, the apartment needs to be close to campus. REALTOR® A thinks about College Student A’s request and later explains to College Student A that she does not render services to college students. Outraged at hearing this, College Student A cites Article 10 of the Code of Ethics and accuses REALTOR® A of violating it. What is Article 10, and is College Student A correct?

Article 10 of the Code addresses fair housing; a violation of fair housing laws also constitutes a violation of the Code of Ethics. According to Article 10, “REALTORS®, in their real estate employment practices, shall not discriminate against any person or persons on the basis of race, color, religion, sex, handicap, familial status, or national origin.” This means that REALTORS® cannot discriminate against a protected class, which includes color, religion, sex (gender), handicap, familial status or national origin;
College Student A is incorrect because college students are not a protected class. If REALTOR® A were to say that she would not render services due to College Student A’s marital status, then it would be violation of the Code because familial status is a protected class.

**Case Study 3**

For the last two years, REALTOR® A has been aware of REALTOR® B’s unethical conduct. REALTOR® B has consistently violated multiple articles of the Code, mainly Articles 1, 6, 16 and 11. REALTOR® A always meant to report the violations, but always felt that REALTOR® B deserved chances to show improvement. A few weeks later, REALTOR® C files an ethics complaint against REALTOR® B because he violated Article 16 by trying to solicit REALTOR® C’s client (who has a written, exclusive listing agreement). When called to appear in front of the board, REALTOR® A refuses to do so, explaining that he can offer no material evidence of the violations. REALTOR® C explains to REALTOR® A that he does not have to have material evidence, but rather, could provide testimonials about REALTOR® B’s unethical conduct. Who is correct?

Article 14 of the Code of Ethics requires REALTORS® to cooperate with the board by disclosing all pertinent information and presenting relevant information in front of the board. By not cooperating, REALTORS® are disrupting the board’s investigation, which results in a violation of the Code. Although REALTOR® A was not directly involved with REALTOR® B, he had witnessed the unethical conduct; therefore, he would serve as an appropriate witness to such actions and could provide a solid testimony. REALTORS® should always report violations of the Code to uphold the high standards of professionalism associated with NAR.

**Case Study 4**

Seller A decides to sell his home and lists it on the open market. REALTOR® A and REALTOR® B both want to attain an exclusive right-to-sell agreement with Seller A, in order to assure themselves commissions. REALTOR® A approaches Seller A and explains to him the benefits of having an exclusive right-to-sell agreement. Having an
exclusive right-to-sell listing agreement will guarantee the seller extensive exposure of his property to other real estate professionals; therefore, under this type of agreement, although only one broker is listing the property, multiple brokers and salespeople are working for the seller. Seller A, upon hearing the advantages of an exclusive right-to-sell listing, agrees to contract with REALTOR® A for 90 days. Two weeks later, REALTOR® B contacts Seller A and discovers that REALTOR® A has already established an exclusive listing agreement with Seller A. REALTOR® B tries to persuade Seller A to terminate his contract with REALTOR® A because he believes that REALTOR® A is incompetent and inexperienced. Seller A explains to REALTOR® B that he cannot break his contract and contacts REALTOR® A and describes to him REALTOR® B’s unethical behavior. What should REALTOR® A do?

In this case, REALTOR® B violated both Articles 15 and 16. Article 15 disallows REALTORS® from making false statements and assumptions about other REALTORS® and Article 16 stresses the importance of not interfering with the relationships other REALTORS® have with clients. Since REALTOR® B is in violation of these Articles, REALTOR® A should file an ethics complaint. If the Panel finds REALTOR® B in violation of the Code, a number of actions can be taken against him. He could receive a letter of warning or reprimand, be fined, get suspended or placed on probation or lose MLS privileges. REALTOR® A was correct by filing an ethics complaint; by doing so, he is upholding the standards of the NAR Code of Ethics.

Case Study 5

Seller A contacts REALTOR® A and explains that he has a property in New Mexico that he needs to sell. He asks REALTOR® A if he can list the property for him and quote him a reasonable price to list the property at. REALTOR® A says that he will call Seller A back as soon as he takes a look at the property to evaluate its value. After inspecting the property, REALTOR® A calls Seller A back and says that he thinks $50,000 is a fair price for the 20 acres of land. Uninformed about land value and trusting the REALTOR®’s opinion, Seller A agrees to the price. One week later, REALTOR® A
contacts Seller A and explains to him that he would like to purchase the property. Now, suddenly suspicious of REALTOR® A’s intention, what should Seller A do?

Seller A cannot be sure that REALTOR® A quoted him a low price just so that he could purchase the property. Most likely, Seller A would have to get an appraiser to evaluate the value of the property. In this case, Seller A can cite a violation of Article 4 of the NAR Code of Ethics because REALTOR® A never initially disclosed his interest in the property until after he listed the property at a price he quoted. If Seller A has the property appraised, and the value is exceptionally more than REALTOR® A’s estimate, Seller A should consider finding new representation, even if they have an exclusive listing agreement. REALTOR® A will most likely agree to terminate the relationship if it is found that his intentions were not in the best interest of the client, which is a violation of Article 1 of the Code. REALTOR® A will most likely try to avoid any litigation or ethics complaints by upholding the client’s wishes.

Case Study 6
REALTOR® A and REALTOR® B both show Buyer A the same listing. REALTOR® A showed Buyer A the property in March 2003, and REALTOR® B showed Buyer A the property in April 2003. After REALTOR® B showed Buyer A the property, Buyer A decided to place an offer on the home. The seller quickly accepted the offer and sold the house to Buyer A. A few weeks later, REALTOR® A discovers that a customer he had shown a property to decided to buy the property after seeing it with REALTOR® B. REALTOR® A asserts that he is the procuring cause of the sale, and since he originally showed the listing, he has rights to the commission, not REALTOR® B. What action can REALTOR® A take?

REALTOR® A should NOT litigate this case. According to the Code of Ethics, REALTOR® A should submit the dispute to arbitration where the local board will review the case or settle the dispute through mediation. The board will review the facts of the case and examine the evidence before making an informed decision concerning the outcome of the case.
Case Study 7

Seller X contacts his friend, REALTOR® Y and asks him to list a commercial property for him. REALTOR® Y explains to Seller X that his expertise is residential real estate, and he cannot adequately provide services to Seller X. Seller X is adamant about REALTOR® Y listing the property because he thinks REALTOR® Y will do a good job. After getting the property evaluated by an appraiser, REALTOR® Y lists the property at $250,000, and it sells within a week. REALTOR® Y calls Seller X with the good news, but Seller X does not sound too happy about the listing price. REALTOR® Y explains to him that he had an appraiser look at the property and evaluate the property’s worth. After hearing the listing price of the property, Seller X gets upset because he feels his property is worth more than that. Using the various methods of ethical decision-making, which decision will best benefit both parties in this case?

The end-results method lists each and every advantage and disadvantage to a decision and opts to make the most number of people happy. In this case, perhaps the best decision in the end would have been for REALTOR® Y to pass the listing on to a commercial REALTOR® who will be better equipped and experienced to handle such a listing; therefore, REALTOR® Y will be happy because he will not expose himself to any possible liabilities or lawsuits, and Seller X will have the quality of expertise that he desires. Since this did not happen, Seller X will most likely have to mediate this issue with REALTOR® Y in order to come to an agreeable resolution. Because REALTOR® Y did seek the help of a professional (a commercial property appraiser), he did not violate the Code of Ethics, and he did inform Seller X of all the facts before listing the property. Most likely, REALTOR® Y will not be held accountable in this case.

The social contract method will require an evaluation of the Code of Ethics to see if any violations of the Code have occurred. Most likely, Seller X will try to charge REALTOR® Y with violating Article 11 of the Code of Ethics, which states that a REALTOR® should not offer services outside his range of expertise without first acquiring the aid of an expert in that field. Since REALTOR® Y did not violate this Article, a decision using this method will be in the favor of the REALTOR®.
The decision resulting from the rules and law approach would depend on the laws of each state. For Example, if the license law presumes that if you take the required education and pass the exam, you are competent to practice all types of real estate, then perhaps the REALTOR® has not violated a law in taking a listing outside his expertise. The REALTOR® was honest with the seller in taking this listing, and the REALTOR® fully informed the seller of his lack of knowledge of commercial real estate and the seller still insisted that the REALTOR® list the property. If there is an affirmative duty in the real estate license law of the broker’s state to always inform the seller of the market value of a property before listing it, then the broker is guilty of failing to determine the market value prior to listing the property. This failure could result in a disciplinary action from the state regulatory agency and/or a possible lawsuit.

Using the personal conscience approach, REALTOR® Y may feel guilty about rendering services in which he was not capable of fully giving; therefore, REALTOR® Y may offer to give Seller X a portion of or the entire commission in order to appease Seller X. REALTOR® Y may also feel that he adequately provided services and may offer to give Seller X nothing. This depends on the conscience and personal beliefs of the decision maker.

**Case Study 8**

Buyer A becomes interested in Seller A's property—a two bedroom, one bathroom house in a seemingly quiet neighborhood. Seller A knew Buyer A liked the home due to the quiet surroundings; however, he also knew that at night, the neighbors liked to play loud music and argue noisily. When Buyer A asked about the noise level, Seller A assured him that the neighborhood was always peaceful and quiet. Knowing that he would lose the sale if Buyer A discovered the truth, Seller A lowered the price of the home so that Buyer A would immediately place an offer and purchase the home. After moving into the home, Buyer A discovers that the seemingly quiet neighborhood only appeared to be so during the day, but at night, it was extremely loud and unbearable. What rights does Buyer A have?
Intentional fraud is a prime example of unethical conduct. Seller A withheld adverse information he knew would affect Buyer A’s decision concerning the property. Seller A is required to disclose any pertinent information to the buyer; by lying to the buyer, Seller A is blatantly swindling him. At this point, Buyer A can file a case against Seller A to recoup his damages or Seller A can offer to void all contracts and refund Buyer A’s money in order to avoid potential lawsuits.

**Case Study 9**

REALTOR® A showed Buyer A a home located in an upper middle class neighborhood; the area is clean and relatively new. REALTOR® A notices that there is a crack on the rear of the house, but he does not disclose this information to the buyer because he figures that since it is not a latent defect, he does not have the responsibility to disclose the information. The buyer can discover the crack on his own; however, the buyer purchased the house without discovering the crack. Two weeks after moving into the home, the buyer discovers the crack in the wall and calls REALTOR® A to complain about the defect. REALTOR® A told Buyer A that it was his responsibility to discover the defects. Is REALTOR® A correct?

According to Article 2 of the Code of Ethics, REALTORS® should not conceal any information that is readily available. By not disclosing the crack in the wall to the buyer, the REALTOR® is acting negligently. The REALTOR® is not responsible for latent defects that are beyond the scope of his expertise; however, he knowingly withheld adverse information from the buyer, even though he knew it was his responsibility to disclose it.

**Case Study 10**

Broker A listed a property on the MLS, offering a compensation of x%. Two weeks later, Broker A decided to change the amount of compensation she was offering, but she did not post the change on the MLS until three days later. Prior to the change on the MLS, Broker B presented the seller with a willing and able buyer, and the seller sold the
property to Broker B’s client. Broker B contacted Broker A and demanded the amount listed on the MLS, but Broker A stated that she had made the change on the MLS, and she would only compensate him for that amount. What can Broker B do?

In this case, if Broker B has proof that he presented the client on the day that the MLS still stated the original X% as compensation, then he is entitled to that amount. An Example of evidence would be a printout of the listing with the X% commission. Broker A has the burden of proving that she made the change in a timely manner and acted according to Standard Practice 3-1. According to Article 3 of the Code, brokers have a responsibility to cooperate with each other in order to best serve the client. In this case, Broker B can dispute the commission with Broker A in arbitration or mediation or just accept the commission given because his primary interest should be that of the client and not the commission.
Fair Housing

Lesson 22: Introduction to Fair Housing

Lesson Topics

This lesson focuses on the following topics:

- Introduction
- Federal Fair Housing Laws
- Protected Classes Established by the Federal Fair Housing Act
- Conduct Prohibited by the Federal Fair Housing Act
- Transactions Not Covered by the Federal Fair Housing Act

Lesson Learning Objectives

By the end of this lesson, you should be able to:

- Explain the purpose of the federal fair housing laws and be able to identify the protected classes covered by the Fair Housing Act.
- Name the seven activities considered illegal as a result of the fair housing laws.
- Identify the five exemptions from the federal fair housing laws for property owners.

Introduction

The U.S. Constitution guarantees everyone certain basic rights and freedoms. For Example, no person may be deprived of property without due process. Fair housing laws were conceived as an extension of this idea. When people are denied housing because of their membership in a particular protected class, they are, in essence,
denied property without due process. So, unfair discrimination in the letting and sale of residential real estate is not just unethical, it also undermines the U.S. Constitution. This lesson will introduce the student to the federal Fair Housing Act. Our discussion will cover the seven protected classes, the conduct prohibited by the law and the few exemptions from the law. Once you have completed this lesson, you should know the legalities of the Act; in addition, you should understand its importance and intent. Finally, you should have a better sense of your role as a real estate professional in implementing this law.

**Federal Fair Housing Laws**

The Civil Rights Act of 1866 was passed by Congress on April 9, 1866, over the veto of President Andrew Johnson. It granted all citizens of the United States—without exception—a set of basic rights regardless of their race, color, or previous condition of servitude. Among the rights granted by this Act are the rights to “make and enforce contracts, to sue, be parties, and give evidence, to inherit, purchase, lease, sell, hold, and convey real and personal property.” The right to make and enforce contracts is the foundation of property ownership and, according to the Civil Rights Act of 1866, fair access to property ownership includes equality in making, fulfilling, modifying, and terminating contracts, as well as equal enjoyment of the benefits, terms, and conditions of the contractual relationship.

In the more than 100 years that elapsed between the passage of the Civil Rights Act of 1866 and the passage of the Fair Housing Act, there were only two serious attempts made to legislate fair housing practices. Both of these efforts only dealt with federally-funded housing. In 1962, John F. Kennedy issued Executive Order 11063, which prohibits discrimination in the selling or leasing of property owned or funded by the federal government, including those properties relying upon Veterans Administration (VA) and Federal Housing Administration (FHA) loans. The Civil Rights Act of 1964
included a prohibition against discrimination on the basis of race, color, and national origin in any program or service funded by the federal government.

Shortly after the assassination of Dr. Martin Luther King Jr., Congress passed the Civil Rights Act of 1968. Title VIII of this Act, also known as the Fair Housing Act, prohibits discrimination in real estate practices. The Department of Housing and Urban Development, commonly referred to as HUD, enforces the Act. The law applies to most, if not all, activities in which real estate licensees may engage, including selling, appraising, managing, and renting real property. Real estate licensees are in violation of the law if their actions or words are discriminatory, even if they have no intention to discriminate.

**Protected Classes Established by the Federal Fair Housing Act**

Under the federal Fair Housing Act, there are seven protected classes. It is illegal to discriminate against someone because of his or her:

1. Race
2. Color
3. National origin
4. Gender
5. Familial status
6. Religion
7. Disability

It is a violation of federal law to discriminate against someone in the sale or letting of residential real estate on the basis of his or her membership in one of these seven protected classes. Some individual states and local jurisdictions, such as counties and cities, have introduced legislation to protect additional classes. It is, therefore,
necessary for licensees to review state laws and local ordinances regarding housing discrimination to ensure that their conduct satisfies any additional requirements.

All of the protected classes listed earlier were established by the Civil Rights Act of 1968 except sex (gender), familial status, and disability. Sex was added in 1974 by the Housing and Community Development Act. A 1988 amendment to the federal Fair Housing Act itself added familial status and handicap. In 2005 the state of Hawaii also added sexual orientation and gender identity or expression to the list of classes protected under fair housing law.

While some of these classes may seem self-explanatory, the definitions of “disability” and “familial status” may be a little less clear. For example, a disability does not necessarily mean a physical disability. The next few screens will define the terms “disability” and “familial status.”

**Definition of Disability**

The law states that a *disability* is any physical or mental impairment that limits one or more of a person’s major life activities, such as walking, talking, hearing, seeing, breathing, learning, performing manual tasks, and caring for oneself. This definition thus includes a variety of conditions, such as being infected with HIV or having AIDS, being an alcoholic, and having a learning disability. It is worth noting here that while alcoholism is considered a disability, being addicted to illegal drugs is not.

A disability can be actual or perceived. This means that if a real estate professional believes that a prospect may have a disability of any kind, and, as a result, refuses to rent, offer services, or show housing, then that professional has violated the federal Fair Housing Act. This is true regardless of whether or not the person is actually disabled.

Real estate professionals and lessors must make reasonable accommodations for people with disabilities. A landlord or real estate professional must make any accommodation that helps a disabled person acquire and enjoy his or her dwelling,
though the parties providing accommodation(s) are not required to suffer undue hardship in doing so. For brokerages, this could mean providing Braille versions of pamphlets and handouts. For a lessor, this could mean allowing a person with an assistive animal to keep his or her animal indoors, even if tenants are generally forbidden to keep pets.

Although you may not discriminate against people because of a disability, it is not illegal to refuse housing to prospective tenants or to evict current tenants who have a physical or mental impairment that poses a direct threat to other tenants. For example, it would not be illegal to refuse to rent an apartment to an unmedicated schizophrenic with a history of violence against others, even though the person has a documented mental impairment.

In cases like these, it is important that real estate professionals, landlords, prospective sellers, and other people bound by the Fair Housing Act show that an actual and direct threat exists. For example, a tenant with Tourette’s syndrome who cannot help making loud noises throughout the night may pose an indirect threat to other tenants through the long-term effects of sleep loss, but does not pose any immediate, direct threat. The courts have ruled that a landlord must also show that no reasonable accommodation could eliminate the direct threat posed by a tenant.

**Definition of Familial Status**

The federal Fair Housing Act also protects families with children under the age of 18 living with one or more parent or guardian, as well as pregnant women and those planning to adopt. In general, no one may deny housing to an individual simply because that person has or may soon have children.

There is one exception to this prohibition: what the Fair Housing Act calls “housing for older persons.” A dwelling is exempt from the requirement to accommodate families if:

- That dwelling is provided under any state or federal program that the Secretary of
Housing and Urban Development determines is designed and operated to provide assistance to the elderly.

- That dwelling is intended for and occupied solely by people who are 62 years of age or older.
- At least 80 percent of all occupied units in that dwelling house at least one person over the age of 55 and the landlord generally adheres to a policy with the demonstrable intent of housing persons over 55.

In some cases, imposing limitations on the number of occupants allowed in a dwelling may constitute discrimination on the basis of familial status. To ensure that fair housing lawsuits regarding this issue remain reasonable, Congress passed the Quality Housing and Work Responsibility Act of 1998. This Act required HUD to set reasonable limitations on the number of occupants allowed in a dwelling. HUD concluded that a "two occupants per bedroom" rule—taking other factors into consideration—constitutes a good basic model.

The law does not prohibit local regulations regarding the maximum number of persons allowed to occupy a dwelling. In 1991, HUD’s then-General Counsel Frank Keating issued a memo that provided a guideline: "... the Department believes that an occupancy policy of two persons in a bedroom, as a general rule, is reasonable under the Fair Housing Act .... However, the reasonableness of any occupancy policy is rebuttable..." and nothing "implies that the department will determine compliance with the Fair Housing Act based solely on the number of people permitted in each bedroom."

**Conduct Prohibited by the Federal Fair Housing Act**

The federal Fair Housing Act describes a number of illegal practices. We will cover these in greater detail in the next lesson, but we can examine them briefly here. They include the following actions when these are based on an individual’s membership in a protected class:
• Refusals to sell or rent
• Discrimination in terms, conditions, or privileges of sale
• Discrimination in advertising
• Denying availability
• Blockbusting and steering
• Denying availability
• Failure to make reasonable accommodations
• Lending discrimination and redlining

There are two discriminatory practices on this list that are not part of everyday language and which thus require special explanation: steering and blockbusting. As previously stated, both of these activities violate the federal Fair Housing Act, and people guilty of such activities—regardless of whether they intended the act or its effects—are held liable. The following screens will define these terms.

**Steering**

*Steering* is the practice of providing real estate advice or other real estate services in a manner that perpetuates segregated housing. All of the following constitute steering:

- Using an individual’s race, gender, or membership in any other protected class as the basis for one’s suggestion that a person live in a specific section of town.
- Using an individual’s membership in a protected class as the basis of one’s refusal to show housing in another section of town.
- Focusing one’s marketing effort in a narrow way that perpetuates the segregation of protected classes.

**Example:**

A Vietnamese family comes into Real Estate Licensee X’s office looking for a home. X knows of a good neighborhood with a substantial number of Vietnamese
residents, one he thinks the family would enjoy. He shows them only properties in that neighborhood. This is considered steering because he is directing the family away from other, less racially-segregated neighborhoods, and the licensee thereby works to perpetuate segregation. Notice that the licensee does not have any malicious intent here—he is not trying to deprive the family of anything nor does he hold any negative beliefs about them. He may actually think he is being helpful. It is still wrong for X to take this choice out of the family’s hands. They should be allowed to choose for themselves among the various properties he has available, regardless of location.

A real estate licensee should not let a client’s membership in a protected class influence the properties he or she shows that client—not even if the client specifically asks that she do so. For Example, if a prospective buyer expresses a wish to live in a Hispanic community, it is recommended that the real estate professional tell the client that he cannot take such factors into consideration, and respond by showing the client a range of listings meeting the client’s other, property-related specifications. The client is free to choose a Hispanic community if he or she so desires, but the real estate licensee can play no role in helping the client to identify or acquire segregated housing.

**Blockbusting**

*Blockbusting* refers to the practice of encouraging the panic selling of homes below market value, generally by raising fears that an influx of individuals belonging to a particular minority group will decrease property values in a neighborhood and affect the area negatively. Because it requires this kind of special effort, licensees are unlikely to engage in blockbusting accidentally and without malicious intent; nonetheless, they should remember that intent is not required for their acts to be a violation of the Fair Housing Act.

Blockbusting may also be referred to simply as *panic selling*. Those wishing to foster this panic selling often cite effects such as a decline in the quality of education and an
increased crime rate, even though there is no justification for making these claims. At its core, though, blockbusting is a profit-seeking practice that relies upon mistaken and discriminatory ideas about various protected classes, and uses these to induce people to engage in real estate transactions that are not in their best interests. As such, it violates the Fair Housing Act and encourages people in keeping their discriminatory beliefs. Real estate licensees have an obligation not to let their work or services be influenced by confused and harmful notions about members of the seven protected classes. Engaging in this kind of activity for profit is unethical and it is forbidden by the Fair Housing Act.

Transactions Not Covered by the Federal Fair Housing Act
The Fair Housing Act defines a dwelling as any building, structure, or portion of a building that is occupied as—or designed or intended for occupancy as—a residence by one or more families. The definition also includes any vacant land offered for sale or lease for the construction of a building, structure, or portion of a building that is intended to be occupied as a residence. This definition is important because the Fair Housing Act does not cover non-dwelling buildings. Therefore, the fair housing laws do not apply to commercial transactions unless those transactions include property that would be properly defined as a dwelling.

The federal Fair Housing Act is primarily intended to prohibit discrimination in the sale, rental, and advertisement of dwellings. Although commercial property transactions are not normally included under the Act, they are covered by other laws, such as the Americans with Disabilities Act.

Even in the case of dwellings, however, the federal Fair Housing Act does not cover all transactions. There are four general circumstances under which a dwelling is exempt from the federal Fair Housing Act. Licensees should remember that even though the federal law allows these exemptions, the laws of their state may not. In most states,
these exemptions do not apply if a real estate licensee is involved in the transaction, so licensees should also be aware that their participation in the process may negate the exemption.

**Single-Family Residences Sold by Owner**
The sale or rental of a single family residence is not bound by the Act, provided that:

- The property owner does not own or own any interest in more than three single-family residences at one time.
- In cases where the owner is not the most recent resident of the property being sold, that owner is only granted one exempt sale in any 24-month period.
- The owner does not use the facilities or services of a real estate licensee, broker, salesman, or anyone else engaged in the business of selling or renting dwellings.
- The owner does not use any discriminatory advertising.

For this exemption to apply, it is important that the person making the sale or arranging the rental not be in the business of selling or renting dwellings. This exemption applies only to those individuals who are incidentally selling their own property, not to people who are professional real estate dealers or investors. The Fair Housing Act judges a person to be in the business of selling or renting if:

- That person has within the preceding 12 months participated as principal in three or more transactions involving the sale or rental of any dwelling or any interest therein.
- That person has within the preceding 12 months participated as agent, other than in the sale of his own personal residence in providing sales or rental facilities or sales or rental services in two or more transactions involving the sale or rental of any dwelling or any interest therein.
- That person is the owner of any dwelling that is designed for or intended for occupancy by or occupied by five or more families.
Rental of Rooms or Units in Owner-Occupied Property
This law does not apply to the rental of rooms or units in a dwelling containing living quarters occupied or intended to be occupied by no more than four families living independently of each other if the owner actually occupies one of the living units as his residence.

Dwellings Belonging to Religious Organizations or Private Clubs
Nothing in the law prohibits a religious organization or private club from limiting the sale, rental, or occupancy of a dwelling that it owns or operates for other than commercial purposes to persons of the same religion or club. Private clubs may show preference to club members under similar circumstances.

Housing for Older Persons
Housing for older persons is also exempt from the requirements of the Fair Housing Act if one or more of the following three conditions apply:

1. The housing is occupied only by persons who are 62 years of age or older.
2. 80% of the housing units have at least one occupant who is 55 years old or older.
3. The housing is provided under any state or federal program that the Secretary of Housing and Urban Development determines is designed and operated to provide assistance to the elderly.

General Considerations
Unlike the federal Fair Housing Act, there are NO EXCEPTIONS to the Civil Rights Act of 1866. This means that you may NEVER turn away a qualified tenant or purchaser because of race or color; neither may you publish an advertisement that discriminates against someone on this basis. For Example, in the U.S. Supreme Court case Jones v. Mayer Co. (392 U.S. 409 [1968]), the refusal to sell a home because of the prospective buyer’s race was found to be a violation of the law. The court decided that the
defendant had violated the Thirteenth Amendment as well as 42 U.S. Code 1982, which provides that all citizens "shall have the same right, in every State and Territory, as is enjoyed by white citizens thereof to inherit, purchase, lease, sell, hold, and convey real and personal property."

It is often difficult to determine whether a specific property or transaction is exempt under the Fair Housing Act, or whether it is exempt from state and local legislation addressing similar issues. Because these cases are complex, any time someone thinks that a property or transaction might be exempt, it is very important to seek legal counsel.

**Lesson Summary**

The Fair Housing Act was passed in 1968 to prohibit unethical discrimination in real estate practices. Under the federal Fair Housing Act, there are seven protected classes: race, color, national origin, sex, familial status, religion, and handicap. To discriminate against someone in the sale or letting of residential real estate because of his or her membership in one of these seven protected classes violates federal law. Sometimes individual states and local jurisdictions, such as counties and cities, have legislation that establishes additional protected classes. Therefore, it is necessary for all licensees to review state laws and local ordinances regarding housing discrimination.

The federal Fair Housing Act prohibits more than just the refusal to sell or rent to an individual because of membership in a protected class. In addition, it forbids:

- Any discrimination in the terms, conditions or privileges of a sale or rental agreement
- Discrimination in advertising
- Denying availability
- Blockbusting (inducing panic selling) and steering (perpetuating segregated housing)
- Refusing to make reasonable accommodations for the disabled
- Discrimination in financing

Not all real estate transactions are covered by federal fair housing law. Exemptions include an owner’s sale of his or her own home, the rental of rooms or units in an owner-occupied dwelling, and housing for older persons. These exemptions do not apply if the owner uses a broker to manage real estate transactions involving the property, and there are never any permissible exemptions regarding the protected classes of race and color, which were established by the Civil Rights Act of 1866.
Lesson 23: Discrimination

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Defining Discrimination
- Discriminatory Conduct Prohibited by the Federal Fair Housing Act

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Recognize discrimination in real estate practice.

Introduction
Fair housing laws define *discrimination* as unfavorable or unfair treatment of a person or class because of race, sex, color, religion, national origin, familial status, or disability. The relative unfairness or otherwise detrimental character of the discriminatory treatment is judged by comparing the treatment of a given group or individual with the treatment of others who are not members of that same class. Note that this definition does not mention intent. This means that a real estate professional can be guilty of discriminatory practices even if he or she did not mean to discriminate.
This lesson will examine the meaning of discrimination. We will begin by exploring what constitutes discrimination. We will then outline the specific actions outlawed by the federal Fair Housing Act.

**Defining Discrimination**

Discrimination is the unfavorable or unfair treatment of a person or class of persons because of race, sex, color, religion, national origin, familial status, or disability. The relative unfairness or otherwise detrimental character of discriminatory treatment is judged by comparing the treatment of a given group or individual at issue with the treatment of others who are not members of that same class. This definition does not concern itself with whether a real estate professional *meant* to be discriminatory—the only issue is whether the licensee’s conduct had negative effects on access to fair housing that are plausibly explained in terms of a client or prospect’s membership in a protected class.

**Example:**

A real estate professional shows families with young children only properties in a certain area of town are near youth centers, schools, and hospitals. This licensee would effectively be discriminating against those families on the basis of familial status, because the licensee limits the properties he or she is willing to show them due to the clients' membership in a protected class. This is true despite the fact that the licensee had no discriminatory intent and most likely believes that she or he is looking out for her clients' best interests. Because the result is discriminatory—that is, because the clients are not presented with a full range of information that allows them to make their own choices and are thus essentially prevented from considering properties in other locations—the licensee’s conduct violates the federal Fair Housing Act. The real estate professional engaged in a
practice called “steering,” even if he or she did not mean to discriminate against anyone.

Interestingly, demonstrable discriminatory intent is not sufficient to establish discrimination legally. For example, suppose a city council must decide whether or not to pass a referendum permitting the construction of low-income housing. One city council member opposes the referendum for discriminatory reasons (perhaps his beliefs about the race or national origin of the prospective residents), but the council passes the referendum regardless. Since no discriminatory result came of the councilman’s intent, the council itself has not violated the federal Fair Housing Act. Thus when thinking about discrimination, we should remember that the action and its results are what truly matters. The intent behind the action is of secondary importance, at best.

This does not mean that any discriminatory result is necessarily a violation of the law. In the case Phillips v. Hunter Trails Community Association, the Seventh Circuit Court of Appeals identified the following criteria for evaluating a case of alleged discrimination:

- The strength of the plaintiff’s statistical showing—that is, the degree to which a practice or policy can be shown to have a statistically disparate impact on members of a protected class
- The legitimacy of the defendant’s interest in taking the action or maintaining the practice that is the object of the complaint—i.e., the extent to which the defendant can offer a plausible, non-discriminatory justification for this action or practice
- Some indication—which might be suggestive rather than conclusive—of discriminatory intent on the part of the defendant
- The extent to which relief could be obtained by limiting or prohibiting the defendant’s current practice, rather than requiring positive remedial measures of the defendant.
Discriminatory Conduct Prohibited by the Federal Fair Housing Act

In addition to the more general definition already given, federal fair housing laws describe specific behaviors and practices that violate the Act. They include:

- The refusal to sell or rent available properties
- Discriminating in terms, conditions or privileges connected with a sale or rental
- Discriminating in advertising
- Denying availability
- Failing to make reasonable accommodations for a tenant or prospective tenant's disability
- Redlining, blockbusting, and steering

**Refusals to Sell or Rent**
When a dwelling has genuinely been offered for sale—for Example, through advertising or the posting of notices—it is illegal to refuse to negotiate the sale or rental of that dwelling, or otherwise make it unavailable to a person, because of that person's membership in a protected class.

**Discrimination in Terms**
Changing the terms, conditions, or privileges of a sale or rental because of someone's membership in a protected class constitutes a violation of federal law. It is similarly illegal to use membership in a protected class to determine what services or facilities shall be made available to the individual in connection with the sale or rental of a dwelling. For Example, a landlord cannot legally charge an individual higher rent or require a larger deposit because of a tenant's membership in a protected class, nor can he demonstrate inequity in maintenance activities. Similarly, it is illegal for an owner to respond to a purchase offer differently simply because of the prospective buyer's membership in a protected class.
Discrimination in Advertising

Discriminatory advertising uses words, phrases, symbols, visual aids, or media in the advertising of real estate that may indicate the advertiser’s preference for or prejudice against members of a protected class. This type of advertising may result in discriminatory practices and is illegal. Because it is not always clear whether a symbol, phrase or choice of media indicates a discriminatory preference, the Department of Housing and Urban Development (HUD) has developed advertising guidelines to help real estate professionals avoid advertising that could be considered discriminatory. These guidelines will be discussed in a later lesson.

If a discriminatory advertisement is published, however, then both the writer and the publisher can be held liable. For Example, if Broker X writes a discriminatory advertisement published by Newspaper Y, then HUD can file a suit against both Broker X and Newspaper Y.

Denying Availability

It is unlawful for a real estate professional to willfully misrepresent a dwelling as unavailable for inspection, sale, or rental to a person because of that person’s membership in a protected class. That is, if a dwelling is in fact available, it is illegal for a licensee to knowingly say that it is not simply because of a client’s or prospect’s membership in a protected class.

Reasonable Accommodations

Under fair housing laws, the landlord must allow a disabled tenant to make reasonable accommodations at the tenant’s own expense. A reasonable accommodation is a modification that allows a handicapped person to enjoy his or her dwelling more fully, and which does not impose an undue financial or administrative burden on the landlord. As discussed previously, a person is considered disabled if she or he has a physical or mental impairment that substantially limits one or more of the major life activities of that individual, has a record of such an impairment, or is regarded as having such an impairment. Major life activities include walking, breathing, seeing, hearing, and caring
for one’s self. People who were previously addicted to illegal drugs, people who are present or former alcoholics, and people with AIDS can all be considered disabled if they have serious physical or mental impairments arising from these conditions.

A landlord cannot charge a higher security deposit for disabled tenants. If the tenant elects to modify the apartment in a way that renders it less usable for non-disabled tenants (for Example, if the tenant chooses to lower the kitchen counters), then the landlord may require that the disabled tenant deposit funds in an escrow account that are adequate to pay for returning the property to its original condition when the tenant moves out. The tenant will collect the interest from the fund if he or she arranges to have this work done satisfactorily, but the landlord will receive the interest if he or she has to pay to have this work done.

Reasonable accommodations can include modification of rules against pets (if the tenant has an assistive pet), designated handicapped parking (if parking is not normally assigned), and specially-printed rental applications and other materials if the tenant has difficulty reading small type. The basic criteria for reasonable accommodations claims are:

- The tenant has a disability, a history of disability, or is perceived to have a disability.
- The tenant has made a reasonable effort to alert the landlord of his or her disabled status and desire for accommodations.
- The proposed accommodations would not constitute an undue burden on the landlord or lead to a fundamental alteration of the dwelling.

Defining what counts as a “reasonable accommodation” must be done on a case-by-case basis. HUD has published guidelines providing technical assistance to homebuilders and landlords in this regard. These will be discussed in a later lesson.
Blockbusting and Steering
Previously, we discussed “steering” and “blockbusting”—two discriminatory acts that violate the federal Fair Housing Act:

- **Steering** is the practice of directing a person seeking to buy or rent a dwelling in a manner that perpetuates segregated housing.
- **Blockbusting** is the practice of encouraging the panic selling of homes below market value by raising fears that an influx of individuals who are members of a protected class will decrease property values and negatively affect the area.

Redlining
In addition to steering and blockbusting, federal fair housing legislation also prohibits unethical discrimination in lending. Specifically, the statutes outlaw certain practices that are called “redlining.”

Some lending institutions limit the number of loans or the loan-to-value ratio in certain areas of a community or city. This is redlining. If an institution practices redlining because of an individual or group’s membership in a protected class, then it violates both the federal Fair Housing Act and the Community Reinvestment Act.

The Fair Housing Act prohibits making race, color, national origin, religion, sex, familial status, or disability a condition of one’s willingness to engage in any of the following practices:

- Making a mortgage loan
- Providing information regarding loans
- Setting the terms or conditions of a loan, such as interest rates, points, or fees
- Appraising property
- Purchasing a loan or setting the terms or conditions for purchasing a loan
It is similarly illegal to make the outcomes of any of these practices contingent upon an individual’s race, color, national origin, religion, sex, familial status, or disability. Some state or local ordinances may prohibit redlining altogether, regardless of the motivation for the practice.

**Community Reinvestment Act**

As the name of the Community Reinvestment Act might suggest, redlining legislation aims not only at preventing unethical discrimination, but also at reversing the abandonment and decay of residential property. The Community Reinvestment Act, passed in 1977, requires lenders to assist their local communities by participating in community development projects. The Act also requires that lenders submit an annual statement including public comments about their attempts to help low-income communities.

**Home Mortgage Disclosure Act**

Unfortunately, enforcing the prohibition against redlining can be difficult. To help prevent discrimination in lending, Congress passed the Home Mortgage Disclosure Act in 1975. The Home Mortgage Disclosure Act requires lenders to disclose specific lending information, which HUD then uses to map lending patterns. In essence, lenders must now disclose how many loans they offer to specific communities, as well as the types of loans and the terms of those loans. This allows HUD to spot problematic lending patterns and helps support lawsuits or other disciplinary measures that HUD deems necessary.

In addition to HUD’s efforts to promote fairness in lending, the Office of Thrift Supervision (a bureau of the U.S. Treasury) also passed a regulation banning redlining. It states that lenders may not limit or refuse loans simply because of the age of a home or the average income in the area in which the person is purchasing a home. The practices prohibited by this regulation are effectively discriminatory because certain members of protected classes are statistically more likely to purchase older homes or homes located in lower-income areas.
Lesson Summary

Fair housing law defines discrimination as the unfavorable or unfair treatment of a person or class of persons because of race, sex, color, religion, national origin, familial status, and/or physical or mental disability. The relative unfairness or otherwise detrimental character of this treatment is judged by comparing it to the treatment of others who are not members of that class. The federal fair housing laws prohibit the following specific activities as discriminatory:

- The refusal to sell or rent, when this decision is based on a prospect’s membership in a protected class
- Inequity in the terms, conditions, or privileges of sale when these are based on a prospect’s membership in a protected class
- Advertising that implicitly or explicitly expresses a preference for or a prejudice against a protected class
- Denying availability, when this decision is based on a prospect’s membership in a protected class
- Blockbusting, steering, and redlining
- The failure to make or permit reasonable accommodations for someone’s disability
- Inequity in lending practices

Under federal law, you may not change the terms of a real estate agreement or your claims about the existence of available housing because of a prospective buyer or lessee’s membership in a protected class. And, in the case of a disability, landlords must make reasonable accommodations so that disabled persons can enjoy their properties. Accommodations may require legal, case-by-case consideration, but in general, an accommodation is reasonable if it does not cause undue financial or administrative burden on the landlord.

Some lending institutions limit the number of loans or the loan-to-value ratio in certain areas of a community or city. This is redlining. Redlining can be illegal when its effect is
unfavorable to at least one of the seven protected classes. If an institution makes redlining decisions on the basis of membership in a protected class, then it violates both the federal Fair Housing Act and the Community Reinvestment Act. In addition to HUD’s efforts to promote fairness in lending, the Office of Thrift Supervision (a bureau of the U.S. Treasury) also passed a regulation banning redlining. It states that lenders may not limit or refuse loans simply because of the age of a home or the average income in the area in which the person is purchasing a home.
Lesson 24: Additional Legal Protections to Prevent Discrimination

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Federal Equal Credit Opportunity Act (ECOA)
- Federal Americans with Disabilities Act

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Recognize the purpose of the federal Equal Credit Opportunity Act (ECOA) and know the classes it protects.
- Describe the purpose of the Americans with Disabilities Act (ADA).
- Outline how the ADA affects real estate practice.

Introduction
Aside from the Fair Housing Act, there are two other important federal Acts that protect individuals from discrimination in their efforts to procure housing: the federal Equal Credit Opportunity Act (ECOA) and the Americans with Disabilities Act (ADA).

This lesson will discuss these Acts, which are important pieces of non-discrimination legislation that licensees must understand. This lesson will begin by outlining the ECOA, covering both its scope and intent. It will then move on to cover the ADA. It is important to note that (unlike the federal Fair Housing Act) these Acts do not speak specifically to housing or residential properties. The ECOA also introduces different protected
classes—for Example, under this act, no lender may discriminate against a potential borrower because of the borrower’s age or the fact that the borrower receives money from public assistance programs. In addition, the ECOA protects against discrimination on the basis of marital status. This definition of *marital status* differs in important ways from the definition of *familial status* as established under the federal Fair Housing Act.

**Federal Equal Credit Opportunity Act (ECOA)**

Individuals seeking housing are granted additional protection against discrimination by the federal Equal Credit Opportunity Act (ECOA). The ECOA is Title VII of the Consumer Protection Act. It prohibits lenders from discriminating against credit applicants on the basis of their:

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

The definition of “marital status” set out in the ECOA differs in important ways from the definition of “familial status” established by the federal Fair Housing Act. Under the ECOA, lenders may not deny a loan to an individual merely because that person is divorced or widowed. Whereas the federal Fair Housing Act’s “familial status” protection focuses on the presence of children (dependants under the age of 18), the “marital status” protection afforded by the ECOA aims to prevent discrimination against people without spouses.
Lenders do, however, need to ask certain questions to ascertain whether or not a loan has a good chance of being repaid as agreed. Lenders are therefore entitled to ask questions concerning the type(s) and stability of the income submitted to support the loan application, as well as questions regarding the individual’s debts and on-going obligations, the quality of his or her credit history, and the source and amount of cash that the individual is investing in purchasing the home.

A lender may ask only questions that are relevant to an individual’s financial standing. This means that while asking if someone is divorced is inappropriate, asking if someone must pay alimony is acceptable. To get a better sense of the types of questions that are acceptable, please consider the following list:

- A lender may not ask if an applicant is divorced or widowed, but may ask if a borrower is married, unmarried or separated.
- The lender may not ask about the receipt of alimony or child support unless the borrower intends to use that money to qualify for the loan, but may ask if a borrower must pay alimony or child support.
- A lender may not ask about a borrower’s birth control or intentions for child-bearing.
- A lender may not ask about a borrower’s spouse unless that person will be involved in the contract.
- A lender may not discount or exclude any income because of the source of that income.
- A lender must report credit information on married couples separately in the name of each spouse.
- A lender may not ask about the applicant’s race or national origin.

Case Study
The ECOA may seem a little more complicated than the federal Fair Housing Act. To get a better sense of its implications, we will examine a case study. You will be
presented with two different situations. Given what we have covered here, try to pick out the situation that is in conformity with the requirements of the ECOA.

Which of the situations below is LEGAL?

**Situation 1:** A lender asks a loan applicant how much child support she, the applicant, is receiving, although she has stated that she doesn’t intend to use the money to qualify for the loan.

Incorrect. Under the ECOA, a lender may only ask about child support if the applicant intends to use that money to qualify for the loan. This means that the borrower would have to mention that she receives child support and would like it to be considered. If she doesn’t, then this information about her personal life is not relevant to the loan application process.

**Situation 2:** A lender asks about the credit of a loan applicant’s husband when the husband is a party to the loan application.

Correct. If an applicant’s spouse is named as a party to the loan application, the lender may ask about him or her. The lender is still required to submit any credit reporting information in the name of each individual. For Example, if the loan is granted and later paid in full, that fact must be reflected on each spouse’s credit report.

**Federal Americans with Disabilities Act**

In addition to protection under the federal Fair Housing Act, individuals with disabilities are protected under the Americans with Disabilities Act (ADA). The ADA is a federal law that serves to protect the civil rights of individuals with disabilities. While it is true that the ADA does not speak directly to housing issues, it does apply to the operation of most real estate offices and most commercial establishments.
A disability is defined as:

- A physical or mental impairment that substantially limits one or more of an individual’s major life activities
- A record of having such an impairment
- Being regarded as having such an impairment

The ADA addresses discrimination in four general areas:

1. **Employment:** Employers are required to provide reasonable accommodation to individuals with disabilities, and they may not discriminate against an individual with a disability when they are making decisions about hiring or promotions. Employers may ask about a potential hire’s ability to perform a job but cannot ask whether he or she has a disability or about the extent of that person’s disability.

2. **Public Transportation:** Buses and trains, as well as their stations, must be accessible to disabled persons.

3. **Public Accommodations and Commercial Facilities:** Reasonable modifications must be made to policies, practices, and procedures to avoid discrimination against the disabled in public areas. This means that physical barriers that interfere with the activities of disabled persons must be removed. All new construction and alterations of facilities must be compatible with making those facilities accessible to the disabled.

4. **Telecommunications:** Companies offering telephone service must offer telephone relay services to allow communications access for people with speech and hearing impairments.
Businesses and other Establishments Affected by the Americans with Disabilities Act

The ADA affects a wide array of businesses and establishments, both public and private. The following list enumerates businesses and establishments affected by the ADA:

- Businesses with 15 or more employees
- Any facilities or offices affiliated with state or local government
- Public and private schools
- Hospitals and dental offices
- Restaurants
- Hotels and motels
- Grocery and retail stores
- Shopping malls
- Libraries and museums
- Banks
- Theaters
- Amusement and recreation parks

Learn more:

The Access Board (also known as the Architectural and Transportation Barriers Compliance Board) a federal organization that issues guidelines to ensure that buildings, facilities and transit vehicles are accessible and usable by people with disabilities. You can find them online here: [http://www.access-board.gov/](http://www.access-board.gov/).

You can Learn more about the scope of the ADA from the U.S. Department of Labor online at: [http://www.dol.gov/dol/topic/disability/ada.htm](http://www.dol.gov/dol/topic/disability/ada.htm).
How the ADA Affects the Real Estate Industry

The most noticeable effects of the ADA are on the operations and construction of real estate brokerages and on broker representation in transactions involving commercial property.

Many brokerages fall within the scope of the ADA, either because of their location (perhaps in a mall or other retail facility, which is bound to follow the requirements of the ADA) or because the brokerage has 15 or more employees. This means that, while every brokerage should work to protect and honor the rights of disabled Americans, brokerages in locations that fall under ADA guidelines and brokerages with at least 15 employees must be especially certain to fulfill the legal obligations that the ADA imposes upon them. Such brokerages will need to make any physical modifications that are necessary for the office accessible to a person with a disability. In addition, the brokerage may need to make other reasonable accommodations, such as providing note takers, Braille documents, assistive listening devices, or interpreters.

It is important to remember, however, that even if the ADA does not apply to a specific brokerage, the licensees who work there are still bound by the Fair Housing Act. This means that even licensees working at brokerages with fewer than 15 employees must make every effort to provide fair housing access for potential clients and customers with disabilities. Any brokerage with questions about its office’s accessibility or general compliance should seek legal counsel.

Informing Commercial Clients about the ADA

Any commercial real estate that a licensee shows to a potential buyer, customer or buyer-client will most likely fall within the scope of the ADA’s requirements. This means that the licensee should inform the client or customer that these ADA requirements apply to the property. If the space does not already comply with ADA accessibility requirements, then the finish-out (i.e., the adaptation of a space for owner or tenant’s use) must include any alterations necessary to ensure that the space is accessible and complies with ADA standards.
Fair Housing Accessibility Guidelines

The Americans with Disabilities Act prohibits discrimination against the disabled, and Title VIII of the Civil Rights Act of 1968 protects the disabled from unfair housing practices. The Department of Housing and Urban Development recognized the need for clear and measurable standards to determine compliance with these Acts. Consequently, it adopted the Fair Housing Accessibility Guidelines. These guidelines provide technical directions for satisfying specific accessibility requirements.

Establishing a specific definition for the term “reasonable” in the phrase “reasonable accommodations” did lead to a degree of controversy. In an effort to resolve this disagreement equitably, HUD enlisted the help from the Southern Building Code Congress International, National Association of Home Builders, and National Coordinating Council on Spinal Cord Injuries. These organizations developed a series of proposals defining the phrase “reasonable accommodation,” which were subsequently published in June of 1990 for public comment. The public seemed to favor one proposal in particular, which is now commonly referred to as Option One. Option One became the basis for HUD’s final accessibility guidelines. Compliance with HUD’s Fair Housing Accessibility Guidelines is not mandatory. It is, however, a way to help ensure the equitable treatment of all potential clients and customers; compliance can also provide evidence of non-discrimination in the event of a lawsuit.

Details of the Accessibility Guidelines

The Accessibility Guidelines only apply to covered multifamily dwellings, which are defined by the Fair Housing Act as “buildings consisting of four or more dwelling units if such buildings have one or more elevators, and ground floor dwelling units in other buildings consisting of four or more units.” The guidelines ask landlords to ensure that:

- Public use and common use portions of the dwellings are readily accessible to and usable by persons with handicaps
- All doors within such dwellings that are designed to allow passage into and within the premises are sufficiently wide to allow passage by persons in wheelchairs
• All premises within such dwellings include the following features of adaptive design:
  o An accessible route into and through the dwelling
  o Light switches, electrical outlets, thermostats, and other environmental controls in accessible locations
  o Reinforcements in bathroom walls to allow later installation of grab bars
  o Usable kitchens and bathrooms that can be navigated by an individual in a wheelchair

Learn more:
You can Learn more about these Accessibility Guidelines from the federal Access Board (also known as the Architectural and Transportation Barriers Compliance Board), which can be found online here: http://www.access-board.gov/.

Compliance with these guidelines is not mandatory. Builders and developers may choose to depart from the Guidelines, and seek alternate ways to meet the legal requirements of the ADA while maintaining the spirit of the Act and other anti-discrimination legislation.

Lesson Summary
Aside from the Fair Housing Act, there are two other important federal Acts that protect individuals from discrimination in their efforts to procure housing: the federal Equal Credit Opportunity Act (ECOA) and the Americans with Disabilities Act (ADA).

The ECOA is Title VII of the Consumer Protection Act; it prohibits lenders from discriminating against credit applicants on the basis of their race, color, religion, national origin, sex, marital status, age or dependence on public assistance programs. Under the ECOA, a lender:
May not ask if an applicant is divorced or widowed, but may ask if a borrower is married, unmarried or separated

May not ask about the receipt of alimony or child support unless the borrower intends to use that money to qualify for the loan, but may ask if a borrower must pay alimony or child support

May not ask about a borrower’s birth control or intentions for child-bearing

May not ask about a borrower’s spouse unless that person will be involved in the contract

May not discount or exclude any income because of the source of that income

Must report credit information on married couples separately in the name of each spouse

May not ask about the applicant’s race or national origin.

The ADA is a federal law that serves to protect the civil rights of individuals with disabilities. The ADA addresses discrimination in employment, public services, public accommodations and commercial facilities and telecommunications. Under the ADA, most commercial real estate, as well as all government offices and facilities, must be assessable to disabled persons.

Specifically, the ADA requires that all of the following be made readily accessible to disabled persons:

- Businesses with 15 or more employees
- State and local government offices
- Public and private schools
- Hospitals and dental offices
- Restaurants, hotels, and motels
- Grocery and retail stores
- Shopping malls
- Libraries and museums
- Banks, theaters and amusement, and recreation parks
These broad requirements mean that if a real estate licensee is assisting or otherwise representing a commercial buyer, buyer-client or customer, then the licensee should tell the customer that the finish-out (i.e., the adaptation of a space for owner or tenant’s use) must include any alterations necessary to ensure that the space is accessible and otherwise in compliance with ADA regulations. To assist homebuilders and landlords in constructing accessible dwellings and updating older dwellings, HUD has published Accessibility Guidelines.
Lesson 25: Enforcement of Fair Housing Laws

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Fair Housing Complaints
- Conciliation
- Penalties and Civil Proceedings

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Describe how fair housing complaints are handled.
- List the penalties for non-compliance with fair housing laws.

Introduction
Members of the public who feel that they have been or are being discriminated against may file suit with HUD. Within 100 days of receiving a complaint, HUD must notify the complainant as to whether it intends to act on the complaint. There are a variety of ways that HUD can handle a particular dispute, including informal negotiations and legal proceedings. The penalties arising from a lawsuit can be extremely stiff. This lesson will outline the specific ways that HUD handles complaints, as well as the use and significance of informal negations, or conciliation, as well as the penalties for non-compliance.
Both the person who files a complaint and the individual who is charged with the violation have the right to ask that the matter be resolved by a civil action, rather than an administrative proceeding. The last section of this lesson will outline the role of civil proceedings in fair housing complaints as well as the role of the Attorney General.

**Fair Housing Complaints**

The Secretary of the Department of Housing and Urban Development is in charge of enforcing fair housing law. HUD can initiate action against licensees who violate fair housing law even if a member of the public does not make a complaint. Any person who believes that he or she has been injured by the discriminatory practices of a real estate licensee, or who believes that he or she is being or will be injured, may file a complaint with HUD. Complaints must be in writing and must contain the specific information that HUD requires, such as the date of the incident, its location, the name(s) of the party or parties involved and other pertinent details. All complaints must be filed with HUD within one year of the date that the alleged act of discrimination took place.

HUD investigates some complaints by using what they call “testers.” These are sets of people who are members of various groups—some legally protected, some not—who employ the services of a business. The goal here is to determine whether that business treats the members of different groups in a fair and approximately equal way. For Example, suppose someone files a fair housing complaint alleging religious discrimination: a Jewish family has complained that a real estate licensee only showed them properties near synagogues, even though they had expressed no interest in living near a synagogue. When they asked to see properties in other areas, they were told that the properties they were being shown were those that best fit their needs. The tester in this situation would likely be a non-Jewish family whose housing requirements and qualifications are quite similar to those of the Jewish family. The testers would be sent to the same real estate office. If the non-Jewish family were then shown properties that were not near synagogues, the results of the testing would incriminate the real estate office.
Self-Testing
In the 1997 Omnibus Appropriations Act, Congress established “a privilege for lender-initiated self-tests of residential real estate related to lending transactions” as part of their efforts to ensure fair lending practices. In essence, this privilege allows lenders to conduct self-tests to evaluate their lending practices. If they find discriminatory practices in their business, then they are allowed to remedy these without federal lawsuits. This Act encourages lenders to be critical about their lending practices and to engage in self-testing, which will ideally lead to more equitable lending practices.

Complaints Requiring Immediate Action
Sometimes, when discriminatory action requires an immediate solution HUD will attempt to establish a temporary solution to the complaint while it works on completing a full investigation. HUD may also ask the Attorney General to handle the suit in court to obtain temporary or preliminary relief. A fair housing complaint that requires immediate action meets the following conditions:

- Irreparable harm will more than likely result without immediate action.
- Substantial, compelling evidence exists that indicates a violation of the fair housing laws.

Given the potential for serious harm and clear indication of illegal activity, you can see why these cases would merit immediate action.

For Example: A tenant is scheduled to move out of her current apartment and into a new apartment. She has submitted her application paperwork electronically and has not yet met the landlord in person, although she has been approved for the apartment. One day she stops by the apartment building with a friend and meets the landlord of the building. The landlord decides that this new tenant looks to be of Middle Eastern descent and feels that he would prefer that there were no Middle Eastern individuals in his building. He revokes the tenant’s lease contract. The tenant’s old lease is up, and
she must vacate her previous apartment. If the landlord does not let her move in, then the tenant may not have a residence.

In this situation, time is of the essence. Consequently, HUD might pass the case on to the Attorney General for immediate attention while it files a complete investigatory report.

**Complaint Referrals**

Depending on state and local laws, there may be other venues—in addition to HUD—in which fair housing cases can be filed; in some cases, multiple venues may have jurisdiction over one case. In other words, a real estate licensee may be subject to more than one legal action for any one act of alleged discrimination.

If HUD determines that a state or local agency in the area of the complainant is “substantially equivalent” in powers to HUD, then it will refer the case to the agency for investigation, and notify the complainant of the referral. If the agency does not take action within a 30-day period, then HUD may take back the case.

**Conciliation**

Within 100 days of receiving any complaint, HUD must notify a complainant as to whether it intends to act on the complaint. In addition to full legal proceedings, HUD may also use informal conferences to resolve complaints as well as issues that arise over the course of an investigation.

Sometimes complaints may be the result of a simple misunderstanding, or an investigation may reveal issues that require additional clarification. If HUD believes this is the case, then it can hold an informal meeting to help resolve the issue. In the federal Fair Housing Act this type of informal conference is referred to as *conciliation*. 
Conciliation is an attempt to resolve the issues raised by a complaint or an investigation through informal negotiations between the aggrieved person, the respondent, and the HUD Secretary. With the exception of actual, written agreements that may result from conciliation, nothing said during the course of informal conferences may be made public or used as evidence in subsequent proceedings without the written consent of all parties concerned.

The respondent and the complainant can reach agreement during conciliation. For any such conciliation agreement to be binding both parties must accept it; the agreement may also be subject to the HUD Secretary’s approval. Such agreements must be made public unless there is an agreement to the contrary that is accepted by both the respondent and the complainant.

If a complainant feels that his or her complaint has not been handled properly, then the complainant may seek civil proceedings to resolve the issue. The complainant has this option following conciliation as well. For Example, if a conciliation process leads HUD to conclude that dismissal is the best way to handle a case, but the complainant still feels that discrimination occurred, then the complainant may take the issue to the civil courts.

Penalties and Civil Proceedings

If HUD determines that a discriminatory practice has occurred or is in the process of occurring, then it can order an administrative hearing on the charges. If an administrative hearing takes place and concludes that there has been a violation of fair housing law, then the person or group who violated the law can be ordered to:

- Compensate the complainant for actual damages, including humiliation, pain, and suffering.
- Provide injunctive or other equitable relief, for Example, making the housing available to the complainant.
- Pay the Federal Government a civil penalty. The maximum penalties are $10,000
for a first violation and $50,000 for a subsequent violation within seven years.

- Pay reasonable attorney's fees and costs.

In addition, if the person charged with the violation is licensed, then the licensing agency must be notified of the decision.

**Civil Action**

Both the complainant and the individual charged with the violation have the right to resolve the matter by a civil action, rather than an administrative proceeding. If the person being charged elects to have the matter resolved by a civil action, then HUD will request that the lawsuit be filed by the Attorney General. The court in such a civil action has the authority to assess sizeable financial penalties, which can also include reparations and relief, court costs, and attorney’s fees.

In any civil action, the burden of proof is on the person making the complaint. In order to have a legal basis for a case, a complainant must show that:

- He or she is a member of a protected class.
- He or she applied for and was qualified to rent or purchase the property but was rejected.
- The property remained available after the rejection—i.e., the property was rented or sold to someone else after it was denied to the qualified person making the complaint.

**Lesson Summary**

The Secretary of the Department of Housing and Urban Development (HUD) is charged with enforcing fair housing laws. Any person who believes that he or she has been or is being injured by a real estate licensee’s discriminatory practice may file a complaint with HUD.
Within 100 days of receiving a complaint, HUD must notify a complainant as to whether it intends to act on the complaint. HUD has the power to order administrative hearings and penalties if it determines that a discriminatory practice has occurred or is in the process of occurring. The maximum penalties that can be imposed are $10,000 for a first violation and $50,000 for a third violation within seven years.

Both the party making the accusation of discrimination and the accused party have the right to resolve the matter in a civil proceeding if they so choose. In a civil action, the burden of proof rests with the complainant. If the person being charged elects to have the matter resolved by a civil action, then HUD will request that the lawsuit be filed by the Attorney General.
Lesson 26: Avoiding Discriminatory Practices

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- General Recommendations
- HUD Advertising Guidelines

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- List various ways a broker might incorporate business practices designed to prevent discriminatory practices.
- Explain the purpose and importance of the HUD/NAR Partnership.
- State the basic principle that should guide licensees in following HUD’s Advertising Guidelines.
- Identify acceptable and unacceptable words and phrases for use in advertisements.
- Describe how to apply the practices that help a licensee show that he or she does not discriminate.

Introduction
This lesson will outline ways that real estate licensees can adhere to both the letter and spirit of federal fair housing legislation. Initially, it will discuss general practices that can help licensees to provide their services in a fair and effective manner. The lesson also covers one professional organization that real estate licensees can join, the National Association of REALTORS®, which works for equity in real estate practices. The lesson
will go on to address common advertising concerns, detailing specifically the types of words and phrases that real estate licensees must avoid in their marketing materials.

In addition to discussing these more specific issues, the last screens of this lesson will go over ways that licensees can publicize their dedication to fair housing and their active commitment to HUD’s various programs and recommendations.

General Recommendations

In order to avoid violating federal fair housing guidelines, it is important that real estate professionals familiarize themselves with the law. A licensee should:

- Be sure that he or she discusses potential sources of conflict with the parties involved—for Example, if a seller client wants his house shown only to members of a particular group, the licensee should inform this seller that she cannot help him to do this nor can she do it for him.
- Never conduct business with individuals who are unwilling to comply with the law.
- Be careful to treat all parties involved in a transaction equally.
- Develop a system of working with buyers (or tenants) that delivers equal professional service to all buyers (or tenants)—that is, the licensee should develop a general approach used with everyone and tailor services only to individuals’ particular housing needs, not to their class membership.
- Develop a system of working with sellers (or landlords) that delivers equal professional service to all sellers (or landlords)—as above, the objective here is a general approach that guarantees everyone the same treatment regardless of their class membership.
- Never use protected classes as a basis for advising a prospect—in a positive or negative way—about renting or buying a property.
• Take fair housing courses annually to ensure awareness of all current and new laws.
• Be positive! The licensee should not merely comply with the law and HUD guidelines—she or he should go beyond this and figure out new and different ways to make the most comprehensive housing opportunities available to the greatest number of people.

Being positive and actively helping all kinds of people is easy. For Example, if a licensee lives in an area that features a wide variety of nationalities and spoken languages, then he or she could contact local organizations, churches, and government services to find translators and interpreters to aid in assisting prospective tenants who do not speak English. This would be a proactive approach that demonstrates a licensee’s desire to provide housing to a wide range of people regardless of their class membership.

It is also important that all licensees develop a reasonably uniform system for assisting buyers/lessees and sellers/lessors that treats everyone fairly. The next screen will go over what such a system might entail. We will first cover buyers and lessees, and then move on to sellers and lessors.

**Systems for Assisting Buyers and Tenants**

A system that aims to provide equitable professional service when working with buyers or tenants may include:

• A standard way of welcoming buyers and tenants to the office—perhaps by offering each person a cup of coffee or glass of water.
• A standard way of discussing the agency relationship and the agency options available to buyers and tenants.
• A standard set of questions to discover what services a buyer or tenant is looking for from a representative.
A standard set of questions used to discover a buyer or tenant’s housing wants and needs, as well as his or her ability to purchase or rent.

A standard way of selling the services available through the real estate professional and his or her company.

A standard way of asking whether a buyer or tenant will allow the licensee to represent him or her.

A standard procedure for selecting appropriate properties to show.

A standard procedure for showing property.

A standard procedure for closing the sale.

A standard procedure for following up with buyers and tenants during the escrow process.

A standard procedure for following up after the sale and asking for referrals.

**Systems for Assisting Sellers and Landlords**

A system that aims to provide equitable professional service when working with sellers and landlords may include:

- A standard way of welcoming sellers and landlords to the office, perhaps by offering each person a cup of coffee or glass of water. Or, if meeting a seller or landlord at a home or property, an equitable general system should include a standard way to greet the person and express the desire to discuss his or her real estate needs.

- A standard way of discussing the agency relationship and the agency options available to sellers and landlords.

- A standard set of questions posed to each seller or landlord to discover his or her motivation for selling or leasing a property.

- A standard set of questions used to discover what services the seller or landlord seeks from an agency.

- A standard way of tailoring services to the seller or landlord’s expressed desires and goals, provided that those desires and goals are lawful and within the scope of the company’s services.
• A standard way of presenting the services that the real estate licensee and company can offer to the seller or landlord in response to his or her express wishes.
• A standard way to present the market analysis and the seller or landlord’s net sheet.
• A standard way to ask for the listing.
• A standard way to follow up on the marketing plan presented in the listing presentation.
• A standard way of communicating activity to the seller or landlord.
• A standard way of preparing to present offers in a timely manner.
• A standard way of following up on transaction details while properties are in escrow.
• A standard way of following up with sellers or landlords.
• A standard way of asking for referrals.

**Importance of a General System**

The point here is not that compliance with fair housing laws requires all licensees to adopt a contrived script that they use in a mechanical way in every market, with every client. Any system of equitable professional service will be unique to its market and will reflect the services offered by the real estate licensee and his or her company. The guiding principle in any non-discrimination measures enacted by a real estate business should be: Treat everyone similarly.

The important thing is to have a system that gives equitable service to all people regardless of their race, sex, color, religion, national origin, familial status, or disability. This type of system will keep a real estate professional from overlooking important details. Perhaps more importantly, it will also prevent the licensee from making assumptions about what clients want, what they can understand, or what they can afford. These assumptions—even when well-intentioned—prevent a licensee from truly understanding what clients are seeking, and thus prevent real estate professionals from
providing the best service they can. In addition, these assumptions can also lay the groundwork for discrimination lawsuits.

The HUD/NAR Partnership

One way that real estate licensees can help to ensure non-discrimination is by joining a professional organization that supports equality and fair housing practices in the real estate industry. One such professional organization is the National Association of REALTORS®, or NAR.

The National Association of REALTORS® and the U.S. Department of Housing and Urban Development (HUD) have entered into a partnership to show that both entities are committed to fair housing principles and will use their collective resources to ensure that this commitment is demonstrated in practice. This partnership is important because it allows the two organizations to benefit from one another’s areas of expertise.

There are four specific goals that guide this partnership. They are:

1. Sharing the responsibility for fair housing compliance
2. Identifying fair housing issues and concerns
3. Developing strategies for addressing fair housing issues and concerns
4. Evaluating the success of attempts to resolve fair housing issues and concerns

HUD Advertising Guidelines

To assist real estate licensees in their efforts to comply with fair housing laws, HUD has established certain advertising guidelines. In real estate advertising, the selective use of words, phrases, symbols, visual aids, and particular media may indicate (or appear to indicate) an advertiser’s preference for or prejudice against members of various protected classes, and may thus result in discriminatory advertising. For Example, if a broker’s advertisements contain words in that could reasonably be construed as
discriminating against the members of a protected class, this advertisement is likely to lead to charges of violating the law. Under the Fair Housing Act, those who publish discriminatory advertising, such as newspapers, can also be held legally liable and be charged with violations of the law.

The fundamental principle that should guide real estate licensees when advertising is: **Describe the property, not the people.**

For Example, a licensee may be thinking about publishing the following ad:

*1 BR/ 1BA Non-smoking white couples preferred. Contact Al 555-7349.*

The underlying problem with this ad is that it describes the type of people to whom the landlord wishes to rent rather than the property itself. “Couples preferred” discriminates on the basis of familial status, and “white” discriminates on the basis of race. This is not only wrong, but is also prohibited by the Civil Rights Act of 1968.

Avoiding unethical discrimination in advertising will not only thwart many a lawsuit, but it’s helpful in selling housing, too! Notice that this problematic advertisement mentioned very few of the property’s features and none of its distinctive qualities, thus giving the reader little reason to want to view it.

Now consider a revised version of the same advertisement:

*1 BR/ 1 BA Cozy, wood flooring. AC/ heat. New windows. Contact Al 555-7349.*

This revision both avoids unethical discrimination and provides a much more effective description of the property. It gives the reader reasons to want to view and perhaps even rent the property.
Liability for Discriminatory Advertisements

HUD has taken the position that newspapers incur liability for publishing advertisements that violate the Fair Housing Act. As a result, many newspapers across the country have created lists specifying acceptable and unacceptable language for advertisements.

In 1995, Roberta Achtenberg (then the Assistant Secretary for Fair Housing and Equal Opportunity) wrote a memorandum that provides specific guidelines for housing advertisements. This document gives specific details about what kind of language should be used to ensure non-discrimination against all seven protected classes.

**Learn more:**

The rest of this section outlines Achtenberg’s memo, but if you would like to view that memo in its entirety, the National Fair Housing Advocate makes it available online:


**Fair Housing Language**

The language in the list of acceptable and unacceptable language provided through the link below is intended merely as Examples. Newspapers in your area may have adopted language standards of their own.

<table>
<thead>
<tr>
<th>Acceptable Words and Phrases</th>
<th>Unacceptable Words and Phrases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bachelor apartment</td>
<td>Adults only</td>
</tr>
<tr>
<td>Close to downtown</td>
<td>Black</td>
</tr>
<tr>
<td>Den</td>
<td>Blind</td>
</tr>
<tr>
<td>Family room</td>
<td>Catholic Church</td>
</tr>
<tr>
<td>Near</td>
<td>Christian</td>
</tr>
<tr>
<td>No smoking</td>
<td>Couple (including “couple preferred,” “couples only,” and similar phrases)</td>
</tr>
<tr>
<td>------------</td>
<td>--------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Sober</td>
<td>Ethnic landmarks</td>
</tr>
<tr>
<td>Fourth-floor walk-up</td>
<td>Family (including the phrase “great for families”)</td>
</tr>
<tr>
<td>Walk to bus stop</td>
<td>Handicap limitations/not suitable for handicapped</td>
</tr>
<tr>
<td>Wheelchair ramp</td>
<td>Jewish</td>
</tr>
<tr>
<td>Number of bedrooms</td>
<td>Male</td>
</tr>
<tr>
<td>Master bedroom</td>
<td>Man</td>
</tr>
<tr>
<td>Mother-in-law apartment</td>
<td>Mentally handicapped</td>
</tr>
<tr>
<td>School district</td>
<td>Mentally ill</td>
</tr>
<tr>
<td>Schools</td>
<td>Mentally retarded</td>
</tr>
<tr>
<td>Play area</td>
<td>Mormon Temple</td>
</tr>
<tr>
<td>One apartment</td>
<td>No members of group X—for Example, the phrase “No Irish need apply”</td>
</tr>
<tr>
<td>Privacy</td>
<td>No children</td>
</tr>
<tr>
<td>Secluded</td>
<td>No wheelchairs</td>
</tr>
<tr>
<td>Security provided</td>
<td>One child</td>
</tr>
<tr>
<td>Seniors (if certified by HUD as senior housing)</td>
<td>Oriental</td>
</tr>
<tr>
<td>Square feet</td>
<td>Private</td>
</tr>
<tr>
<td>Townhouse</td>
<td>Race</td>
</tr>
<tr>
<td>Traditional (style of home)—for Example, “traditional Victorian”</td>
<td>White family home</td>
</tr>
</tbody>
</table>
Fair Housing in Real Estate Advertising

In addition, advertisements should avoid words like “private,” “exclusive,” and “integrated,” which may indicate the advertiser’s preferences and imply certain things about the community’s economic or ethnic make-up. It is also important to avoid referencing racial, cultural, religious or ethnic monuments, museums or landmarks, because these references can be taken to imply that only certain people are welcome in that location. For Example, an advertisement mentioning a specific religious venue might be taken to suggest that only those who participate in that religion should contact the advertiser, or to indicate that the advertiser has a preference for those who are involved in that religion.

Colloquialisms and regional phrases that may convey discriminatory preferences do not generally lend themselves to statewide or nationwide lists. Consequently, brokers should familiarize themselves with local and emerging terminology that might be interpreted as discriminatory and avoid such language in their advertising.

Other Advertising Considerations

Even if the language used in real estate advertising does not convey a discriminatory preference, the selective use of particular media or models still can. For Example, if the cast of an advertisement lacks diversity or the advertisement uses different models depending on the community in which the advertisement is to be displayed, these practices can be discriminatory. Consider the following Example:

Broker X runs two ads in two different sections of town, Y-ville and Z-burg. In Y-ville, his advertisement uses models of various ethnic backgrounds; in Z-burg, his advertisement uses a racially homogenous cast.
The discrepancies between X’s advertisements are suspect. The advertisement without diverse models may illustrate a preference for the class of persons represented, effectively discriminating against all others. Even if this is not Broker X’s intent, his advertisement may still be interpreted this way, by both the law and his potential clients. When planning an advertising campaign featuring pictures of buyers and sellers, it is important to consider the diversity of the people shown in the campaign and to commit to using diverse casts consistently.

There are numerous other ways that advertisements can discriminate. For Example, some advertisements discriminate against people because of a broker’s practice of making listings accessible in only one language. Consider the following Example:

Broker X works in an area where English is not the primary language of many residents. Although several bilingual publications are printed in the area, the broker advertises his listings only in publications that are printed in English.

Because Broker X works in an area that has a large non-English-speaking population but advertises his listings only in English-language publications, Broker X may be (or may be viewed as) favoring English-speaking applicants, effectively discriminating against all non-English speaking individuals.

**Equal Housing Opportunity Logo and Poster**

One way licensees can indicate their dedication to fair housing practices is by including the Equal Housing Opportunity logo on everything they distribute. According to one recent study, however, only 16% of real estate licensees display the Equal Housing Opportunity logo on their business cards.

HUD’s fair housing regulations require real estate licensees who market dwellings to display a fair housing poster in the broker’s place of business. Brokers can get these posters from any HUD office. The poster describes the basic fair housing practices and tells people how to register a complaint if they feel they have been discriminated
against. The fair housing poster must be prominently displayed so that it may be easily seen by any person seeking to engage a broker’s services.

**Learn more:**

The National Fair Housing Advocate offers a description of HUD’s mandated fair housing poster online:


Although the law requires brokers to display this poster, there is no specific penalty simply for failing to do so. The legislation does note that failure to display the poster is taken to be presumptive evidence of discriminatory housing practices, so it is truly important that brokers comply with this law. A broker who features the Equal Housing Opportunity logo prominently in all publications and displays this poster is in a better position to defend against discrimination lawsuits than one who does not.

**Lesson Summary**

This lesson outlined ways that real estate licensees can adhere to both the letter and spirit of federal fair housing legislation. In particular, it focused on ways that licensees can avoid discriminatory advertisements and demonstrate their dedication to fair housing to their potential clients and customers.

In general, developing a standard way of addressing, meeting, and greeting all potential clients and customers—both in person and on the phone—will help you avoid accidental discrimination. Similarly, it is important to develop a standard battery of questions that are asked of all buyers and lessors (or all sellers and landlords) to help identify their needs and goals. This is a good idea because it will help ensure that the licensee’s assumptions are not mistaken for facts about the client and that these assumptions do not lead the licensee into accidental discrimination. In addition, a generalized approach
helps a licensee to provide the same degree and quality of customer service to all clients.

One way that a real estate licensee can evidence non-discrimination is by joining a professional organization that works to promote fair housing. One such organization is the National Association of REALTORS®. In fact, the National Association of REALTORS® and the U.S. Department of Housing and Urban Development (HUD) have entered into a partnership, with the goal of making fair housing more accessible. Together, HUD and NAR hope to share the responsibilities associated with fair housing compliance, to identify fair housing issues and concerns, to develop strategies for addressing these issues and concerns and to evaluate the success of these endeavors.

Brokers must be especially careful in their advertisements. In addition to discriminatory statements, HUD will also prosecute those persons who exploit language barriers, models or particular media to illustrate an unethical and unfair preference. If a discriminatory ad is published, then both the writer and the publisher (for Example, the newspaper or magazine) can be held responsible. Avoiding discriminatory advertising is easy! Just remember: Describe the property, not the people.
Lesson 27: Real World Practice

Lesson Topics
This lesson focuses on the following topics:

- Real World Practice
- Case Studies

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Identity violations of the fair housing law in scenarios.
- Explain why certain actions violate the fair housing laws in case study scenarios.

Real World Practice
We have covered a lot of detailed information in a relatively short time. To help ensure your comprehensive understanding of the material presented in this module, the content has been integrated into a series of broad questions and case studies.

Practice Questions
Which of the following situations is ILLEGAL under the Equal Credit Opportunity Act?

Situation 1: Lender A is evaluating applicant B for a loan. A asks B whether or not B has any obligations to pay alimony or child support.

- It is legal for a lender to ask a prospective borrower about any obligations to pay alimony or child support because these obligations affect the prospective borrower’s financial standing and ability to repay the loan. It is illegal for a lender
to ask whether a prospective borrower RECEIVES alimony or child support unless the prospective borrower has stated an intention to use that money to qualify for the loan.

**Situation 2:** Lender C is evaluating applicant D for a loan. C asks D whether or not D is divorced.

- The lender may ask if the borrower is married, unmarried or separated, but may not ask if the applicant is divorced or widowed.

Which “tester” situation provides evidence of ILLEGAL discriminatory practices?

**Situation 1:** HUD receives a complaint of racial discrimination from a client of a real estate business. In response, HUD sends eight testers to visit the business, four of them African-American and four of them Caucasian. All of them have similar financial qualifications and housing requirements. The business tells the four African-American testers that they have no listings that meet their needs, but shows the four Caucasian testers available properties.

- Because persons of one ethnicity/color are turned away while persons of a different ethnicity/color are not, HUD’s testing process has provided strong evidence that discrimination is occurring.

**Situation 2:** HUD receives a complaint stating that an apartment complex discriminated against a person because of the person’s disability. HUD sends four testers to view the complex, all of whom have similar qualifications and requirements. Three of the testers have physical disabilities that the landlord will likely notice, the other does not. The landlord shows all four testers the same available units.

- Because the landlord showed all of the testers the same units regardless of whether the person was visibly disabled, it is unlikely that the landlord is
discriminating based on disability. If HUD believes that further investigation is necessary, then it can continue looking into the matter—that is, the fact that the landlord “passed” this test does not mean that HUD’s investigation of the complaint is over.

Which of the following advertisements is UNACCEPTABLE?

Advertisement 1: 2br/1ba apt /Berber carpet/ close to downtown/ no smoking

- All of the words and phrases used in the advertisement are acceptable under HUD advertising guidelines.

Advertisement 2: 5br/3.5ba townhouse/no smoking, drinking/near Jewish temple

- Under HUD advertising guidelines, it is unacceptable to specify that the home is near a Jewish temple.

Which ad is UNACCEPTABLE under HUD advertising guidelines?

Advertisement 1: 3br/1ba house downtown. Tranquil setting.

- All of the words and phrases used in the advertisement are acceptable under HUD advertising guidelines.

Advertisement 2: 2br/2ba cottage near cape. Couples only. Non-smoking/drinking.

- Under HUD advertising guidelines, it is unacceptable to specify that the home is for couples only because it discriminates on the basis of familial status.
The following screens present five case studies that highlight some of the fair housing issues we have covered. The first three are presentations of actual court cases; the last two are hypothetical situations offered for your consideration. As you read, try to anticipate the outcome of the case or the appropriate response to the hypothetical situation.

The case studies will cover each of the following topics in the order listed below:

- Disability
- Non-Discrimination
- HUD
- Discrimination Depends on the Act, Not the Intent
- Placing an Advertisement

**Case Study 1: Disability**

In *Gittleman v. Woodhaven Condominium Association, Inc.*, the Woodhaven Condominium Association refused to grant an exclusive parking space to a disabled unit owner because the Master Deed stated that parking spaces were to be nonexclusive, common elements owned by all unit owners as tenants in common.

Given this statement in the Master Deed, the Woodhaven Condominium Association claimed that it was unable to take any action which would diminish the undivided interest in the common elements held by each unit owner and further asserted that the only way to grant a particular parking space to an individual owner would be by a two-thirds affirmative vote of the unit owners.

Such a vote was taken, but the disabled unit owner did not receive the required number of votes and subsequently filed suit for relief under the Fair Housing Amendments Act, which makes it unlawful to discriminate against any person in the provision of services or facilities in his or her dwelling because of that person's disability.
Federal fair housing legislation requires that a landlord or property management association make reasonable accommodations in the rules, policies and services that are necessary to afford a disabled person the equal opportunity to use and enjoy a dwelling; the refusal to do so is tantamount to discrimination. Whether the disabled person was discriminated against or not in this case depends upon whether or not the parking space request constitutes a “reasonable accommodation.”

Given the information in this course, how do you think the Courts settled the matter?

**Court’s Decision**
The U.S. District Court agreed that, under the Master Deed, the parking spaces were nonexclusive and that two-thirds approval from the rest of the unit owners would usually be required for such policy changes. It maintained that the association was legally able and, in fact, required by the federal fair housing legislation to grant an exclusive parking space as it constituted a reasonable accommodation.

The court held that the Master Deed and bylaws of the condominium gave power to the Association to regulate use of the common elements. But, furthermore, and perhaps most importantly for our purposes, the Court stated that any provisions of the Master Deed that violated federal fair housing legislation were unlawful and, consequently, could not legally be enforced. In essence, the Court decided that providing a parking space to a disabled person constitutes a reasonable accommodation and, therefore, not providing such a space violates the federal Fair Housing Act.

Because enforcing the provision of the Master Deed at issue in this case would violate the Fair Housing Amendments Act, the Court refused to grant the Association’s motion for summary judgment. The Court also cited case law and the legislative history of the Fair Housing Amendments Act prohibiting discrimination based on the enforcement of private agreements, such as a master deed.

**Case Study 2: Non-Discrimination**
Fenner v. Coldwell Banker. The plaintiffs in this case were two Chicago police officers, Fenner and Jones, who were interested in purchasing a new home. Their real estate agent was Anice Richard; notably both Fenner and Richard were African-American.

The property that Fenner and Jones wished to purchase was listed for sale by Coldwell Banker through a listing broker, Nugent, for $124,500. A first offer of $123,000 was tendered by a family named McGuire and accepted by the owners. Fenner subsequently submitted another smaller offer of $120,000 while the first contract was pending. The owners counter-offered $123,500 subject to the pending McGuire contract; importantly, Jones and Fenner never responded to the counteroffer.

The problems in this case began prior to the offer-counteroffer process; while Fenner and Jones were viewing the home, the neighbor shouted racist statements at them. Nugent, the listing broker, told the neighbor that he was going to continue to show the property while the McGuire contract was pending. Ultimately, Jones and Fenner’s offer was not accepted, but they were never contacted. Feeling as though race played a role in the issue, they filed suit under the federal Fair Housing Act.

The Plaintiffs (including Richard, their real estate agent) complained that Nugent never intended to follow up with Richard after the incident, allegedly discriminating against the prospective buyers on the basis of race. The Plaintiffs alleged that Nugent had a duty to contact them regarding the status of the offer, although they did not respond to the owner’s counteroffer of $123,500.

Given the information in this course, how do you think the Courts settled the matter?

**Court’s Decision**

The Courts ruled against the Plaintiffs, giving several reasons for their decision that this was not a case of discrimination.
Initially, the Plaintiffs acknowledged that the Defendants, Nugent and Coldwell Banker, continued to show the property and never refused to conduct business. The Plaintiffs’ complaint was simply that they weren’t subsequently contacted about the status of their offer and felt that this act, in and of itself, constituted discrimination. The Courts did not find sufficient evidence for this, citing—among their other reasons—the fact that the Jones and Fenner offer was the lowest offer received and Jones and Fenner’s failure to respond to the seller’s counteroffer.

The Court stated that the unfortunate event may have had something to do with Jones and Fenner’s representation. Richard, as a real estate professional, should have known that the seller has no obligation to respond to all offers and that, when both sides have professional representation, real estate licensees are ethically prevented from contacting the buyers or sellers directly. Because this practice is standard conduct in the field of real estate, ethical real estate practices would have forbidden Nugent or Coldwell Banker to contact either Jones or Fenner directly.

The Courts also noted that, although unfortunate and discouraging, neither Coldwell Banker nor Nugent could be held responsible for the distasteful and unethical comments made by the neighbor.

**Case Study 3: HUD**

In *Pfaff v. U.S. Dept. of Housing and Urban Development*, landlords sought to enforce occupancy limits, regardless of the occupants’ ages. The landlords in this case, the Pfaffs, had a very small two-bedroom house for rent. One of the bedrooms was 10’x10’. There was a “den” consisting of an alcove opening into the living room. There was “very little yard,” no basement, and an “undersized garage.” The house had 1,200 total square feet. The landlords instructed their rental agent to restrict rentals in this house to no more than four persons. They had other rental properties that they offered to larger groups, including families with children and families with nontraditional arrangements. They concluded that this particular house, however, would suffer significant
deterioration—and thus that they would be economically affected in a negative way—if it were occupied by more than four residents.

The agent nevertheless showed the house to a family of five, with three young children. When the landlords told the agent that the four-occupant limit was firm, the real estate agent argued that their policy violated the Fair Housing Act. The landlords fired the agent, and the tenants were forced to look elsewhere.

The tenants then filed suit, stating that they suffered considerable inconvenience in identifying substitute housing, that this experience led to the breakup of their marriage and that they felt “demeaned” as a result of the imposition of the occupancy limits upon them.

Given the information in this course, how do you think the Courts settled the matter?

**Court’s Decision**

Ultimately, and regardless of whether the landlords intentionally discriminated against certain families, a HUD hearing officer found that the Fair Housing Act imposed liability for more flexible occupancy limitations if firmer limits would have the effect of making housing inaccessible to families with children. HUD statistics showed that—in the area where this case occurred—households of five were overwhelmingly made up of families with children. This means that even if the Pfaffs really were trying to protect their investment, their actions had violated the Fair Housing Act.

The Pfaffs were found guilty of refusal to rent on a discriminatory basis and of making discriminatory statements in the course of business. After the investigation, the officer ordered damages, an injunction and a civil penalty, assessing the Pfaffs $20,000 in damages for emotional distress, an $8,000 civil penalty and $4,212.61 in compensatory damages.
Case Study 4: Discrimination Depends on the Act, not the Intent

Real Estate Licensee A is an apartment locator in a major metropolitan city with a population of three million. She has pre-qualified prospective tenant B over the phone. B has given A the following information.

- B and her husband work downtown and have very demanding jobs.
- They are expecting their first baby in two months.
- B plans to resume working after she has been home with the baby for six weeks.
- B’s husband makes enough money for them to qualify for $2,500 per month in rent without B’s income, but B enjoys working.
- They both want a good view, perhaps in a high-rise apartment building.
- They would like two bedrooms and a study.
- Since their jobs are demanding, they want to keep their commute to work as short as possible.
- B has provided her last name, which Licensee A believes is Hispanic.

Licensee A is a mother of four who believes that she knows how to raise children. She believes that B is in for a surprise in terms of the changes coming in her life with the arrival of a new baby. A realizes that B and her husband want a good view, but there is no way that A could sleep at night if she leased a high-rise apartment to a mother with a new baby. Licensee A believes that babies need fresh air and a yard to explore. In addition, she thinks that it would be too strenuous for a family to carry all of the baby’s things up the stairs or in the elevator every day.

Licensee A also knows of a lovely patio home for lease in a very nice Hispanic community, not too far from downtown. There is a wonderful nursery program in the neighborhood in which she thinks B and her family might be interested. She thinks that the patio home would be perfect for B and her husband, but she is also willing to show them some first floor apartments.
Licensee A has access to several listings offering very nice high-rise apartments that are just five-minute commutes from B and her husband’s offices. Licensee A does not want to show these high-rises to B because of A’s belief that high-rises are not suitable for children. Besides, A is sure that B and her husband would enjoy either the patio home or the first-floor apartments and that once they have seen these options they will forget all about their high-rise idea.

Given what we have covered in this course, is there a violation of fair housing legislation taking place here?

**Response**

There are several problematic issues in this case study. First, Licensee A plans on steering B and her husband to a Hispanic neighborhood based on her own beliefs about the sound of their surname. The federal Fair Housing Act prohibits steering and discrimination on the basis of race and religion.

Second, Licensee A is discriminating against B and her family on the basis of their familial status by refusing to show them high-rise apartments. The fact that Licensee A has no prejudicial bias or discriminatory intent is not enough to absolve her of discrimination charges if a fair housing complaint is filed. As we discussed in this course, it’s the result of the licensee’s actions, not her intent, which matters.

**Case Study 5: Placing an Advertisement**

Landlord Z owns four single-family dwellings. He has not made an exempt fair housing sale or rental in the past, and he has never lived on the property that is the subject of this case study. Z is very conventional in his views and lives a very conservative lifestyle. He has located a real estate professional whom he believes shares these conservative beliefs and whom he believes he can trust to find suitable tenants for his properties. Z has written an advertisement; the licensee publishes this advertisement in the local paper. It reads as follows:
2-1 duplex on quiet street. Suitable tenant will be non-smoking; straight, male preferred; no pets.

Landlord Z is now waiting for responses to the advertisement and for his real estate representative to produce prospective tenants.

Has the landlord done anything that violates the federal Fair Housing Act? Has the real estate licensee representing him violated the Fair Housing Act?

Response
This is a complex Example, the nuances of which require professional legal interpretation. On the surface, we can identify a number of problematic issues. It is more than likely that Z and the real estate licensee (as well as the publishing entity, i.e., the local paper) have violated federal fair housing laws, and perhaps state and local fair housing laws, as well.

As the student may recall, the exemption to the federal Fair Housing Act reads that a sale or rental of a single family residence is exempt, provided that the owner:

- Does not own, or own an interest in, more than three single-family residences.
- Was the previous occupant of the dwelling being sold, or—if the owner was not the most recent resident—the owner has not made another sale or rental exempt from the fair housing laws in the past 24 months.
- Does not use the facilities or services of a real estate licensee, broker or salesman.
- Does not use any discriminatory advertising.

The first problem here is that Z owns more than three dwellings. He is not the most recent resident of the property, but neither has he made any exempt sales or rentals in the last 24 months. If he owned three or fewer dwellings, this fact might help him qualify
for an exemption, but since he owns more than three properties this fact is not relevant to whether this transaction is exempt.

In addition, as soon as Landlord Z hired a real estate professional and published the discriminatory advertisement, he created further problems for himself by failing to satisfy the last two requirements for an exempt transaction. Federal housing law considers this advertisement as discriminatory because Landlord Z’s request for a male tenant indicates a preference based on gender. While sexual preference is not currently a protected class under the federal Fair Housing Act, it is in many state and local jurisdictions. That is to say, many states, cities, and counties have more stringent laws which would make the author of this advertisement guilty of other sorts of discrimination as well. Sexual orientation, gender identity, and age are among the common groupings that local and state jurisdictions protect. It is possible (depending on where Landlord Z lives) that he violated other statutes, in addition to the federal Fair Housing Act.

It is worth noting that the newspaper that published the ad may be held liable as well. As the student may recall from earlier lessons, HUD decided that publications incur liability for discriminatory advertisements.

Remember: fair housing laws protect all of us from unethical, unwarranted, and inappropriate discrimination. Financially, it is a poor business practice to turn away qualified prospects, or to run advertisements that focus on eliminating potential tenants rather than describing the property. Lost prospects may not translate into financial hardship, but discriminatory practices are not a good way to build up clientele, earn referrals, or develop a respectable reputation. Ethically, we should all strive to prevent unfair treatment and do our best to treat others fairly and respectfully, thereby upholding both the letter and the spirit of fair housing legislation.
Lesson 28: Texas State Laws and Regulations

Lesson Topic
This lesson focuses on the following topic:

- Texas Fair Housing Regulation

Lesson Learning Objective
By the end of this lesson, you should be able to:

- Describe Texas state laws regarding fair housing

Texas Fair Housing Regulation
In 1989, the Texas Congress passed the Texas Fair Housing Act. It created a body known as the Texas Commission on Human Rights. The Texas Fair Housing Act and the Texas Commission on Human Rights are analogues of the federal Fair Housing Act and HUD, respectively.

Fair housing complaints may be filed with the U.S. Department of Housing and Urban Development (HUD); but, since Texas has a fair housing program that has been judged “substantially equivalent” to that of HUD, complaints may also be filed with the Texas Commission on Human Rights. Complaints filed with HUD will be referred to the Commission.

Complaint resolution under the Fair Housing plan of the Texas Commission is similar to complaint resolution with HUD. Complaints must be filed within one year of the offending incident, and the Commission has 100 days to investigate the complaint. If the Commission determines that a violation of state or federal fair housing laws has
occurred, the complaint may be resolved informally or given to an administrative law judge. An administrative judge may assess those same penalties HUD has the power to assess, including monetary penalties between $25,000 and $50,000. The complaint filer may choose to take the matter to court to be resolved by a civil action, and in such an event the Commission will request that the Texas Attorney General file a lawsuit.

**Texas Real Estate Commission Code of Ethics**

Every applicant for a broker’s or salesperson’s license in Texas is required to pledge to comply with the Canons of Professional Ethics and Conduct. This document outlines what the Texas Real Estate Commission considers a discriminatory practice and prohibits real estate licensees from engaging in such practices. It states:

“No real estate licensee shall inquire about, respond to or facilitate inquiries about, or make a disclosure which indicates or is intended to indicate any preference, limitation or discrimination based on the following: race, color, religion, sex, national origin, ancestry, familial status, or handicap of an owner, previous or current occupant, potential purchaser, lessor or potential lessee of real property.”

“Lessor” and “lessee” here refer to landlords and tenants, respectively. Note that the Code of Ethics prohibits discrimination on the basis of *ancestry*, as well as the other federally protected classes.

**Lesson Summary**

Texas law has in effect the Texas Fair Housing Act, which closely parallels the federal Fair Housing Act. The former created the Texas Commission on Human Rights. It is the job of this commission to handle fair housing complaints in a timely manner. Real estate professionals in Texas are required to pledge to uphold a set of ethical standards defined in the Texas Real Estate Commission Code of Ethics, including prohibitions on discriminatory practices. The Code of Ethics protects ancestry as a class in addition to the seven federally protected classes.
Lesson 29: Land Description

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Informal Location References
- Metes and Bounds Survey System
- Rectangular Survey System
- Recorded Plat Method of Land Description
- Vertical Land Description
- Reference to a Previous Record

Lesson Learning Objectives
At the conclusion of this lesson you will be able to:

- Outline the basic features of the metes and bounds survey method.
- Locate a parcel of land using the rectangular survey method.
- Distinguish the vertical method of land description from other survey methods.

Introduction
In the previous lessons, we discussed the elements or characteristics that distinguish land, real estate, real property, and personal property from one another as well as the laws that encompass the practice of real estate. In this lesson, we will discuss how land and property are located, measured, and legally described and identified. This process
of defining and describing land and real estate is essential because legal ownership requires that we be able to distinguish the owned piece of land or real estate from all others—otherwise, there would be no clear way to tell what was owned by any particular individual, or what lot was described by any particular deed. The exact boundary of a property can be determined several ways; by metes and bounds, rectangular survey systems, as well as by recorded plats or, sometimes, a pre-existing document describing the property. A less exact, but nonetheless common way to locate a property is informal location reference. We will begin our discussion of land description by considering informal location references.

**Informal Location References**

For purposes of legal documents the exact size and location of a property requires precise measurements. For everyday commuting and travel, complex legal land descriptions are unnecessary and irrelevant. This is why in everyday use we have a system of informal references that describe location by street. We can use these informal descriptions when a practical need for simplicity supersedes our need for precision.

Street numbers and place names are all informal references. For Example, 1234 Main Street and 123 First Street, Apartment B are informal references, as are districts or titles, such as “Hyde Park” or “Lazy River Ranch.” The advantage of an informal reference point is that it is easy to understand and makes it possible for the layman to locate a home or an office building without the aid of a survey team. The disadvantage, from a real estate standpoint, is that informal references are not specific enough because they do not describe a particular property’s borders.
**Metes and Bounds Survey System**

In the past, when people wanted to record title to a particular lot they would reference its location relative to some landmark, such as a stream, road, bridge or tree. This worked well enough for a time, but as our cities grew and property disputes arose, it became necessary to establish more exact descriptions of a property's location. The drawbacks of the landmark system are evident: streams, roads, bridges, and other landmarks change and deteriorate over time. In addition, not all properties are fortunate enough to be favored with a noticeable landmark in their immediate vicinity. To solve this problem, communities developed the *metes and bounds* system of land description.

Metes and bounds is a legal method for describing land that gives the exact dimensions and location of a lot in reference to a man-made or possibly natural fixed monument. To use the metes and bounds method, a surveyor places a monument in a corner of a parcel; the monument can be a metal pole one to two inches in diameter, or a stone or concrete fixture. The surveyor then records the parcel's distance and direction from that point by measuring the perimeter of the lot in feet, usually to tenths or hundredths of a foot. He or she indicates direction in degrees, minutes, and seconds.

The sexagesimal system is one form of units used to describe angular measurement. In this system, there are 360 degrees (°) in a circle, 60 minutes (') in every degree, and 60 seconds (") in every minute. Therefore, the directional notation 80°50'32" reads 80 degrees, 50 minutes, and 32 seconds. These measurements provide a way for the surveyor to describe any direction in the 360° circle around the set monument. The monument is described as the point-of-beginning (POB) or the point of commencement for a directional notation because we move clockwise from the monument around a parcel of land describing size in feet and direction in degrees, minutes, and seconds.

**Compass Directions**

The sexagesimal system of degrees coupled with measurements in feet may seem complex. To understand how surveyors use degrees, minutes, and seconds to distinguish direction, and thus location, just place the measurements on a 360° circle.
marked with cardinal directions, or a compass. Imagine you are standing directly on the monument holding the compass. From this position, you can move outward in any direction from the center of the 360° circle—forward, backwards, or to either side.

Whichever way the surveyor chooses to move, surveyors describe that direction relative to two transecting lines: a north-to-south line and an east-to-west line. Their directions are relative to these lines. Consequently, metes and bounds directions indicate:

- Whether we move north or south of an east-to-west transaction through our monument.
- Whether we move east or west of a north-to-south transaction though our monument.

In essence, we give directions relative to a 90° crosshair placed dead center on top of our monument. Using this method, we can also describe complex geometric perimeters, such as arcs. In the metes and bounds survey method, a surveyor uses a compass that contains four 90° quadrants—taken together, these encompass the full 360° of a circle.

**Bench Marks**

Metal rods and stone fixtures are ultimately no more permanent than a stream or tree, so how do we ensure that no confusion arises in the event that a parcel's monument is destroyed? To compensate for the impermanence of these monuments and ensure that lot dimensions are not lost even if the monument itself disappears, we record the monument’s exact location by means of a connection line to a nearby fixed reference mark of known location and elevation as established by a government survey team. These permanent reference points are called “bench marks” and they generally consist of a marker attached to a durable object.

The marker may be a simple object, like a metal pole, or it may be an elaborate, engraved brass disc placed in cement by the U.S. Geological Survey (USGS) or the U.S. Coast and Geodetic Survey (USCGS). The locations of bench marks are extremely
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accurate, usually to less than an inch. Records are kept regarding the locations of all official bench marks, relative to each other. Therefore, in the event a bench mark is destroyed, it can easily be replaced because the exact locations of all bench marks are known.

Rectangular Survey System

In 1785 Congress authorized the use of the rectangular (or government) survey system as an alternative to metes and bounds. Back then, the metes and bounds system would have been extremely difficult to use, given the lack of permanent monuments and the relative difficulty of establishing precise locations. The rectangular survey system provided an easier way to describe newly acquired or surveyed land.

Whereas the metes and bounds method of survey requires a physical monument, the rectangular survey method depends upon the longitude and latitude system of mapping. Longitude lines (meridians) run north to south, segmenting the globe along the Earth's poles, while latitude lines (parallels) run east to west, parallel to the equator. Certain longitude lines serve as principal meridians. For any given principal meridian (a "noted longitude line"), there is an intercepting, specially-noted latitude line, called a "base line."

Every 24 miles north and south of a base line, we name a correction line, or standard parallel. Conversely, every 24 miles east and west of a principal meridian, we name a guide meridian. This method allows for the Earth's curvature. That is to say, a map might illustrate a grid of lines intersecting at 90° angles, but accurately mapping the surface of a sphere requires a slight shifting of our lines. This curved surface requires that the Earth's grid of meridians and parallels be slightly distorted; as one approaches either pole, longitude lines (meridians) get closer together. Every 24-by-24-mile area created by a guide meridian and a standard parallel is known as a "check."
There are 36 principal meridians (with corresponding base lines) in the U.S. public land survey system. Generally, each state will utilize the one principal meridian (north-south) and corresponding base line (east-west) that run through that state as the principal point of reference. Some states, however, do not follow this rule. For Example, Ohio uses rectangular plots that are established relative to state boundaries and rivers. Even if they do not use the principal meridian and corresponding baseline as a general point of reference, states will create a system of ranges and townships, which create a smaller, more detailed grid relative to the larger principal meridian and base line grid.

**Ranges**

A “range” is a column created by drawing a parallel line every six miles east and west of a principal meridian (north-south). Ranges are numbered consecutively east and west from their respective principal meridians. In essence, these range divisions establish a series of narrower longitudinal lines, adding greater detail that allows us to locate specific parcels of land within a “check.” The rectangular survey system uses these range columns in conjunction with township lines, which are the more-detailed counterparts of latitude lines. We will now discuss this other component of the rectangular survey system.

**Townships**

Just as range columns run parallel to meridians (the north-south longitude lines), township lines run parallel to base lines, thus making the township lines run east-west. These lines intersect with range lines to create 36-square-mile parcels (six-by-six-mile squares) called townships. We number township “rows” consecutively, north and south of a base line. For Example, for the first tier of townships lying north of a base line, the entire row is called “Township 1 North” (T1N) and all those comprising the first row south of the base line are dubbed “Township 1 South” (T1S). By attributing the appropriate range column to a specific township, we can identify it uniquely. For Example, “T1N, R1E” identifies a township located on the first tier north of the base line (east-west) and one range column east of the principal meridian. This six-by-six-mile square is thus differentiated from all others on the grid.
This diagram provides a visual depiction of the way that township lines and range columns intersect to form townships. It also shows the way that identifiers like “T1N, R1E” pick out a unique location in a grid of six-by-six mile squares, relative to the base line and the principal meridian.

The Dissection of Townships

Establishing the unique location of a township is, for our purposes, the most difficult part. After that, designations become a little easier. Each 36-square-mile township is divided into 36 individual square mile sections, starting in the upper right-hand corner. Each square mile contains 640 acres, and every acre has 43,560 square feet. Perhaps you have flown over farmland and seen a visible demonstration of our rectangular survey system. From a plane, much of the Midwest looks like one giant checkerboard.
Concluding Notes on Rectangular Survey

In terms of the surface area surveyed, more U.S. land is defined by rectangular survey than by any other method. In light of this, it is important that licensees understand a few key points about the rectangular survey method:

- Not all sections are exactly 640 acres; some are slightly smaller because of the Earth's curvature.
- It is customary to name the county and state along with any rectangular survey title.
- Some rectangular survey descriptions will include fractions; the fraction identifies a portion of a 640 acres area (for Example, if you see 1/4, then it means one-fourth of 640 acres, or 160 acres). A fractional designation will generally include notation indicating which half or quarter is meant; for Example, “NE 1/4 “picks out the upper right quadrant of the 640-acre square.

Recorded Plat Method of Land Description

Next to the informal use of addresses and districts, recorded plats are probably the simplest method of land description. They are used when parcels of land, divided up into individual lots, are ready for sale or development.

The term “plat” refers to a surveyor or developer's map detailing the borders of the individual lots that he or she will develop or sell. We will discuss plats in detail in coming lessons. When a surveyor or developer records his or her plat in the public records office of the county where the land is located, then the map becomes a legal description of property for ownership. The recorded plat system of land description is also called the “lot-block-tract system” and the “recorded map method.” It utilizes the metes and bounds method of land description to locate the borders of each parcel. Once a surveyor establishes a parcel's perimeter using this method, he or she records the dimensions on a plat for easy reference.
To understand how the recorded plat system works, we must understand the “pieces” that make up a plat. Specialized terminology is used to identify these “pieces.” “Parcels” are the individual lots that are combined to make a “block,” and blocks are combined to make a “tract.” The tract is the totality of the property represented on the plat.

When discussing the recorded plat system of land description, it is imperative that these terms are used in only these ways—using the terms carelessly or inconsistently will create confusion. Understand, however, that in other sections and in our daily conversation, a lot or a tract is often the same as a parcel: a piece of land or real estate. This distinction between specialized terminology and everyday conversation regarding the parts of a plat is similar to the distinction discussed earlier regarding the conventions governing the terms “real estate,” “real property,” and “land.”

**Recording a Plat**

While the exact recording method depends on the jurisdiction, generally, a surveyor completes the following steps to record a plat:

1. Give each parcel a lot number.
2. Give each block a block number.
3. Give the tract a name or number.
4. Deliver the plat on which all property lines are described by metes and bounds, listing all relevant lot numbers, block numbers and tract numbers to the county recorder’s office in which the land is located.
5. The county recorder places it in the map books or survey books, alongside all other tracts in the area.

**Vertical Land Description**

All of the methods we have just discussed are surface identification methods. That is to say, informal methods of land description, rectangular survey, metes and bounds, and
recorded plats all distinguish pieces of land in terms of their surface location. While we commonly think of surface description when we consider land distinction, it is not the only way to describe the location and layout of a particular parcel.

Land can also be described according to vertical measurements. You may recall the different types of rights associated with real estate ownership: subsurface rights, air rights, surface rights, and water rights. A vertical land description is most commonly used when air rights and subsurface rights need specific explication. Vertical land description is also used to express condominium ownership boundaries.

In essence, we create a vertical description by establishing a base point (called a “datum”), from which we move upward or downward marking standard heights or depths (we can imagine this arrangement as something like a very large ruler extending upward or downward from the datum). We reference these heights or depths to denote locations in space. In this way, we can describe land points at any elevation, the air space above a lot, and the minerals below a lot. Usually the datum used is mean sea level, although some cities or other local jurisdictions utilize a different standard. From the datum, bench marks are placed at regular intervals established by a U.S. government survey team.

An “air lot” is the space above a particular parcel. To locate a particular air lot, two pieces of information are needed; the location of the parcel of land where the air lot is believed to be and then the elevation (from the point of the datum) of where the air lot is thought to extend. We use the same method to identify individual units in multi-story condominiums and to pinpoint the location of minerals or soil boundaries beneath a particular lot for the purposes of selling or leasing mineral rights.

**Contour Maps**

Elevation affects development. Consequently, developers need to have a clear picture of the terrain and elevation for a given parcel. A contour map (also called a “topographic
map”) is a map in which curved lines (called “contour lines”) connect contiguous points of equal elevation to define the contours of the land.

A contour map shows hills, valleys, plateaus, and other patterns that may affect water drainage or runoff and other development issues. A developer uses a contour map to determine the need for leveling, grading, and engineering problems that may arise—building upon a slope with a 90 degree angle is difficult.

Reference to a Previous Record

For legal purposes, such as deeds and mortgages, a parcel description must distinguish that parcel from all other parcels in the world; however, a parcel does not need a new description each time it changes hands. Instead, we can reference previously recorded descriptions for the new conveyance. Consider the following Example:

Developer C sells a parcel to Owner A. Developer C has already described this parcel using a detailed metes and bounds description and filed it in a subdivision plat located at the county recorder’s office. Owner A files the deed giving her title to the property in the public record. Six years later Owner A decides to convey title to Owner B. Already on public record (in Owner A's recorded deed) is a detailed metes and bounds description of the parcel's location. Therefore, there is no need to describe the land's location again.

Rather than employ a surveyor, Owner A and Owner B simply record the new deed, using something like the following phrase: "All land described in Owner A’s deed received from Developer C, recorded in (book, page, county, and state). . ." A seller of real property can typically use and rely on a survey for seven years. After seven years, lenders and title companies generally require a new survey, to ensure the land area has not been compromised by sale or purchase of the land or altered by development, infringing neighbors or natural changes in the land.
Lesson Summary

A legal description must distinguish a particular parcel from all other parcels of land in the world. There are, generally, five methods used to establish this legal distinction: metes and bounds, rectangular survey, recorded plat, vertical land description, and reference to a previous record. In this lesson, we discussed all five of these methods, as well as the role of informal land descriptions in identifying particular properties.

Many of these methods for identifying a parcel are extremely complex. For this reason, we developed a system of informal reference based on street addresses, districts, and titles. We use this method when our need for practical simplicity supersedes our need for precision. An informal reference point is advantageous because it is easy to understand; the main drawback of this system is that it fails to uniquely identify a location. For example, there may be multiple properties identified by the address “123 Main Street”—in fact, there could be a 123 Main Street in every city or town that has a street by that name. All of these properties are distinct, but we cannot tell that just by looking at their addresses. In addition, informal references like addresses do not describe the size or shape of the lot, which is necessary for legal purposes.

Mettes and bounds is one method we might use to determine a legal land description. It distinguishes the exact dimensions and location of a lot in reference to a fixed monument, usually a small metal rod or a concrete or stone structure one to two inches in diameter. In the event that one of these monuments is destroyed, we record their exact location in reference to a nearby mark established by a government survey team. This ensures that no lot dimensions are lost, even if the monument itself disappears.

A developer using the metes and bounds method will describe direction in degrees, minutes, and seconds using the sexagesimal system, one form of units used to describe angular measurement. In this system, there are 360 degrees (°) in a circle, 60 minutes (') in a degree, and 60 seconds (") in every minute (thus, 58°6’34” is read aloud as “58 degrees, 6 minutes, and 34 seconds”). The monument is described as the point of
beginning or the point of commencement for the survey description. From this point, we move clockwise from the monument around a parcel of land, describing size in feet and direction in degrees, minutes, and seconds.

The rectangular survey method depends upon the longitude and latitude system of mapping. Longitude lines, or meridians, run north-to-south, while latitude lines, or parallels, run east-to-west. Certain longitude lines serve as principal meridians. For any given principal meridian (a noted longitude line), there is an intercepting, specially-noted latitude line, called a base line. Every 24 miles north and south of a base line, we name a correction line (a standard parallel), which helps to ensure that our grid reflects the curvature of the Earth’s surface. Analogously, every 24 miles east and west of a principal meridian, we name a guide meridian. This creates 24-by-24-mile squares called “checks” that we break down yet further into ranges and townships.

A range is a column created by drawing a parallel line every six miles east and west of a principal meridian; the ranges are numbered consecutively as they move out from the center axis created by the principal meridian. For Example, the first range column to the right (i.e., to the east) of the principal meridian is R1E (first range east), while the first range on the left (to the west) is R1W. The second ranges are R2E and R2W, and so on.

Range columns are used in conjunction with township lines in the rectangular survey system to locate specific parcels of land. Just as ranges run parallel to meridians (longitude lines), township lines run parallel to base lines. Township “rows” are numbered consecutively, north and south of a base line. For Example, the first tier of townships above (i.e., north of) a baseline are identified as T1N, the second tier is T2N, and so on. Township lines intersect with range lines to create a grid of 36-square-mile parcels (six-by-six-mile squares) called townships. Each 36-square-mile township is then further divided into 36 individual square-mile sections that are numbered consecutively starting in the upper right-hand corner. Each square mile contains 640 acres, and every acre has 43,560 square feet.
A recorded plat is a surveyor or developer's map detailing the borders of individual lots in a particular tract. On the plat, the developer will write a lot number for each parcel, a block number for each block (a collection of parcels), and a name or number for the tract (a collection of blocks). A plat is a legal form of property description only if the developer records it in the public record. Usually, the metes and bounds method of land description is used to distinguish each individual lot.

The vertical land description method is most commonly used when the air space above a lot or the mineral or subsurface rights below a lot require specific description (most likely because they are to be leased or owned by someone other than the owner of the surface rights). To use this method, we establish a base point, or datum, which is usually mean sea level, and then define heights up or down relative to that base point.

The last method of land description relies on a pre-existing, recorded, and legally distinguishing description. Although legal description must distinguish a particular parcel from all other parcels, it is not necessary to create a new legal description every time a particular parcel changes hands. A deed or mortgage could reference a parcel description in another recorded deed or mortgage using language similar to the following clause: "All land described in the deed from Person A to Person B recorded in (book, page, county, and state)...."
Lesson 30: Forms of Ownership

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Single and Co-Ownership
- Community Property
- Ownership by a Business Entity

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Explain the differences in tenants in common and joint tenancy.
- Identify what is community property vs. separate property.
- Explain the four unities of joint tenancy.

Introduction
Previously we learned what real estate is, the various methods of describing parcels of real estate and the business of real estate practice. Here we are going to focus on how we own or hold this interest in real estate. We will learn about single or individual ownership and the many forms of co-ownership. In some states, there may be community property laws that govern the shared intents of spouses in real estate. This lesson will cover the various types of ownership and how they can affect a property owner’s right to sell, use, or distribute property.
**Single and Co-Ownership**

For our purposes, there are three basic forms of ownership. Property can be owned individually, it can be co-owned, or it can be held in trust. We will now discuss the details of these three forms of ownership.

**Individual Ownership**

Individual ownership occurs when one person is the owner of a property. He or she has absolute control over the distribution and use of the land as well as final say over any other decisions affecting the property (within the confines of the law). Individual ownership is also called “sole ownership;” property that is owned by a single individual is sometimes referred to as being “held in severalty.” The term “severalty” derives from the term “sever,” which means to make separate or individual. When a property is held in severalty, it usually belongs to single or married individuals. It might also be held by a corporation, a form of business that has legal standing as an individual.

**Co-Ownership**

Co-ownership occurs when two or more persons have ownership rights to a property. Under this type of ownership, these individuals become co-owners or concurrent owners. Co-owners may all have possession of a property at the same time, or one owner may take possession while the others do not use the property but maintain their ownership interest(s). Similarly, co-owners may have equal ownership rights in a property, or the ownership interests may be divided in some other way. Responsibilities to and liabilities regarding the property may be divided in a similar way. Some states have specific laws regulating the division of rights and responsibilities regarding a co-owned property.

There are four basic types of co-ownership:

1. Tenancy in common
2. Joint tenancy
3. Community property
4. Property held in partnership

**Tenancy in Common**

When two or more parties own a property as a tenancy in common, each owner has a partial ownership interest and partial rights in a property. The ownership interests may be divided in various ways, but there is no actual physical division of the property. If the various ownership interests are not equal—that is, if each owner is not assigned the same percentage of ownership rights in the property—then the co-owners’ fractions of ownership interest are stated in the deed that created the tenancy in common. In the absence of any deed stating an unequal division, it is often assumed that all rights and obligations regarding the property are divided evenly.

In a tenancy in common, each co-owner of the property holds his or her individual portion of the ownership interest in severalty. This means that each individual co-owner can sell, transfer, mortgage, or lease his or her interest in the property without the authorization of the other owners of the property, as long as that owner’s actions do not endanger or abridge the rights of the other owners. Each of the tenants-in-common has an equal right to enjoy the use of each part and the whole of property, but none of them has a right to possess any part of the property exclusively.

The co-owners, as a group, have sole rights to use and distribute the property as they wish, as long as their choices conform to state and federal laws. If one owner dies, distribution of his or her interest in a co-owned property is done according to the will or by the laws of descent and distribution if there is no will. It is important to note that there is no right of survivorship here; that is, it is *not* the case that when one co-owner dies, his or her ownership interest reverts to the surviving co-owners.
Joint Tenancy

In a joint tenancy, two or more individuals share ownership of a property. Under this form of co-ownership, there is a right of survivorship; when a joint tenant dies, the surviving joint tenants inherit the deceased co-owner’s ownership interest in the property. The only way for a joint tenant to acquire an ownership interest that can be conveyed in a will is for that person to be the only surviving joint tenant. Otherwise, when any of the joint tenants dies his or her ownership interest reverts to the surviving joint tenants.

Because joint tenancy involves the right of survivorship, many states require co-owners who wish to own property in this way to create a written contract that specifies their intent to create a joint tenancy and identifies the co-owners as joint tenants. Without a contract or conveyance that clearly identifies their relationship as a joint tenancy, it may be presumed to be a tenancy in common.

Joint tenancy is more explicitly an arrangement for sharing a property equally than is a tenancy in common. Four unities distinguish a joint tenancy from other kinds of co-ownership, all of which must be present for the method of ownership to qualify as a joint tenancy:

1. **Unity of interest:** All of the joint tenants’ ownership interests and rights must be equal in their extent, nature, and duration.
2. **Unity of time:** Joint tenants are required to acquire their property ownership or ownership interests at the same time. Thus no additional joint tenants can be added to an established joint tenancy unless a contract is created defining a new joint tenancy arrangement.
3. **Unity of title:** Joint tenants are required to acquire their property from the same transaction, and they must hold title under the same document, such as a deed or a will.
4. **Unity of possession**: Each joint tenant has an equal right to enjoy the use of each part of the property as well as the whole of the property. No joint tenant has a right to possess any part of the property exclusively.

A joint tenant annuls a joint tenancy when any one of the four essential unities of joint tenancy is terminated. Bankruptcy, foreclosure, and suits to partition the land can also cancel a joint tenancy. Having co-owned land legally partitioned by a court is a legitimate way to dissolve a co-ownership when the parties cannot or will not voluntarily agree to its termination. If a court cannot divide the land in a way that satisfies the co-owners, it will often force them to sell the land and divide the proceeds between the joint tenants.

**Community Property**

Community property is property that is held in common between a wife and a husband, in which each party holds half of the ownership interests in the property. This arrangement is generally created by community property laws, under which the ownership interests in any property that is acquired during the course of a marriage are automatically divided equally between the two spouses. Only the following states recognize community property laws: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin. They are often referred to as “community property states.”

Community property laws recognize ownership based on the spouses’ marriage agreement, rather than the actual holding of title. This means that all property acquired during a marriage belongs equally to both individuals, and will be equally divided if their marriage is dissolved. If one spouse dies, his or her portion of their community property will transfer to the surviving spouse.

These laws do not govern property that is received as an inheritance or a gift, and they do not apply to property acquired prior to the marriage; all such property is considered
to be “separate property.” Prior to marriage, both parties can agree to convert their separate property into community property; they can also agree that none of their property will be considered community property, though this arrangement generally must be specified in writing.

Ownership by a Business Entity

Partnerships
A partnership is created when two or more parties agree to combine their property and talents to create a for-profit business. Parties can create a variety of partnerships; we will discuss two common types of partnership here:

1. General partnerships
2. Limited partnerships

General Partnerships
A general partnership combines two or more parties’ resources, assets, and expertise into a business unit. The creation of this partnership also creates financial and legal responsibilities for all of the partners. Consequently, all partners can be held legally responsible for the other partners’ actions and commitments. Most states’ laws follow the Uniform Partnership Act (UPA), which is designed to bring various states’ partnership laws into accord. The UPA outlines the basic requirements of a partnership agreement, apart from any specific details that might be written into a particular partnership contract. Although the UPA provides a helpful general outline to follow while drafting a partnership agreement, partners should create and define the key clauses that shape and regulate their unique partnerships.

Limited Partnerships
A limited partnership is an alternative to a general partnership. A limited partnership is made up of both limited and general partners. The general partners do the work of
managing and overseeing the business; they usually accept unlimited personal liability. Limited partners function more as investors, supplying capital but playing no role in the day-to-day operation and management of the business. Limited partners’ liability is generally limited to the amount of their investments in a business.

The relationship between limited and general partners must be set out in a written agreement if the partnership contract is to conform to the requirements of the Uniform Limited Partnership Act (ULPA), later amended to become the Revised Uniform Limited Partnership Act (RULPA). The majority of states follow the directives of the ULPA or the RULPA, which acknowledge the legality of a limited partnership.

**Trusts**

When a property is held in trust, an individual transfers ownership of that property to another individual who in turn manages that property for a *third* party. The transferor or creator of the trust is called the *trustor*; the individual who receives the trust is called the *beneficiary*; and the manager of the trust is called the *trustee*. The trustee carries out the trustor’s wishes by holding title to the trust and performing according to the trustor’s wishes concerning the property.

**Example:**

Person X owns a condominium, and she wishes to place this property into a trust so that it will become her grandson’s property in the future. Person X asks Person Y to act as a trustee for this trust. If Person Y accepts this responsibility, this means that Person Y will need to manage the property according to the terms set out in the trust agreement, and that Person Y is responsible for delivering the property to the grandson in approximately the condition specified in the agreement.

In this case, Person X is the trustor, Person Y is the trustee, and the grandson is the beneficiary.
Lesson Summary

This lesson discussed the three different types of property ownership. Property can be owned independently (i.e., it can be held in severalty), it can be held in trust or it can be co-owned. When an individual holds a property in severalty, only one individual (or one married couple) has ownership rights to the property; this is also known as "sole ownership." When property is held in trust, an individual (the trustee) temporarily holds title to a property, which is later to be transferred to another person (the beneficiary) according to terms set out by the person who made the trust (the trustor).

In co-ownership, two or more parties have ownership rights to the property. Co-ownership of a property can take the form of a tenancy in common, a joint tenancy, community property or a property held in partnership. When co-owners own property as a tenancy in common, there is no requirement for each owner to have an equal interest in the property as there would be in a joint tenancy. There is no physical division of the property, only a division of the interest vested in the property. Tenants in common may pass their portion of ownership rights in a will; they may also sell, lease, or otherwise dispose of their ownership interest in any way that does not compromise the interests of the other co-owners.

In a joint tenancy relationship, the co-owners’ ownership rights are subject to the right of survivorship, under which the surviving joint tenants inherit a deceased co-owner’s interest in the property. Joint tenants may not pass their ownership interests in a will, nor can they otherwise transfer their ownership rights to anyone else in such a way that the new owner becomes a joint tenant. To add new joint tenants, a new joint tenancy agreement must be created. A joint tenancy arrangement must satisfy certain requirements; in particular, joint tenancies are distinguished by four unities: the unity of time, the unity of title, the unity of interest, and the unity of possession.

In states that recognize community property laws, all property acquired by a couple during the course of their marriage that is not a gift or an inheritance is referred to as
community property. Under these laws, each spouse has an equal ownership interest in property acquired during the marriage.

When two or more parties agree to combine their capital and talents in order to create a for-profit business, they have created a partnership. Partners can be co-owners of various kinds of property, including real estate. In this lesson, we discussed two kinds of partnerships, the general partnership and the limited partnership. A general partnership requires all partners to take responsibility for the actions of all other partners. In a limited partnership, on the other hand, the general partners who see to the management and daily operations of the business assume full liability, while the limited partners (who function primarily as investors and are not involved in the day-to-day operations of the business) assume only limited liability.
Lesson 31: Interest in Real Estate

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Freehold and Leasehold Estates
- Encumbrances and Non-Tax Liens

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Explain the differences between a freehold estate and leasehold estate.
- Identify the classification of different types of liens: voluntary, involuntary, statutory, or general or specific.
- Explain the concerns with encumbrances and the effect they have on real estate ownership.

Introduction
Describing parcels of real estate and the importance of the legal description in the business of real estate is extremely important. But what does one actually own and what rights do they have associated with that ownership. The quantity and extent of interest one owns is referred to as an estate. There are basically two forms of estates, freehold and leasehold estates. The interest held in real estate can be limited by rights or interest of others. These interests can be statutory as in tax liens or encumbrances such as the rights of others to use specific rights of way on a parcel of land. In conveying real estate it is important to determine what interest is being conveyed and
who else if any, own any other interests or rights on that specific parcel of real estate. One can only convey what one owns and has a right to convey. This lesson will provide a greater understanding as to the rights and interests in real estate.

Freehold and Leasehold Estates

With land or real estate ownership described as a freehold estate, the property owner has ownership for an undetermined or unspecified period of time with full ownership rights and the right of disposition or right to convey the interest he or she owns. With ownership interest described as a leasehold estate, the tenant owns a right to possession and use of the property. This interest is typically held for a specified or determined period of time with no ownership rights. A freehold estate may be evidenced by a deed while a leasehold estate may be evidenced by a lease.

Freehold estates

Freehold estates are held for an undetermined or unspecified period of time and can be categorized into two forms of estates:

- **Fee Simple Estate:** A fee simple estate is the least limited, most absolute interest in real property. It is of indefinite duration, freely transferable and freely inheritable. When a grantor conveys a fee simple estate, the grantor conveys to the grantee full ownership of a property for the grantee’s lifetime. The grantee then has the right to use, occupy, and dispose of the property as he or she sees fit. Fee simple estate may also descend to heirs.

- **Life Estate:** A life estate is a more limited interest in real property than fee simple estate because ownership is limited to the lifetime of the owner or some other designated party. The owner does not have the right to dispose of the property or allow the property to descend to heirs. Instead, a life estate owner may designate a third-party as a *remainderman* for the *reversion*. A reversion is
the remaining estate of the grantor that is conveyed to the remainderman upon the grantor’s death. Life estates may be created by agreement of the parties or by operation of the law.

**Leasehold Estates**

A leasehold estate is a type of property interest allowing tenants to occupy and use a property they do not own with a reversionary right. Leasehold estates are established when a tenant has possession of a property and has the legal right to use the property, but he or she does not have actual ownership interest (i.e., he or she does not hold legal title and cannot legally sell the property). Instead, he or she has a special kind of “possessory estate” in the property for the duration of his or her lease, as long as he or she honors the terms and conditions of the lease contract. This form of estate has a reversionary right, which means possession of the property reverts to the landlord after the lease term has expired. The landlord’s interest in the property is specifically known as a “leased fee estate plus reversionary right.” Leasehold estates will be discussed in greater detail in the Principle II course.

**Encumbrances and Non-Tax Liens**

**Encumbrances**

The term *encumbrance* refers to any claim or right against a property held by another that is not the fee title owner. These encumbrances affect its clear title or may limit the use of the property by the fee title owner. These encumbrances are attached to the title and may transfer in the transfer of the deed or ownership. Because encumbrances affect the title interest or use of a property, it is important that the claims or rights of others are understood in the transfer of real estate. Encumbrances can affect the use of real property such as in easements, restrictions, licenses or encroachments.

An easement is a right owned by one party to use the land of another. This is typically a specific area of the land and for a specific purpose such as in a shared driveway or to
ingress or egress to an otherwise landlocked parcel of land. These types of easements or rights run with the land, meaning these rights of use by another will convey in the transfer of that deed or title. Unlike a license, which is a right to use the land of another that can be granted as well as terminated by the property owner, these rights typically do not run with the land or transfer with the transfer of deed or title.

Encumbrances can also be in the form of private deed restrictions (added by previous owners) or restrictions added to deeds by the developers or covenants for specific subdivisions. The deed restrictions can put limitations on the use, maintenance or require specific standards for improvements, lot sizes, or architectural design. Any deed restrictions that violate the current laws would not be enforced in any conveyance of that deed.

When a property borders a body of water or a river, the right to enjoy the water is usually included in the bundle of rights and not provided for by deed or adjoining property owner. Any interest held in the right to use adjacent bodies of water are determined by the statues pertaining to the riparian and littoral rights or doctrine of appropriation of those rights. Groundwater or subsurface water, on the other hand, can be captured by drilling a well and used by the property owners under the “rule of capture”. The rule of capture does not provide any ownership interest in the water under the ground, only what is captured.

Although an encroachment is an illegal use of another land owner’s property, it is when the property of one owner extends beyond their property boundaries and onto or encroaching on the adjacent property. An encroachment is a physical intrusion on someone else’s property without direct permission. It is important to identify if any part of an adjacent property extends beyond their boundaries to ensure all of the rights of the property owner are conveyed in the sale. This can easily be identified on a survey, which is typically required in the conveyance of real estate. An encroachment uncontested over 10 years could result in the legal right to use the land of that adjacent property owner by creating a prescribed easement.
Liens

A lien is a form of encumbrance that is a claim against a property as security of a debt, such as in a mortgage. Because liens are creditors’ claims that impact title, they are all considered encumbrances. Liens are legal claims or rights to a debtor’s property that serve as a security interest for obligations or debt. A key element of liens is that they provide an almost immediate right for lien holders to liquidate property upon default of a debtor. Unlike lenders that obtain liens, lenders of unsecured loans must file a lawsuit to gain access to a borrower’s property. In some cases, liens can still be enforced in the event of bankruptcy.

Real estate liens “attach” to a specific piece of property; thus a debtor cannot sell his or her property without the lien accompanying it. A lien represents a superior claim to a piece of property even after it has been sold unless the lien is cleared before transfer of title. So, in order to sell a property, the owner likely will have to take steps to clear the land of its liens. Although a person who has bought a property that has liens is not responsible for paying off the associated debts, the lien holders can still take legal action to gain control of the property. Which lien holder is entitled to property in what order depends upon the priority of the liens.

Title Theory vs. Lien Theory

As previously stated, the interest that a debtor holds in a particular property, as well as when and how the debtor may seize property upon default, depends upon the state in which the owner lives. There are three different approaches to liens: title theory, lien theory, and modified lien theory. It is easiest for a debtor to seize property upon default in title theory states. This is because the debtor actually holds title in the property until the debt is paid in full.

In title theory states, lenders are considered the owners of mortgaged land and hold legal title, while the borrower has equitable title. These states are called title theory states. Legal title is transferred to the borrower only when the mortgage has been paid
in full. In the event of default, the lender can take immediate control over the mortgaged property.

In lien theory states, because they consider borrowers to be the owners of mortgaged property, lenders only have a lien on the property with no right of possession. When the loan is paid in full, the lien is removed. In the event of default, the lender can foreclose on the mortgaged property after notice is given and enough time has passed in order to obtain the balance due on the loan. Some states allow a statutory redemption period after foreclosure when debtors may redeem their property.

Some states are considered modified lien theory, or intermediary theory, states. In intermediary states, borrowers hold title to the mortgaged property during the mortgage term. If the borrower defaults on payments, the lenders may take back title and assume possession of the property.

**Classification of Liens**

Liens are classified in a variety of ways. They can be general or specific, voluntary or involuntary, statutory or equitable, and tax or non-tax. We will briefly discuss each classification and types of liens, including non-tax liens and tax liens in this lesson.

**General vs. Specific Liens**

*General liens* affect any property an individual or institution owns, including both real and personal property. This includes many kinds of taxes, such as IRS and inheritance taxes. While *specific liens* are claims against particular parcels of real estate; they do not affect any other property. Examples of specific liens are vendor’s liens, execution liens, vendee’s liens, surety bail bond liens, mechanic’s liens, mortgages, special assessments, property taxes, and attachments.

**Voluntary vs. Involuntary Liens**

When a person takes some action that places a lien on his or her own property, the lien is *voluntary*. That is, they choose to initiate a lien that would not otherwise exist.
Lenders usually require security for a loan, so borrowers often provide the real estate as security. A common example is a mortgage. With a mortgage, a debtor voluntarily offers the property as security for the loan. Liens are involuntary when a property owner does not take any action to initiate them; they are either statutory or equitable. Real estate tax liens and judgment liens are examples of involuntary liens. Statutory liens are local, state or federal law established liens for a specific set of circumstances. Because the liens are imposed through law, they are called “statutory” liens. They include federal tax liens, mechanic’s liens, ad valorem tax liens, and judgment liens. And an equitable lien is a right that exists only in equity, with one party charging his or her property as security for a debt or loan. Equitable liens are created by courts and derived from common law. A vendor’s lien is an example of an equitable lien. When a buyer does not pay in full, for example, a seller might obtain a vendor’s lien on the property. Equitable liens also occur when a tenant for life, joint owner or occupant make alterations to the land that increase its value.

Types of Liens
It is important to note that tax liens generally take precedence over non-tax liens. In the event of default or delinquency on payments for the lien, this means that the state or federal tax liens will typically be addressed first. Here are some of the non-tax liens:

**Mortgage Liens**
Typically, when a person buys a home, the home itself becomes collateral for the loan, so the lender obtains a mortgage lien. Because the owner creates the lien, a mortgage lien is considered voluntary. Lenders may also require a preferred lien, which means that no other liens can take priority. Mortgage liens can also be deed of trust liens. Under a deed of trust (or trust deed), title is held by a trustee as security for a debt until it is paid.

**Mechanic’s Liens**
Mechanic’s liens protect suppliers, contractors, architects, engineers, surveyors, and other parties whose labor or materials has improved the value of real
property. Mechanic’s liens are based on the *enhancement of value theory*: the parties who performed the labor or supplied the materials used have increased the value of the real estate, and thus have an interest in the property; the property itself becomes security for money owed. Mechanic’s liens are specific, involuntary, statutory liens.

Mechanic’s liens are a crucial means for people to ensure payment for the work they perform. For example, a homeowner might hire a contractor to add an additional room to his home. If the homeowner refuses to pay after the work is completed, the contractor may enforce a mechanic’s lien against the property. A court can force the homeowner to sell his home to satisfy the debt. When the home is sold, the contractor will receive compensation.

To obtain a mechanic’s lien, parties must work under contract (including implied contracts) with the owner of a property or the owner’s representative. Parties usually have a limited period of time to file a lien after work has been performed, or they may not receive compensation. This time period varies from state to state, as does the point in time when a lien attaches to the property (this may have an effect on lien priority, which is discussed later). States might establish one of the following points in time for lien attachment:

- The time a contract is signed
- The time an individual’s or contractor’s work ends
- The time construction begins
- The time a lien is recorded

**Judgment Liens**

*Judgments* are decrees given by courts. When judgments specify the amount of money owed, they are called *money judgments*. *Judgment liens* are general, involuntary liens, so they apply to both real and personal property. The written
court decree is called an *abstract of judgment*; it takes effect only after it has been recorded in the county clerk’s office. The lien applies to property currently owned or acquired in that county.

A *writ of execution* can be issued by a court to force payment of monies owed from a judgment when a debtor does not pay. It gives court officers the right to confiscate and sell the debtor’s property to satisfy the debt. The writ of execution is itself an involuntary lien, called an *execution lien*. It attaches to the property until it is sold.

The government can file a *federal judgment lien* for failure to pay certain debts, such as student loans. These liens are filed in the county where real property is held.

**Lis Pendens Notice**
A notice called a *lis pendens* is used to notify the public when a lawsuit is filed that affects a specific piece of real estate. This informs the public and any interested parties of the potential claim on the property. A *lis pendens* notice is often useful because a considerable time period may elapse between the time a lawsuit is filed and the time a judgment is rendered.

**Attachment Liens**
Plaintiffs in a lawsuit may seek a *writ of attachment*, in which the court seizes property until it reaches a judgment. This protects creditors from a conveyance of title before a judgment is rendered. A writ of attachment is also called an attachment lien.

Creditors must post a surety bond or a deposit large enough to cover any potential losses the defendant might suffer in order to obtain a writ of attachment. This protects debtors if the court decides in their favor.
Exempt Property
Certain kinds of property are exempt from attachments and executions. Exemptions are often limited to a certain value; they vary from state to state but might include items such as:

- Tools used for a trade or business
- Social Security
- Basic household appliances and furniture
- School books
- Money owed to debtors for child support or injury
- Prescription health supports
- Basic wages
- Cemetery lots

Vendor’s Liens
A vendor’s lien is a specific, involuntary lien on a property as security for the purchase price that arises when a seller has not yet received full payment for the property. When a seller does not finance a loan, the lender holds the vendor’s lien. Vendor’s liens are enforced by filing suit to have the property sold.

Vendee’s Liens
When a seller fails to deliver title to a parcel of real estate when all terms of the contract for a sale have been satisfied by the buyer, a vendee’s lien applies to the property to ensure the repayment of what the buyer paid in. It is a specific, involuntary lien that protects buyers.

Bail Bond Liens
Bail bonds can be put up in the form of real estate in lieu of cash when a property owner is accused of a crime. This creates a bail bond lien—a specific,
statutory, involuntary lien enforceable by a court officer or the sheriff if the accused property owner does not appear in court.

**Municipal Utility Liens**

If a property owner refuses to pay bills for municipal utilities, the municipality can obtain a *municipal utility lien* on the property. It is a specific, involuntary lien.

**Lesson Summary**

The quantity and extent of interest one owns is referred to as an estate. There are basically two forms of estates: freehold and leasehold estates. Freehold estates are the highest form of ownership while a leasehold estate is primarily a right to possession and use. Not all interest held in real estate is considered an estate; some interest can be held as security for a debt such as in a lien. The interest held in real estate can be limited by the rights or interest of others such as in the form of a lien or encumbrance.

*Liens* are legal claims or rights to property that serve as security for obligations or debt. A lien does not usually constitute ownership of a property, but it does represent a claim against the property. Lien holders can take legal action to enforce a lien if necessary. Liens are particularly useful in the event of default because they provide a relatively immediate means to liquidate a property to satisfy debt. Liens in real estate are usually attached to a specific parcel; although property with a lien can be sold, the lien will accompany it. Liens are a type of encumbrance, a term referring to any claim against a property that affects its title or use. Not all encumbrances are liens, but all liens are encumbrances.

Liens are classified as general or specific, voluntary or involuntary, statutory or equitable, and tax or non-tax. General liens affect all the property a person owns, both real and personal, whereas specific liens attach to an individual piece of property. State law often specifies exemptions to general liens. Voluntary liens go into effect because an owner takes a specific action, whereas involuntary liens affect owners’ land without
any action on their part. Involuntary liens are either statutory, which means they are created by statute, or equitable, which means that they derive from common law.

This lesson covered non-tax liens, which include mortgage liens, mechanic’s liens, judgment liens, federal judgment liens, attachment liens, vendor’s and vendee’s liens, bail bond liens, and municipal utility liens. With mortgage liens, the property is itself security for a loan. Mechanic’s liens protect parties whose labor or materials improved a parcel of real estate when an owner refuses to pay; parties must have an express or implied contract with the owner or the owner’s representative. Judgment liens apply to both real and personal property. A writ of execution can be issued by a court to force payment of monies owed from a judgment when necessary. A lis pendens notice is often given before a judgment is rendered to notify interested parties of the potential future claim on a parcel of real estate. An attachment lien, or writ of attachment, protects creditors from a conveyance of title before a judgment is rendered; the court retains custody of the property pending a decision.
Lesson 32: Taxes

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Classification of Taxes
- Ad Valorem Taxes
- Special Assessments
- Priority of Liens
- Real Estate Transfer Taxes
- Federal Taxes

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Recognize how ad valorem taxes and special assessments are levied.
- Identify how homeowners and investors can save on federal income taxes and capital gains taxes through the use of tax shelters.

Introduction
In order to raise revenue for the local community and government agencies, state and municipal governments impose taxes on real estate. Governments typically levy two types of taxes on real estate: special assessments (also called improvement taxes) and ad valorem taxes, which are assessed real estate taxes. Both types of taxes are specific, involuntary, statutory liens on a taxpayer’s real estate.
This lesson discusses special assessment and ad valorem taxes, and other taxes that relate to real estate, including: real estate transfer taxes and federal taxes on income and capital gains. A tax lien is a statutory lien that is imposed against real property if the property owner becomes delinquent in the payment of taxes. It is important to note that real estate professionals are not expected to be nor should they be treated as tax experts; however, they should be familiar with the following tax issues, and should direct a client to an accountant or tax advisor if he or she requires specific tax information.

**Classification of Taxes**

Taxes are generally classified as *progressive*, *regressive*, or *proportional*.

- **Progressive taxes**—a greater percentage of an individual’s income is taxed as the income level increases; the higher the income, the higher the tax rate.

- **Regressive taxes**—a greater percentage of an individual’s income is taxed as the income level decreases; the lower the income, the higher the tax rate.

- **Proportional taxes**—an individual pays taxes that are proportional to the amount of income at a fixed tax rate. For Example, if the tax rate is 20%, someone who earns $100,000 will pay $20,000 in taxes. If that person’s income increases to $150,000, the tax rate is still 20%, and he or she will pay $30,000 in taxes.

It is generally understood that the U.S. Income Tax is a type of progressive tax, and sales tax is a regressive tax. Income tax is a progressive tax because, as an individual's income increases, the percentage of money that is taxed increases as well; high-income earners pay a higher income tax rate. Sales tax is a regressive tax, because the percentage of money that is taxed increases as income decreases. As a result, low-income earners pay a higher regressive tax rate than high-income earners.

**Example**

To understand the effects of regressive tax, consider the following Example:
Person A has $100,000 and Person B has $1,000, and they both want to purchase a stereo that costs $500.00. The sales tax rate in their state is 8%.

First, we calculate the tax owed on the stereo. Eight percent stated as a decimal equals .08. We can multiply this amount by the cost of the stereo to find out how much tax must be paid on the purchase:

\[
.08 \times $500.00 = $40.00
\]

Second, we must calculate what percentage of each person’s income goes to sales tax if they purchase the stereo. We will first calculate Person A and then Person B.

**Person A:**

\[
\frac{$40.00}{$100,000} = X
\]

\[
X = \frac{100}{100} \times \frac{$40.00}{$100,000}
\]

\[
X = 0.04\%
\]

This means that if Person A buys the stereo, then **0.04%** of her income goes to sales taxes. Now, let's compare that tax rate with that of Person B.

**Person B:**

\[
\frac{$40.00}{$1,000} = X
\]

378 of 480
$1,000 100%

$1,000 \times X = 100 \times 40.00

X = \frac{100 \times 40.00}{1,000}

X = 4\%

This means that if Person B buys the stereo, then 4% of his income goes to taxes.

This is a significant difference in tax rates, even though Person A and Person B are buying the same stereo. If Person A buys the stereo, then only 0.04% of her income will be taxed. When Person B buys the same object, he will be taxed 4% of his income. This regressive tax rate will continue to increase as the amount of income decreases.

**Ad Valorem Taxes**

Ad valorem taxes are general real estate taxes. The term ad valorem is Latin for "according to value." It follows, then, that the amount of an ad valorem tax is determined according to the appraised value of the property to be taxed. Many governmental bodies have the authority to levy ad valorem taxes, including the following:

- Counties
- Cities
- Towns
- Districts containing parks or preserved forests
- Hospital districts
- Water districts
- School districts
Governmental bodies impose ad valorem taxes to support state and local agencies. Ad valorem taxes are specific, involuntary, statutory liens.

**Real Estate Valuation**

The value of an individual parcel of property is usually assessed for tax purposes by local assessors whose methods of appraisal may vary from state to state. Assessments are based on the market value of the property; the value of the land upon which the property is situated is usually appraised separately. Assessed values are then listed in the local *tax roll*. Homeowners may object to the appraised assessment of their property, but must take their appeals to court.

**Equalization Factor**

Value assessments for properties may vary substantially according to their location in a particular taxing district. This creates an inequity in tax assessments, and would result in an unfair distribution of statewide taxes. So, in order to equalize tax assessments throughout the state, the assessed values of properties are equalized by multiplying the assessed value of a property by an equalization factor. Taxes are then levied against the adjusted assessments, and all property owners in the state pay an equal share of the state tax.

In an area with a low tax assessment, an equalization factor greater than 100 percent is applied. For Example, if the tax assessment for an area is 20% lower than the state average assessment, an equalization factor of 120% is multiplied by the assessed value of each property in that area. In an area with a high tax assessment, an equalization factor of less than 100 percent is used. Ad valorem taxes are then calculated according to the adjusted assessments.

**Example:** A certain county’s assessments are found to be 10 percent lower than other counties in the state. The state decides to apply an equalization factor to the assessments in this county. What factor should be used, and what would be the new assessment for a home previously assessed at $120,000 in the affected area?
Let $A =$ the adjusted assessment of a home. So 90 percent of $A$ is equal to the original price of the home. To find the equalization factor, we must determine the adjusted price of the home expressed as a percentage of the original price:

$$\frac{A}{(90\% \text{ of } A)} = \frac{A}{0.9A} = \frac{1}{0.9} = 111\% \text{ equalization factor}$$

To find the new assessment value of the $120,000$ home, we multiply the equalization factor by the original assessment:

$$111\% \times \$120,000 = \$133,200$$

**Tax Rate Calculation**

When a taxing district creates a budget for a fiscal year, it must determine the total expected expenses, as well as the expected revenues from sources like revenue sharing and fees. The difference between total expenses and total revenue is equal to the amount of money that the district must raise from the collection of real estate taxes. If a district expects to raise $40$ million in revenues and expects to spend $50$ million in a given year, then the district must raise $10$ million in real estate taxes.

To determine the tax rate applied to each property owner, the district divides the total amount to be raised from real estate taxes by the total assessed value of all real estate in the district.

**Example:** A district’s fiscal budget indicates that expected expenses are $68$ million and expected revenues from fees and other sources total $66$ million. If the total assessed value of real estate in the district is $50$ million, what will the real estate tax rate be?
The total amount that needs to be raised is:

$68 \text{ million} - 66 \text{ million} = 2 \text{ million}$

Now we can express this figure as a percentage of the total assessed value of real estate:

$2 \text{ million} / 50 \text{ million} = 4\% \text{ (tax rate)}$

Tax rates are usually expressed in terms of 	extit{mills}. One mill is equal to one thousandth of a dollar ($1/1000^{th}$ of $1.00$, or $0.001$.) So, in the previous Example, the tax rate could be expressed as $4$ per $100$ of the assessed value, which is also $40$ per $1,000$. A tax rate of $40$ per $1,000$ equals $40$ mills.

**Tax Bill Calculation**

To determine an individual property owner's tax bill, the tax rate is simply applied to the assessed value (or, adjusted assessment if an equalization factor was applied) of the property. Sometimes, the bills from different taxing districts are combined into a single tax bill, and sometimes bills are given out separately. Districts may also have different ends for their fiscal years; in such cases taxes must be paid at different times.

**Example:** The assessed value of a home is $85,000. If the tax rate for that taxing district is $15$ mills, what is the total amount of taxes the property owner must pay?

If the tax rate is $15$ mills, then the owner must pay $15$ for every $1,000 of the assessed value of the property.

Therefore, $15 \times 85 \text{ (which is } 85,000 / 1,000) = 1,275$

The tax rate of $15$ mills may also be expressed as $1.50$ for every $100$. Therefore,
$85,000 \times 1.50 = 1,275

**Appropriation**

The actual method by which a district imposes a tax is called *appropriation*. A district passes a law or ordinance that states the details of the proposed tax, and the district obtains authority to collect needed funds for the proposed expenditures. Finally, the district officially imposes the tax, an action called a *tax levy*.

**Real Estate Tax Due Dates**

Due dates for real estate taxes vary from state to state and are regulated by statute. Some states require payment the same year the tax is levied, and others require payment the following year. In some cases payments can be made in installments, and only a portion of the tax bill is due during the year the tax is levied. A knowledge of local due dates, also called *penalty dates*, is especially important for the proration of taxes when a property is sold.

**Exemptions from Ad Valorem Taxes**

Many properties are exempt by state governments because the properties are used for tax-exempt purposes. Examples of properties commonly exempted include the following:

- Hospitals
- School property
- Property owned by religious organizations
- Property owned by non-profit organizations
- Property owned by municipalities, cities, and counties
State and local governments also may reduce general real estate taxes for senior citizens, on land used for agricultural purposes, or for certain industries. Other possible reductions include homesteads and reductions for persons with disabilities.

**Investment in Tax Liens**

When a taxpayer fails to pay their real estate taxes, some states impose a tax lien on the property, and sell the tax lien at a tax sale. The highest bidder on the tax lien may purchase the lien. The buyer receives a *tax lien certificate*, which entitles him to one of the following:

- A yield from the lien that must be paid by the defaulting taxpayer upon redemption (redemption is discussed later).
- Title to the property after a specified period of time.

It is important to note that the buyer does not purchase the property, only the tax lien on the property. These provisions make tax lien sales a lucrative opportunity for investment. They are somewhat risky, however, because in some states, if the delinquent taxpayer declares bankruptcy, IRS liens or liens from lenders may take priority, rendering the tax lien certificate worthless. Another risk associated with tax lien sales is that they are often sold with little opportunity to inspect the property; the purchaser may discover problems after obtaining the tax lien certificate.

**Special Assessments**

Special assessments, also called improvement taxes, are taxes levied on property to pay for public improvements. Homeowners whose property is near or adjacent to the improvement bear the expense of these improvements, but only if the owner benefits from the improvement.

Special assessments can be voluntary or involuntary. For Example, a city may decide to improve the curbs in a neighborhood without seeking approval or consent from the
homeowners. In this case, a tax lien will be placed on the affected homeowners’ property whether or not they wanted the improvement. Sometimes, however, members of a neighborhood might petition the city for a public improvement such as a sidewalk. They agree to pay for the improvement, so the special assessment is voluntary. All special assessments are statutory and specific, and are held against the affected homeowners’ properties until paid. If the assessment is not paid, a lien may be placed on the defaulting owner’s property.

Special assessments are levied for common improvements, such as:

- Gutters
- Street lights
- Curb improvements
- Street paving
- Sidewalks

Depending on the type of improvement, property owners can share the cost of improvements on an equal or prorated basis. For Example, several homeowners might equally share the cost of a street lamp, but the cost of a new sidewalk might be prorated according to the length of sidewalk built on each individual property.

**Special Assessments Procedure**

Special assessments may be imposed by implementing the following general procedure:

1. A local government body submits a proposal for an improvement, or affected property owners petition the city for an improvement. Both submissions must indicate the need for or desirability of the improvement.
2. The proper authority holds hearings on the improvement after the affected property owners have been notified of the proposal or petition.
3. An ordinance is passed that describes the improvement, the cost of the project, and the area affected.

4. The amount to be assessed is calculated against all assessable properties in an *assessment roll*. The assessment roll indicates how the cost will be divided, usually according to front footage or estimated individual benefit.

5. Public hearings are held to *confirm* the assessment roll. Community members can raise objections at this time; the proposal is then decided by a local court.

6. The special assessment becomes a lien on the affected owners' properties.

7. Local authorities issue a *warrant* after the improvement is completed that allows a local collector to issue bills to begin collecting the special assessment.

Special assessments become liens on affected homeowners' properties after the warrant and bills are issued. Special assessments may be prepaid in full to avoid interest charges or taxpayers may pay the special assessments in installments. Some taxpayers may be eligible for special assessment deferral. Types of special assessment deferrals may be used by senior citizens and disabled persons with hardship status, and for assessments levied on unimproved land.

**Priority of Liens**

A lien on a specific parcel of property evidences an owner's debt and obligation to pay the debt. If a person defaults on the lien and fails to make payments on that debt, the governing body may foreclose on the property. The property is usually sold at a public auction, and proceeds from the sale are used to satisfy the owner's debt. This money is used to pay any outstanding liens, in order of their priority.

The priority of liens is generally determined by the date when the lien was recorded in the county clerk's office. For Example, a lien that was recorded on March 1, 2004 has priority over a judgment lien that was recorded on May 31 of the same year. The priority of mechanic's liens is established not by the date of filing but by the date the work began or materials were delivered to that specific property. It is also important to note,
however, that special assessments and state property taxes have the highest priority over all other liens, regardless of when they were recorded. State law may change the order of lien priority; in some states mechanic’s liens have priority over other liens.

Consider the following Example:
A parcel of property is foreclosed and sold by a court to satisfy all of the owner's outstanding debts. This debt includes a second mortgage lien recorded in June 2002. The first mortgage on the same property was recorded in May 1997. The property owner never paid a contractor for improvements performed in September 2000, for which a mechanic's lien took effect in January 2001. A special assessment was levied for curb improvement on the property in August 2003. The order of payment from the proceeds of the sale is as follows:

1. The special assessment for the curb improvement, along with any outstanding general property taxes, is paid first.
2. The first mortgage lien is then paid, because it was recorded earliest.
3. Next, the contractor is paid to satisfy the mechanic's lien that took effect in 2001.
4. The lender for the second mortgage then receives payment.
5. Finally, if there are any proceeds left over from the sale, the property owner receives the remainder.

Subordination Agreements
Subordination agreements are written compromises between lien holders to change the priority of their liens. When buyers obtain a mortgage loan to purchase a property, lenders often require a highest-priority lien. In that case, a seller might agree to have a subordinate lien in order to sell the property, if the full price will not be paid.

Real Estate Transfer Taxes
Many states and municipalities have passed laws that impose a tax on the conveyance of real estate from one party to another. A real estate transfer tax must be paid when
the property is sold, and the seller usually bears this expense. The amount of transfer tax is set by the state; a common transfer tax rate is $0.55 per $500 of the final sales price. The money collected from this tax may be divided between the county and state. For Example, Michigan’s real estate transfer tax is $4.30 per $500 of the sales price of a single property. $0.55 of that rate goes to the county, and $3.75 goes to the state.

Real estate transfer taxes are usually paid by purchasing tax stamps, which are affixed to a deed at the time of recording at the county clerk’s office. Some states also require that both buyers and sellers sign a declaration form, which indicates the type of transfer being affected, the address and legal description of the property, and the type of deed being used to transfer title.

Some property transfers are exempt from transfer taxes. Common Examples include the following:

- Transfers between governmental bodies
- Transfers by educational or religious institutions
- Transfers of real estate as security for a loan
- Real estate gifts

**Federal Taxes**

**IRS Tax Liens**

When a person does not pay Internal Revenue Service (IRS) taxes, such as the federal income tax, the IRS may obtain an *IRS lien*, which is a general, involuntary, statutory lien that is held against all of the defaulting taxpayer’s property. The IRS will first assess the taxpayer’s liability then send a Notice and Demand for Payment to the taxpayer. If the taxpayer does not respond within ten days after receiving this notice, the IRS may then create a lien for the amount of the debt. The lien creates a claim on the taxpayer’s real and personal property, including any property purchased *after* the lien is filed.
An IRS tax lien may be released if the taxpayer satisfies the debt within 30 days by paying the amount due or by submitting a bond that guarantees payment of the debt.

Homeowners and investors must pay federal income tax on profit made from the sale or use of real estate; however, both homeowners and investors can reduce these taxes through the use of tax shelters.

**Tax Deductions**

Federal income tax is assessed according to an individual's net income. Deductions are ordinary expenses that a person pays in a taxable year that may be subtracted from his or her taxable income, thus reducing the tax liability on that income. Common deductions for homeowners include:

- Real estate taxes levied on primary residences.
- Interest on mortgage payments for primary residences.
- Other costs associated with a mortgage, such as prepayment penalties, fees, and discount points.

Homeowners *may not* deduct the following expenses from taxable income:

- The principal portion of a mortgage payment
- Depreciation expenses on a primary residence
- Insurance premiums
- Escrow payments
- Utility expenses

Deductions can greatly benefit an individual by lowering his or her tax liability; however, many of these deductions apply only to individuals who own and pay property taxes on a home. Consider the following Example, which illustrates how a tax deduction can make owning a home more lucrative than renting.
**Example:** Assume that a homeowner and a renter each make $50,000 a year. The renter pays $900 a month to rent a house, but he cannot deduct any portion of rent payments for tax purposes. The homebuyer, on the other hand, can deduct both the interest on her mortgage payment and property taxes.

Assume the homeowner owns a $100,000 home, the monthly payment on which is $1,000 dollars. Assume that the amortization period is 20 years and the principal portion of the payment is $417, so the interest portion is $583 a month. The homeowner pays a total of $6,996 in interest each year.

Assume that both the renter and the homeowner are in the 28 percent income tax bracket. After the homeowner applies her deductions, she pays less tax than the renter. The renter pays $900 a month, which comes to $10,800 a year to live in a rented house. He pays the following federal income tax:

\[
28\% \times 50,000 = 14,000 \text{ (federal income tax)}
\]

The homeowner pays $12,000 a year in mortgage payments, plus $1,000 in real estate tax, for a total of $13,000 per year to live in her home. She can deduct the interest portion of her mortgage payment, which equals $6,996, as well as the real estate tax, so she pays the following federal income tax:

\[
(50,000 - (6,996 + 1,000)) \times 28\% = 42,004 \times 0.28 = 11,761 \text{ (federal income tax)}
\]

The renter pays a total of $24,800 in rent and federal income tax; the homeowner pays a total of $24,761 in mortgage payments and federal income tax. Even though the homeowner’s monthly mortgage payment is $100 more than the renter’s monthly rent payment, they spend almost the same amount of money to live and pay taxes in this Example. If their monthly payments had been the same, the homeowner would effectively have had much lower monthly payments, after deductions were taken into
account. The homeowner’s benefits are greater still when we consider that in this case she also generated the following equity:

\[
\$417 \text{ (principal portion of mortgage payment)} \times 12 \text{ months} = $5,004 \text{ (amount of the principal paid off)}
\]

**Taxes on Capital Gains**
Capital gain refers to the profit received from selling a capital asset. Conversely, capital loss refers to the loss incurred from selling a capital asset. Capital assets include all of taxpayer’s tangible property, such as real estate, investment properties, and equipment, but do not include property that is held for regular sale to consumers. The IRS imposes a tax on all forms of capital gains. In real estate, capital gain typically can be calculated using the following equation:

\[
\text{Sales price} - (\text{purchase price} + \text{cost of improvements}) + \text{total depreciation} - \text{expenses} = \text{gain}
\]

The purchase price may be replaced by the price of the lot plus construction costs. It is important to note that residential properties do not depreciate; this part of the equation must be omitted when calculating gain on the sale of a primary residence. We will cover why and discuss depreciation in detail later in this lesson.

**Holding Period**
Whether a capital gain is taxed as a short-term or long-term gain is determined by the length of time the property is held (the amount of time between the day a property is bought and the day it is sold), called the *holding period*. If the holding period was shorter than one year, then the capital gain is short-term; if the holding period was greater than or equal to one year, the capital gain is considered a long-term gain.
Short-Term Capital Gains
Short-term capital gains are taxed as normal income, according to federal income tax rates. This means that in most cases short-term gains are taxed at a much higher rate than long-term gains.

Long-Term Capital Gains
Long-term capital gains are currently taxed at 5 percent, 15 percent, 25 percent, 28 percent, or a combination of these rates. The income level of the individual taxpayer determines the tax rate at which the gain will be taxed. For individuals in the top four federal income tax brackets, a tax rate of 15 percent applies. Most people claiming capital gains fall into this category. Capital gains are taxed at 5 percent for those in the 10 percent and 15 percent income tax brackets. If the capital gain would push these individuals into one of the top four income tax brackets, then the portion of the capital gain below the minimum for the lowest of these brackets is taxed at five percent, while the rest is taxed at 15 percent.

The 25 percent rate applies to depreciated properties, which are discussed later in this lesson. The tax rate is higher because investors received previous tax benefits by depreciating a property over its useful life; this helps the federal government to recapture money.

The 15 and 28 percent capital gains tax rate applies to gains from the sale of small business stock and collectibles. Examples of collectibles are antiques, gems, expensive wine collections, and works of art.

Homeowner Tax Benefits when Selling Principal Residences
The Taxpayer Relief Act of 1997 created certain exclusions from capital gains taxes for homeowners. Under the universal exclusion, married homeowners may exclude up to $500,000 on the sale of a primary residence and single homeowners may exclude up to $250,000. This exclusion is reusable every two years after the sale.
Taxpayers must meet ownership and use requirements to be eligible for the exclusion. The taxpayer must have owned and occupied the home as a principal residence for at least two of the five years preceding the sale. The two years may be an aggregate amount of time, and need not be continuous.

For married couples, both spouses must have occupied the residence for at least two years out of the prior five years. Only one spouse needs to have owned the property for at least two out of five years. Some time and use requirements may be modified or waived for certain individuals who cannot meet these requirements due to incapacitation, divorce, or death of a spouse. For example, if homeowners are forced to sell their homes as a result of a change in employment or health, they can exclude a fraction of $250,000, or $500,000 for joint filers, proportionate to the fraction of two years they spent at the residence.

**Exceptions**

Exceptions to the two-year use requirement also include the following:

- Property acquired in rollover transactions, which are transfers of funds to investments of the same type, used to defer the payment of taxes (i.e. 1031 exchanges)
- Property transferred by a spouse
- Property owned by a spouse, former spouse or deceased spouse
- Owners who have received care from a nursing home

Exceptions may only be made once every two years, again unless the sale is a result of a change in health or employment.

When homes are sold for under $250,000 (or under $500,000 for joint filers), the owners do not have to file an information return reporting the sale of their principal residence.
For principal residence sales occurring after May 6, 1997, sellers are required to provide to the government a written assurance containing the following two items:

1. A statement that the entire gain made from the sale can be excluded
2. A statement that the property is the owner’s principal residence

The 1997 law allows most people to avoid any taxes from gains on the sale of their primary residences because the exclusion can be used frequently; however, these benefits do not apply to investment properties.

**Application of Previous Rules**

Previous rules addressing the postponement of gain and $125,000 exclusion for individuals older than 55 years do not apply to sales after May 6, 1997. Taxpayers may choose to have the old rules apply if a sale occurred:

- On or before August 5, 1997
- On or after August 5, 1997, pursuant to a contract that was binding on August 5, 1997; or
- On or after August 5, 1997, if, under the old rollover transaction rules, gain would not have been recognized because a replacement residence was acquired (or pursuant to a binding contract) on or before August 5, 1997.

**Investors**

Real estate investors can also benefit from tax shelters. When an investor sells a parcel of real estate, gain is determined by the basis and the adjusted basis. The term *basis* typically refers to the purchase price of real estate, and the *adjusted basis* is the purchase price plus the cost of improvements less the depreciation. The gain is the difference between the selling price (minus expenses) and the adjusted basis.
Depreciation

Investors can use depreciation, sometimes called cost recovery, as a tax shelter on investment property to recover costs. The term *depreciation* generally refers to the decline in the value of an asset or property due to use, wear or obsolescence. Depreciation may also refer to the allocation of the cost of an asset over its useful life. Only improvements to a parcel of real estate depreciate. The land itself is considered to be indestructible and, therefore, does not depreciate. An improvement, such as the construction of a home on unimproved land, only depreciates and can therefore be deducted from the taxpayer's income when the property is used to generate income, such as a rental house. Improvements may be depreciated regardless of the physical damage and deterioration the property suffers. Tax deductions from depreciation lower the adjusted tax basis of a property.

Capital Gains on Depreciated Properties

When investors claim depreciation deductions for a piece of property, the depreciated portion of the gain is taxed at a rate of 25 percent, and the rest is taxed at the usual rate of 15 percent (or five percent).

**Example:** An investor sells a building for $700,000. The building has depreciated $100,000 in value, and was originally purchased for $500,000. What will the capital gains taxes be for this sale (assume the seller is in one of the top four income tax brackets)?

Because the building has depreciated by $100,000, the gain is $300,000. The $100,000 portion is taxed at 25 percent, and the remaining $200,000 of the gain is taxed at 15 percent. So the total tax paid will be equal to the following:

\[
25\% \times 100,000 + 15\% \times 200,000 = 25,000 + 30,000 = 55,000 \text{ (total capital gains tax)}
\]
Removal of IRS Tax Liens

The following are Examples of ways to remove IRS tax liens:

- Tax liens can be removed when such an action benefits both the IRS and the individual.
- Tax liens can be removed if they are not in agreement with established procedures.
- The IRS can remove a tax lien if the taxpayer enters into an installment agreement, which involves periodic payment of the tax debt.
- If the IRS mistakenly imposed a tax lien, it can be sued for its removal.
- Taxpayers can appeal tax liens.
- If taxes are not collected within the period of time set forth in the statute of limitations, IRS tax liens are removed (usually they will be removed in 10 years).
- Tax liens can be removed if they are imposed prematurely.
- Tax liens can be removed if written notice of the lien is not issued within five business days of the day of filing; the notice must specify the amount as well as inform the recipient of the right to appeal the lien within 30 days of the notice’s issuance.
- Tax liens can be removed if they are not based on an assessment that adheres to the requirements of valid assessments.
- Tax liens can be removed if the National Taxpayer Advocate determines that removal is in the best interest of the taxpayer.

Offer in Compromise

If taxpayers are unable to pay their tax debt in full, and payments in the installment program is not a viable option, the IRS may accept an offer in compromise from the taxpayer. An offer in compromise allows the taxpayer to pay the IRS an amount that is less than the amount of delinquent taxes under certain circumstances. Requests for offers in compromise might be granted in the following situations:
- A doubt exists that the amount for assessed taxes the taxpayer owes is correct.
- The taxpayer is unable to pay the full amount; all assets are considered for ability to pay that are in excess of the amount needed for basic living expenses.
- An individual suffers a hardship, and the collection of the tax would be inequitable or unfair.

After a request for an offer in compromise has been accepted, the IRS may not pursue collection action until the request is accepted or rejected. If it is rejected, the request may be appealed. Requests often take about one year to process, but may take longer if the tax liability is greater than $50,000. If an offer in compromise is accepted, the IRS has 30 days to remove the tax lien.


**Other Tax Liens**

There are other tax liens that we have not covered. For example, liens can be enforced when state inheritance or federal estate taxes, as well as corporate franchise taxes, fall delinquent. State inheritance taxes and federal estate taxes are general, involuntary liens created by statute that apply to deceased persons' property; the taxes are normally paid in probate court. Some states require corporations to pay a franchise tax to conduct business in the state. Failure to pay such a tax can result in a *corporation franchise tax lien*, a general, involuntary lien that may operate as a priority lien on all corporate property.

As previously noted, not all taxing districts have the same tax liens and often there are multiple taxing authorities that govern a particular parcel of real estate. To know all of the tax liens that affect a particular property you must consult all local, state, and federal tax authorities.
Lesson Summary

The two main taxes affecting real estate are ad valorem taxes and special assessments. Other taxes that might affect real estate are real estate transfer taxes, federal income taxes, and capital gains taxes. Taxes can be generally classified as progressive, regressive, or proportional.

Ad valorem taxes are general real estate taxes that can be levied by many types of governmental bodies. Some parcels of real estate are exempt from these taxes, such as nonprofit organizations. Real estate is typically appraised, or assessed, for tax purposes by local assessors; if particular districts are appraised below or above surrounding districts, the state may apply an equalization factor to make the distribution of the tax burden fair.

Districts calculate real estate taxes as follows: total estimated expenses—total expected revenue from other sources such as fees = total money needed; the total amount that needs to be raised is distributed as a tax burden proportionally to each parcel of real estate. The method by which a district officially imposes taxes is called appropriation. Due dates for ad valorem taxes vary from state to state. Individuals can invest in tax liens; they can be highly lucrative but are somewhat risky.

Special assessments are taxes levied for public improvements and can be voluntary or involuntary; they attach specifically to those parcels of real estate whose owners benefit from the improvement. Special assessments are always statutory, specific liens.

When a court sale of a parcel of real estate occurs, money is paid out according to the established priority of liens. Ad valorem taxes and special assessments generally have priority over all liens. Other liens are usually paid off in the order they took effect, which in most cases means the order in which they were recorded. Subordination agreements allow the priority of liens to change.
Some states impose real estate transfer taxes that take effect whenever a parcel of real estate changes title.

This lesson discussed federal income taxes and several tax shelters that homeowners and investors can use to save money on the purchase or sale of real estate. Mortgagors can deduct real estate taxes and the interest portion of mortgage payments from federal income tax, effectively lowering their monthly payments. Homeowners who sell their primary residences are now exempt from capital gains tax for gains of up to $250,000 (for single filers), if they have lived in the dwelling for two of the previous five years. Short-term gains are taxed as regular income, whereas long-term gains (sales of property held for longer than one year) are taxed as capital gains; investors can save money by owning property on a long-term basis. Investors can also save money through depreciation, also called cost recovery, which can be deducted from income.

Federal income tax liens can be removed in special cases, such as when removal benefits both the government and the individual. The IRS is also sometimes willing to accept an offer in compromise, under which the IRS will accept a lower amount of money to satisfy the tax lien.
Lesson 33: Real Estate Practice

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Field Applications of Land Descriptions and Real Property Concepts

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Identify boundaries or locate a parcel of land using the meets and bounds description method.
- Identify concerns in given case study scenarios.

Introduction
We have covered a lot of specific information over a relatively short period of time. To ensure a comprehensive understanding of these details, we will now integrate the information provided in this section, using case studies that examine the principles and ideas presented. Upon completion, you will have a better understanding of the real-world applications of the information you have been studying.

Field Applications of Land Use and Real Property Concepts
Please consider the following case studies. After reading the details of each situation, use the information you have learned in this course to decide how you could resolve the dilemma or complication.
Case Study 1
Developer A establishes the size and shape of each residential lot in her plat using the metes and bounds method of land description. After she gives each lot a lot number, gives each block a block number and gives the tract itself a name, she wants to begin selling the lots to potential homeowners. How can her choice of land description method make the conveyance process easier for both herself and potential purchasers?

Answer
Every deed requires a legal land description. Rather than record the extended metes and bounds description of each lot every time one is sold, Developer A could record the plat itself with the proper local authorities and then refer to the tract, block, and lot number of each parcel in its individual deed. To record her plat, Developer A must take the finished map, with the metes and bounds descriptions labeled, to her county records office. This office will record her plat as a unit among the other plats in the area. The recorded plat method is probably the simplest method of legal land description, although it is not as commonly used as the rectangular plat. Note: it is not legal in Texas to refer to a tract by lot and block until the subdivision plat has been approved and recorded with the county recorder’s office.

Case Study 2
Purchaser A, represented by Licensee C, receives land from Seller B. Purchaser A is looking at the parcel's description in the deed; it is identified as “Section 1 of T4S, R2E Niceville, TX.” This description leaves Purchaser A a little confused. What general information could Licensee C offer Purchaser A that would ease his client's confusion?

Assuming there are no further specifications regarding the property, Licensee C should be prepared to answer the following questions.

- **What kind of land description does the deed use?** Given the nature of the description, we know that the deed uses the rectangular survey method of land
description. This method employs a grid system which relies on longitude and latitude.

- **To what does the term "section" refer?** “Section” refers to a one-square-mile unit within a township. This number identifies the location of the lot as one of the 36 one-square-mile sections that make up a township. The section numbers begin in the top right corner of the 36-square-mile block, so we know that section one is the unit in the uppermost right.

- **To what does the term “T4S” refer?** “T4S” identifies the location of the township on a north-south continuum. “T4S” tells us that the township is in the fourth row of townships if we go south from the base line that helps to define the 24-by-24 mile area that contains this township along with many others. There will be four township lines between the baseline and this township, running east-to-west, occurring every six miles.

- **To what does the term “R2E” refer?** “R2E” identifies the range in which the township is located. Ranges are a north-to-south analogue of township lines, creating vertical columns every six miles running outward from a principal; meridian. Taken together, the ranges and township lines create a grid of six-by-six mile squares, i.e., a grid that marks the various townships in a check.

- **Using cardinal directions and basic “left/right” terminology, where is Purchaser A’s land located relative to the principal meridian, the base line, and within the township?** Purchaser A’s lot is located four townships south of the base line (a specially-noted latitude line), two ranges east of the principal meridian (a specially-noted longitude line) and in the rightmost top corner of the township.

- **How big is Purchaser A’s parcel?** Since there are no further restrictions in the description (such as might suggest that Purchaser A’s lot is only a fraction of section one), we can conclude that Purchaser A’s lot includes the entirety of section one, which is one square mile or 640 acres.
An actual land description by rectangular survey in a deed will usually be more complex than the description given here, as most parcels do not consist of a single, whole section; this may mean that the survey description will exceed a licensee’s knowledge on the subject. A more detailed explanation of the rectangular survey method is probably a bit much to offer the average consumer. Nevertheless, one can see how knowledge of this terminology can set a licensee apart from a less knowledgeable real estate professional; these distinctions are becoming increasingly important as the industry continues to grow. If Licensee C is able to convey at least some accurate and helpful information about survey descriptions, then he is likely to stand out among his peers, fostering a loyal clientele base and good recommendations, as well as creating an image of dependability and reliability.

**Case Study 3**

Buyer A contracts Licensee B to locate a suitable property near a river. Licensee B locates several local parcels she feels will satisfy Buyer A’s needs, and Buyer A and Licensee B examine a few of the locations. Buyer A informs Licensee B that he likes one of the parcels and would like to look into purchasing it. During a discussion of the purchase, Buyer A states that he likes this particular location because he is interested in building ponds in his backyard; he believes that the river will allow him to do this easily and cheaply, compared to pumping all the water from the city water mains. Licensee B tells Buyer A that he might not be permitted to do this, even if the river flows extremely close to the property. Is Licensee B correct in her concern? Why or why not?

**Answer**

Licensee B is correct to be concerned about her client’s plans because of the nature of riparian rights, i.e., the rights that property owners have regarding the use of and access to the rivers and streams that cross or border their properties. Generally speaking, these property owners must use the river or stream water in conjunction with the other owners along the same waterway. No one owner has complete ownership of the river or stream, so everyone must use the water that flows along or through their properties in a reasonable and equitable way. If a particular owner’s use greatly affects the natural
course or content of the waterway, then he or she is probably violating the riparian rights of other owners who share the stream or river.

It may be that Buyer A’s plans for his backyard ponds will not affect nearby property owners' riparian rights. It is good that Licensee B brings this issue to her client's attention as it may affect Buyer A’s decision to purchase that particular parcel. Buyer A may need to check with several other professionals, such as an attorney or an environmental expert, before attempting to carry out his project.

Case Study 4
Creditor A files suit against Debtor B for failure to repay a loan. The creditor is worried that Debtor B may decide to convey title to the real estate he owns, and give his valuable personal possessions to a family member, thus preventing Creditor A from obtaining payment. Creditor A decides to seek a writ of attachment. Which of the following statements are true about writs of attachment?

- Under a writ of attachment, the court maintains custody of the property until a judgment is rendered.
- Debtor B has no means for recovering lost money from the writ of attachment.
- A writ of attachment will protect Creditor A from a title conveyance of Debtor B’s real property.
- If Debtor B does not wish to have all the property he owns attached, then he can request to have certain property exempted from the writ of attachment.
- A writ of attachment is also referred to as a writ of certiorari.

Answer:
Under a writ of attachment, the court maintains custody of the property until a judgment is rendered. A writ of attachment will protect Creditor A from a title conveyance of Debtor B’s real property. If Debtor B does not wish to have all the property he owns attached, then he can request to have certain property exempted from the writ of attachment.
Creditor A is required to post a surety bond or deposit great enough to cover any potential losses the defendant might suffer. A writ of attachment is also called an attachment lien.

As previously noted, certain property may be exempted. Which items are likely to be exempted from the writ of attachment?

**Answer:**
Exemptions are often limited to a certain value; they vary from state to state but might include items such as:

- Tools used for a trade or business
- Social Security
- Basic household appliances and furniture
- School books
- Money owed to debtors for child support or injury
- Prescription health supports
- Basic wages
- Cemetery lots

**Case Study 5**
A state has determined that a particular county’s tax assessments are unusually high. Homes appraised at $80,000 in other jurisdictions were compared with similar homes in this area that were appraised at $100,000. The state decides to apply an equalization factor to the county to make the real estate tax burden more fairly distributed. What equalization factor must the state apply?

**Answer:**
To determine the equalization factor, we express the price of homes in other counties as a percentage of the area in question.
$80,000 / $100,000 = 80% equalization factor

We can check our work by applying the equalization factor:

\[ 0.8 \times 100,000 = 80,000 \]

Now apply the equalization factor to another home in the equalized jurisdiction with an originally assessed value of $540,000.

\[ 0.8 \times 540,000 = 432,000 \]

**Case Study 6**

A taxing district’s fiscal budget outlines the following information:

- The total expected expenses for the district are $50,000,000.
- The expected revenues from fees and other sources (excluding real estate taxes) are $47,000,000.
- The total assessed value of real estate in the district is $120,000,000.

What will the real estate tax rate be for the year, and what will the tax bill be for an owner whose property is assessed at $220,000?

**Answer:**

The district needs to raise the following amount of money in real estate taxes:

\[ 50,000,000 - 47,000,000 = 3,000,000 \]

To determine the tax rate, we must express the needed money as a percentage of the total assessed value of real estate in the district:

\[ \frac{3,000,000}{120,000,000} = \frac{3}{120} = 0.025 = 2.5\% \]
What is the tax rate expressed in mills?

One mill is equal to \( \frac{1}{1,000} \)th of one dollar. To convert the percentage to mills, we must express the tax rate as a decimal and multiply by 1,000:

\[
.025 \times 1,000 = 25 \text{ mills}
\]

Now determine the tax bill for the property owner whose real property was assessed at $220,000:

\[
2.5\% \times $220,000 = .025 \times $220,000 = $5,500
\]

**Case Study 7**

Homeowner A purchased a home a year ago, and now is trying to calculate her federal income taxes. Use the following information to calculate Homeowner A's federal income tax bill after deductions:

- Homeowner A makes $80,000 a year.
- Homeowner A's income tax rate is 25 percent.
- Homeowner's monthly mortgage payment is $2,000.
- The principal portion of Homeowner A's mortgage payment is $800.
- Homeowner A pays insurance premiums of $200 a month.
- Homeowner A's utility expenses for the year totaled $1,200.
- Homeowner A's real estate taxes for this property are $2,500.
- Homeowner A paid $500 in deductible mortgage fees during the year.

**Answer:**

Homeowner A must first determine her federal income tax deductions for the year. Of the listed items, the interest portion of the mortgage payment, the real estate taxes, and the mortgage fees are deductible. Homeowners typically cannot deduct insurance premiums, utility expenses, and the principal portion of interest payments.
She can now calculate her total deductions:

$2,000 (total mortgage payment) — $800 (principal portion of payment) = $1,200 interest portion of payment

$1,200 (monthly interest payment) \times 12 \text{ months} = $14,400 total interest payment for the year

$14,400 (total interest) + $2,500 (real estate tax) + $500 (mortgage fees) = $17,400 total deduction

$80,000 (yearly income) - $17,400 (deductions) = $62,600 taxable income

Homeowner A’s tax rate is 25%, so she must pay the following amount in income taxes:

\[ 25\% \times 62,600 = 15,650 \]

After deductions are taken into account, what are Homeowner A’s effective monthly savings on her mortgage payment?

If Homeowner A were renting, she would receive no tax deductions, so all of her income would be taxed:

\[ 25\% \times 80,000 = 20,000 \]

Her monthly savings, then, are the following:

\[ 20,000 - 15,650 = 4,350 \]
\[ 4,350 / 12 \text{ months} = 362.50 \text{ (monthly savings)} \]
\[ 2,000 - 362.50 = 1,637.50 \text{ (effective monthly payment)} \]
Case Study 8

Homeowner A has just sold her primary residence. Property values have gone up considerably over the years: she originally bought the property for $180,000, but she was able to sell the home for $400,000. She has lived in the home for the past 10 years. Assume that the capital gains tax rate is 15 percent and that she is in the 28 percent federal income tax bracket. What is the total amount of tax that Homeowner A must pay for the sale of her home?

Answer:
She does not have to pay any tax on the gain. According to a 1997 tax law, sales of principal residences are exempt from capital gains taxes for gains up to $250,000, or $500,000 for those filing jointly ($250,000 for each spouse). To be exempt from capital gains taxes, homeowners must have lived in their primary residence for two of the previous five years before the sale, so the sale of Homeowner A’s home is exempt from capital gains taxes.

What kind of tax applies to the gain on the sale of an investment property that was bought nine months prior?

Answer:
Federal income tax. Because the investor owned the property for less than one year, the gain is taxed as normal income. The investor would most likely save money if she had waited to sell the property and generated a long-term gain instead of a short-term gain.
Introduction to Contracts

Real estate professionals expend a great deal of effort on listings. Obtaining, showing, and selling listings occupy much of any licensee’s working time. Because these listings are so important to a successful licensee, it would be unfortunate if a transaction fell through because of a misunderstanding or uncertainty surrounding an agreement to buy or sell a listing.

To avoid these problems, licensees should make an effort to understand contracts, which are the legally binding agreements that prevent such misunderstandings and
uncertainties in real estate transactions. Clear, mutually-acceptable agreements are an essential component of the legal transference of ownership, and contracts are the instruments by which such agreements are legalized in real estate transactions.

Parties who are entering into an agreement regarding ownership or other kinds of interest in real estate need a contract because it establishes the terms of the agreement in clear and comprehensible language. It allows the parties to understand their role in their agreement and to know what is expected of them. If either party disputes the agreement, the parties should be able to use the contract to resolve any confusion. A well-defined and comprehensive contract establishes the facts of the agreement in mutually-accepted terms, and can often prevent the parties from having to go to court to resolve their conflicts.

Both parties are liable for carrying out the terms of the contract—that is, they are obligated to perform (or refrain from performing) any actions required by a legally valid contract that they have signed or otherwise accepted. Because contracts create obligations that can be legally enforced, it is extremely important both parties understand and accept all of the stipulations in any contractual agreement. This requires they understand the different types of contracts that exist (so they know what options they have); they should also be able to recognize the basic components of a legally valid contract, so they can tell whether a given contract will have the legal effects it should.

Because contracts serve many purposes, they take many forms. This lesson will focus on those that are most commonly involved in real estate transactions, though the lesson will also provide a more general discussion of the various types of contracts that exist. For example, legally valid contracts can be written or oral. Another perhaps surprising fact about contracts is that (depending upon the intent of the agreement) a contract can require action on the part of all the contracting parties or it can impose obligations on only one of the contracting parties.
Because of the variety of contracts and the important differences between them, it is prudent for the contracting parties to consult with knowledgeable professionals who can help guide them through the process of choosing and accepting a contract.

**Types of Contracts**

This lesson discusses the general types of contracts available along with their purposes and differences. Contracts take on specific forms in order to carry out specific purposes and can be as simple or as complicated as a situation may require. Contracts do not always have to be written and signed. A strictly oral or implied contract can be just as legally binding as a written contract.

Contracts can require the action of all the parties involved or merely the action of one party along with just the acceptance of the one party’s action from the other parties. The real estate industry relies heavily on certain types of contracts to facilitate the tasks at hand. It is wise to acquire the consultation of a professional who can guide all parties involved through the process of choosing, writing, and accepting a contract catering to their needs.

**Note:**

Oral contracts are established when the offeror states the offer and the offeree accepts the offer. In an oral contract, there are no formal or written documents spelling out the terms and conditions of their agreement. Instead, each party relies on the word of the other. Oftentimes, oral contracts are called verbal contracts in everyday speech. The term “verbal” simply means “in words.” This would make all contracts verbal contracts, regardless of whether they are written or spoken. For legal purposes it is best to use the term “oral contract” (meaning a *spoken* agreement) when we want to identify a contract that is not recorded in writing.
Implied Contracts

Implied contracts are inferred from the actions of various parties, but are not necessarily written or spoken. Even though these contracts are established by the parties’ conduct rather than a written document or an explicit discussion, they can have all of the legally binding power of more explicit contracts.

For implied contracts to be legally enforceable there must be an exchange of promises. One party offers money, services, property rights, etc., in exchange for something else of value. Implied contracts have an offer and acceptance that are simply understood and not explicitly spoken or written.

Examples of implied contracts include:

- When individuals visit their doctor for an examination, they generally expect to pay for the exam at the end of the visit. It is the general social conventions surrounding medical practices combined with an individual’s acceptance of the doctor’s services that create an implied contract between doctor and patient. The patient owes the doctor compensation for services rendered.
- When an individual dines at a restaurant, orders food and eats it, he or she creates an implied contract with the restaurant. The individual is expected to compensate the restaurant for the meal.
- When an individual takes a taxi cab to one’s destination, this creates an implied contract with the cab driver. The passenger must compensate the cab driver for the transportation provided.

Note:

Social conventions play a large role in creating implied contracts. To avoid errors, oversights and misunderstandings from an individual not familiar with a specific service, many individuals take steps to spell out the terms of implied contracts. Taxi cab drivers post rates on the windows of their taxi cab. Restaurants post prices on their menus. This makes it clear services are for sale, not a gift.
Real estate licensees should not let any aspect of their services be defined by an implied contract. Implied contracts do not help avoid errors, oversights, and misunderstandings of an agreement with individuals outside the real estate industry. Implied contracts are likely to be a source of confusion. For Example: a licensee can show prospective clients many properties and not be their real estate agent.

**Express Contracts**

Express contracts are oral and written contracts in which the parties explicitly state, or “express,” their intentions and their expectations regarding the contract. They stand in contrast to implied contracts where the existence of a contract (and the nature of its terms) is inferred from the parties’ conduct.

If one party deviates from the agreed-upon terms of an express contract, the injured party can seek damages and legal recourse. Express contracts essentially serve as a reference in the event of errors, oversights, and misunderstandings. An express contract best serves as a reference when it is written.

A lease agreement is an express contract in which both the lessee (tenant) and the lessor (landlord) sign the agreement. If the lessee fails to uphold the terms in the lease, then the lessee is subject to the conditions set forth in the lease agreement concerning such violation. Most written leases explicitly state the penalties (such as late fees or eviction) for violations (such as non-payment of rent), which provide prospective tenants and landlords an opportunity to see and consider all terms before accepting a lease.

**Bilateral Contracts**

This is an agreement in which both parties give consideration and promise to perform the actions specified in a contract. This kind of contract creates reciprocal obligations, in which each party is mutually obliged to the other.
Examples of bilateral contracts include:

- In a bilateral contract, Party A must promise to do something for Party B and Party B must promise to do something for Party A. This contract obligates both parties to fulfill certain terms. To satisfy or complete a bilateral contract, all parties involved must carry out their promises.
- In a real estate transaction, the buyer (Party A) promises to pay the seller (Party B) the agreed-upon price and the seller (Party B) promises to transfer the property title to the buyer (Party A). There are thus specific things both of them must do before the contract can be considered complete. If the buyer pays the seller, but the seller does not transfer the title, then the contract is not complete and the buyer can seek legal recourse against the seller for failing to honor the obligations imposed by the contract.

Unilateral Contracts

This is a contract made between two or more parties in which only one of those parties makes a promise or otherwise accepts an obligation. In short, this is a contract in which only one of the contracting parties is bound to act.

Examples of unilateral contracts include:

- In a unilateral contract, Party A makes a commitment and Party B accepts this commitment. This contract is completed or fulfilled when Party A has carried out the commitment. There is nothing Party B must do to execute such a contract. Party A does not have to agree to the contract openly or explicitly. Instead, Party A agrees to the contract by carrying out the action specified in the contract.
- A broker promises to pay a $1,000 bonus to any salesperson who brings in 10 new listings, not knowing who will bring or will not bring 10 new listings. This does not obligate a salesperson to do anything. The broker unilaterally agrees to give $1,000 to any salesperson who satisfies the set performance standards. No
salesperson in the office has to agree to anything but may collect on the promise if he or she chooses.

**Executed Contracts**

This is a pre-existing contract in which all terms have been fulfilled by all parties. There are many kinds of contracts, but all contracts become an executed contract once all parties have completed their contractual obligations. When a contract is fulfilled, then it is executed, or ceases to exist. It has no further legal power to bind any of the parties and is not considered to have any meaningful legal existence.

For Example, a buyer pays a seller the agreed price for an agreed property and the seller has transferred the title to the buyer. If there are no further stipulations in their particular contract, then they have an executed contract.

**Executory Contracts**

This is a contract that is not completely executed or performed. The terms are not fully carried out or are in the process of being carried out by one or more parties in the agreement. Usually, executory contracts are created when one party fulfills his or her end of the agreement, but the other party has not yet fulfilled his or her part of the agreement.

For Example, a broker promises to pay the top salesperson $5,000 at the end of the year. The broker does not pay anyone this bonus at the year’s end. The broker and the top salesperson have an executory contract, where the salesperson has fulfilled one end of the contract, but the broker has not fulfilled his or her promise.
Valid, Void, and Unenforceable

Valid Contracts

Valid contracts are legal agreements meeting all the essential, basic requirements of the law. They accurately reflect the contracting parties’ intentions, making them legally binding and legally enforceable for all parties involved.

The five components of a valid contract are:

1. Mutual assent
2. Legally competent parties
3. Consideration
4. Lawful objective
5. Adherence to a statute of frauds

The features of a valid contract will be discussed at length in the next lesson.

Void Contracts

This is a contract failing to meet the legal requirements defining a valid contract. A void contract is not legally enforceable against any of the contracting parties. It is a contract in name only. All contracts have the potential to become void contracts, because all contracts can be invalidated if they involve minors, mentally incompetent individuals, misrepresentation, fraud, or illegal actions.

For Example, if Party A and Party B enter into a contract, but the fulfillment of the contract involves an illegal activity, the contract is void, that is either the parties to the contract or terms of the contract have rendered it void. The contract was not valid in the first place.
Voidable Contracts
This is a valid contract structured so it can be terminated or rescinded by either party. Voidable contracts specifically permit one or both parties to opt out of an agreement under specific reasons, often having to do with non-performance of some or all terms of the contract.

For Example, a seller agrees to deliver a valid title clear of any financial obligations to the buyer. Their contract specifically states the buyer can opt out of the agreement with no legal consequences if such conditions are not met. The buyer discovers a lien has been placed on the title. The voidable contract now permits the buyer to invalidate the contract and walk away without facing legal repercussions because the seller failed to produce the kind of title required in the contract.

Unenforceable Contracts
This is a valid contract that cannot be enforced legally due to a technicality or it is in contradiction with a state’s legislation.

The most common reasons a valid contract becomes unenforceable are:

- **Statute of Frauds**: A state law establishing the features of a valid contract. The law generally requires certain types of contracts to be set out in writing and written contracts be signed by all the parties bound by the contract.
- **Statute of Limitations**: A state’s statute of limitations is a law establishing a time limit for civil suits, setting a maximum period of time to elapse between the dates an injury occurs or the basis for a legal claim is discovered and the date a civil lawsuit is filed. There are also federal statutes setting maximum time limits regarding federal crimes and suits filed in federal courts. All claims must be filed prior to the statutory deadline or the legal right to press a claim is barred.
- **Doctrine of Laches**: The doctrine of laches is a principle that courts use to bar dated claims. Under this doctrine, unreasonable delay or negligence in asserting or defending one’s rights can create a legal bar to equitable relief if a delay or
negligence has importantly influenced the conduct of the person responsible for the violation.

**Note:**
Licensees should acquaint themselves with the specific requirements set out in their state’s statutes, because there are frequently subtle differences between one state’s statutes compared to another state’s statutes.

Person A has a legitimate claim against her old firm for sexual harassment. She waits many years to file her claim, but is still within the statute of limitations. During those many years she waited, the alleged harasser has passed away and all witnesses have moved. Person A does not have a reasonable explanation for her delay in filing the claim. The courts deny her claim under the doctrine of laches, as she has no explanation for the delay in filing her claim. A trial cannot be held without the accused harasser, evidence, or witnesses. In this case, Person A receives no legal relief on a valid claim still within the statute of limitations due to her negligence in filing her claim within a reasonable time period.

**Lesson Summary**
You have been introduced to the most general distinctions among contracts:

- **Implied contracts** are inferred from the actions of various parties and are not necessarily written or spoken and can be just as legally binding as more explicit contracts.

- **Express contracts** are the opposite of implied contracts and are often in writing where the terms of the contract are explicitly stated and accepted.

- **Bilateral contracts** create mutual or reciprocal obligations involving a promise being exchanged for a promise. They require all parties to carry out all promises.
• Unilateral contracts—One party promises to perform and the other party accepts this promise, requiring only one party to act.

• Executed contracts are pre-existing contracts in which all terms have been fulfilled by all parties; all contracts become executed and cease to legally exist.

• Executory contracts are partially or wholly incomplete and are usually created when one party completely fulfills his or her end of the agreement, but the other party has not.

• Valid contracts have five components:
  
  1. Mutual assent
  2. Legally competent parties
  3. Consideration
  4. Lawful objective
  5. Adherence to a statute of frauds

• Void contracts are contracts only in name and are not legally enforceable. They are not legal, but also not illegal if fulfilled.

• Voidable contracts have all the essential features of a valid contract as well as additional provisions allowing either party to opt out of the agreement.

• Unenforceable contracts cannot be legally enforced for the following reasons:

  o Technicality or mistake
  o Failure to adhere to the statute of frauds
  o Failure to adhere to the doctrine of laches
Lesson 35: Features of a Legally Valid Contract

Lesson Topics
This lesson focuses on the following topics:

- Mutual Assent
- Legally Competent Parties
- Consideration
- Lawful Objective
- Adherence to a Statute of Frauds

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Outline the features of a contract (and the contracting parties) that make a contract legally binding.
- List the essential elements for a legally binding contract

Mutual Assent
A legally valid contract is an agreement meeting all essential, basic requirements of the law reflecting the contracting parties’ intentions making it legally binding and legally enforcing for all parties. If a contract is not legally valid, other facts in or about the contract are unimportant because it ceases to exist legally.

A major requirement for a legally valid contract is mutual assent. This requires all the contracting parties to agree to all of the contract’s provisions and conditions. Parties can
indicate their agreement to a contract’s provisions and conditions via actions and/or words.

- Mutual assent requires:
  - An offer and an acceptance
    - A counteroffer to the original offer can exist
    - Acceptance of the original offer is not required
  - The absence of fraud, misrepresentation or duress
  - The absence of mistakes

A buyer offers to purchase a seller’s property for a mutually agreed upon price of $50,000. Both the seller and buyer agree to this price. The seller transfers the title to the buyer, and the buyer places a down payment on the property. The seller and buyer show mutual agreement to their real estate contract through their actions.

**Offer and Acceptance**

When making an offer it is important to remember that the offeror is the person extending the contract and the offeree is the person accepting the contract.

An offer remains open until it:

- Is accepted
- Is rejected
- Is retracted prior to acceptance. For Example: The offeror can revoke the offer at any time if he or she has not heard from the offeree, whether the offeree has technically accepted the offer or not.
- Is countered
- Expires
There are three types of acceptance:

1. **Express acceptance**: A candid and unqualified outward manifestation of an agreement, such as: “Yes, I agree to your offer.”

2. **Implied acceptance** is:
   - When the parties bound by the contract act in a manner implying acceptance of the offer
   - Expressed when all parties involved act out the contract’s obligations instead of openly stating an agreement or acceptance

3. **Conditional acceptance**:
   - Requires a specific condition to be satisfied or an event to take place before acceptance of the contract
   - Can be viewed as a counteroffer
   - Is such as: “I will buy this shirt if you give me a 20% discount.”

**Example of Offer and Acceptance**

A seller advertises that a property is selling for $250,000. A buyer contacts the seller by phone and verbally accepts the terms of his offer of $250,000 for the title to the property. The seller accepts the money and gives the buyer the title to the property. The buyer accepts the title to the property and gives the seller $250,000. The contract is signed, the money is deposited into the seller’s account, and the title is transferred into the buyer’s name.

What is the offer in this Example?

**Answer:** The seller offering the property for $250,000 represents the offer.
**Answer:** The buyer expressly accepts the offer when he calls him on the phone.

You would consider this to be what type of contract?

- **Bilateral contract:** A bilateral contract is when both parties give consideration and promise to perform the actions specified in a contract. This kind of contract creates reciprocal obligations, in which each party is mutually obliged to the other. Given the three options, this is a bilateral contract. It can also be considered an express contract.

- **Unilateral contract:** A unilateral contract is made between two or more parties in which only one of those parties makes a promise or otherwise accepts an obligation. In short, this is a contract in which only one of the contracting parties is bound to act. Therefore, this is not a unilateral contract.

- **Voidable contract:** A voidable contract is a valid contract structured so it can be terminated or rescinded by either party. Voidable contracts specifically permit one or both parties to opt out of an agreement under specific reasons often having to do with non-performance such as a prenuptial agreement. Therefore, this is not a voidable contract.

**Counteroffers**

Counteroffers are attempts to find mutually-acceptable contract terms. The counteroffer is a modification of the terms the offeree does not agree to and are presented to the offeror as a modified contract. An offer is considered to be rejected if the offeree makes changes to the offer. A new offer (the counteroffer) is now on the table.

The seller advertises a property is selling for $250,000. A buyer contacts the seller and offers him a counteroffer of $225,000 for the property. The seller tells the buyer he is considering the offer. The buyer states to the seller the offer will be revoked in two weeks. The seller has two weeks to make a decision.
The seller has the following options:

- To accept the offer by
  - Express acceptance
  - Implied acceptance
  - Conditional acceptance

- To reject the offer by
  - Allowing the offer to expire
  - Verbally rejecting the offer

- The buyer can:
  - Wait until the offer is accepted
  - Wait until the offer is rejected
  - Retract the offer prior to acceptance
  - Wait until the offer is countered
  - Wait until the offer expires

**Fraud and Misrepresentation**

Contracts involving fraud, misrepresentation, or duress create a situation in which the parties involved are unable to make a free, fully-informed decision about the agreement.

*Fraud* is intentional misrepresentation or concealment of significant facts. Fraud includes false statements, false promises, and intentional failure to disclose important information resulting in losses for other parties.

*Misrepresentation* means to give a false or misleading representation, usually with intent to deceive or be unfair.
Note:

_Innocent_ misrepresentation is not fraud. Innocent misrepresentation occurs when an individual provides incorrect information, but does not intentionally deceive another person. For Example, suppose a buyer visits a seller's home and notices a hiking trail behind the property. The seller speaks highly of the trail and the benefits it adds to the location. The buyer loves the prospect of living near a trail and makes an offer on the house, which the seller accepts. The city closes the trail to the public two weeks before the buyer moves into the home. The seller genuinely did not know about the city's plans to close the trail and had no intention of misrepresenting the trail as a benefit of his property. The seller did not intentionally withhold information with the intention of deceiving the buyer.

Suppose a buyer tells a licensee to look for a home in a safe neighborhood in which the buyer can raise a family. The licensee shows the buyer a wonderful three-bedroom home. The buyer specifically asks if crimes have recently been committed in the area. The licensee states there have been no crimes committed in the area. The licensee knows five cars in the area were stolen within the last three months. The licensee purposefully withholding information that will affect the buyer's decisions about a specific property. The licensee is now committing fraud.

**Duress**

_Duress_ is compulsion by threat; _specifically:_ unlawful constraint. When a contract is not freely accepted it is made under duress. The contract is not legally binding and may be revoked; however, it is not enough for the offeree simply to say a contract was made under duress in order to invalidate a contract, duress needs to be legally proven.

A tenant blackmails a landlord into reducing the rent. A new contract or lease is made under duress. This new contract is not legally enforceable if the landlord can legally prove the contract was made under duress for reason of blackmail.
Mistakes

Mistakes regarding the terms or conditions of a contract occur when there is an unintentional ambiguity or an oversight affecting the entire agreement. A contract containing mistakes is not a contract. Ambiguity or an oversight can turn one contract into a completely different contract.

A seller advertises a beachfront property is for sale. A buyer contacts the seller to view the property. The seller explains he or she is not available to show the property, but to look over the exterior of the property if he or she chooses to do so. After viewing the property, the buyer makes an offer on the property. Upon further discussions with the buyer, the seller realizes the buyer misinterpreted the directions and viewed the wrong property. The buyer made a mistake, and his offer cannot rightly be viewed as a contract with the seller.

Legally Competent Parties

The notion of “legal competency” implies two things:

1. Individuals involved are of 18 years of age or older or have parental consent
2. Individuals without impaired mental capacity

Majority laws protect minors from entering into agreements they do not have the experience or knowledge to understand fully. A contract in which one or more of the contracting parties is a minor is considered void or voidable. If the contract is considered void, it ceases to have legal existence. If the contract is considered voidable, the minor can withdraw from the contract at any time and the majority party is still bound to the contract.

Mental competency laws protect individuals of unsound mind from agreeing to terms they do not fully understand. Individuals who have been declared mentally incompetent
by a judge or are under the influence of drugs or chemicals and incapable of comprehending contracts (but who have not officially been declared incompetent by a judge) cannot legally enter into a contract.

If an individual wishes to enter into a contract with someone of unsound mind, he or she must involve a third party who is “legally competent” and has power of attorney to represent the mentally incompetent individual in legal matters.

**Power of Attorney**

There are two terms you need to know for this section:

1. **Principal**: individual giving another person the power of attorney to act on his or her behalf
2. **Attorney-in-fact**: the person to whom the power of attorney is granted

There are four basic types of power of attorney:

1. **Limited** power of attorney:
   - Grants limited rights to the attorney-in-fact
   - Is revoked if principal becomes mentally disabled
   - For Example, the principal gives an attorney-in-fact (for Example, a friend) check-writing powers while on an extended vacation

2. **Ordinary** power of attorney:
   - Grants broad powers to the attorney-in-fact over personal finances
   - Is revoked if the principal becomes mentally disabled
3. **Durable** power of attorney

- Grants the broadest powers of all to the attorney-in-fact
- Remains effective if principal becomes incapacitated

4. **Springing** power of attorney:

- Becomes effective when the principal becomes mentally disabled or otherwise incapacitated
- Allows the principal to provide his or her own definition of "incapacitated"
- Here are two Examples:
  
  - The principal wants to limit the term "incapacitated" to a judgment, rendered by the court, stating the principal is senile.
  - The principal defines “incapacitated” as lapsing into a coma for more than a specified number of days.

The power of attorney gives the attorney-in-fact power over the principal's affairs for various purposes, such as:

- To buy or sell real estate on the principal's behalf
- To manage the principal's properties
- To conduct the principal's banking transactions
- To invest the principal's money
- To make legal claims and conduct litigation
- To give gifts on the principal's behalf
**Consideration**

All contracts must have an exchange of consideration, which means:

- No one may obtain anything of value without providing some form of compensation (in a contract, you cannot get something for nothing).
- Examples of compensation include:
  - Money
  - Property
  - Giving up a right or valid claim
  - Making a promise to do or not to do something
  - Services
- If there is no consideration, then the contract is not legally binding.
- All contracts are created out of self-interest and all parties acknowledge the self-interested character of the contract, and agree something valuable is changing hands because of the contract.

**Lawful Objective**

Thus far, we have discussed legally competent parties and mutual assent as features of a legally valid contract. The third feature of a legally valid contract is that it must have a lawful objective. This requirement means that a contract cannot explicitly or implicitly call for any illegal activities. When a contract has a lawful objective, it considers all the relevant laws and statutes to ensure that the contract is not suggesting or requiring actions that are against the law. Lawful objective in a contract includes:

- Considering all relevant laws and statutes
- Confirming there are no illegal action(s) being required of any parties involved
- Becoming void if it implicitly or explicitly requires illegal conduct
• Being held accountable for attempting to fulfill a contract devoid of lawful objective

**Adherence to a Statute of Frauds**

The *statute of frauds* is a state law establishing the features of a valid contract. It generally requires certain types of contracts to be set out in writing and written contracts to be signed by all the parties bound by the contract. The statute of frauds can vary slightly from one state to another. A statute of frauds is designed to prevent dishonorable conduct. The statute of frauds generally does not void a valid contract failing to adhere to a statute of frauds, but makes it *voidable*. This contract remains valid until one party opts to void it.

**Note:**
The term “statute of frauds,” is derived from “An Act for Prevention of Frauds and Perjuries.” This was an act ratified by the English Parliament in 1677, over 300 years ago.

A majority of states’ statute of frauds require contracts to be in writing if:

• It involves the sale or transfer of real estate.
• It concerns debts or specific duties.
• The terms extend for a period of more than one year.
• The terms extend beyond the lifetime of the promisor.
• It involves the sale of goods valued at $500 or more under the Uniform Commercial Code.

**Note:**
The Uniform Commercial Code (UCC) is a body of statutory laws aiming to regulate important categories within contracts and to standardize business transactions. Every
state, except Louisiana, has a Uniform Commercial Code. You can view the Uniform Commercial Code (UCC) online: http://www.law.cornell.edu/ucc/ucc.table.html.

Real Estate Applications of the Statute
Most real estate contracts are in writing. The statute of frauds applies to most real estate contracts including, but not limited to:

- Trust deeds
- Mortgages
- Leases for periods of longer than one year
- Rights to rights of way through property and any and all encumbrances incurred or suffered by the owners, or by operation of law

Note: The statute of frauds does not apply to lease agreements of a year or less.

Parol Evidence Rule

*Parol* literally means “word of mouth.” Parol evidence, then, are the terms and conditions the parties discuss before the final contract is written. This discussion provides evidence of what the parties expect from the contract; however, the *parol evidence rule* holds that when important details of an agreement discussed between two or more parties fail to make it into the written contract, the written, signed contract is given authority over any parol evidence.

This rule can be invoked when a court is deciding whether to admit parol evidence during a contract dispute. Once a court reviews the contract in question, the details of the case are used to decide whether the parol evidence rule should apply.
Lesson Summary

This lesson provided a detailed discussion of the conditions a contract must satisfy if it is to be legally valid. A legally valid contract must be comprised of the following components:

- Mutual assent:
  - Requires an offer and an acceptance
  - Requires the absence of fraud, misrepresentation or duress
  - Requires the absence of mistakes

- Legally competent parties:
  - Individuals involved are of 18 years of age or older or have parental consent
  - Individuals without impaired mental capacity
  - Individuals can enter into a contract with the power of attorney of a person of unsound mind.

- Consideration: No one may obtain anything of value without providing some form of compensation.

- Lawful objective: The contract cannot expressly or implicitly require illegal activity.

- Adherence to a statute of frauds:
  - A contract must adhere to the statute of frauds of the state in which it is created.
  - Statute of frauds does not apply to oral contracts as imposed by the parol evidence rule.
Adherence to a state’s statute of frauds is often the weakest of these requirements. A contract containing the other four features can sometimes be a legally valid contract.

Individuals having questions on the legal validity of a contract should always ask for legal advice from a lawyer.
Lesson 36: Contract Fulfillment

Lesson Topics
This lesson focuses on the following topics:

- Introduction
- Performance of a Contract
- Non-Performance of a Contract

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Identify when a contract can be discharged.
- Recognize the difference between a forbearance and performance agreement.

Introduction
This lesson will discuss what must happen to fulfill the terms of a contract after it has been made and accepted. The result will be either the performance or non-performance of a contract. We will discuss the performance of a contract first.

When there is a contract, there must be an offer, acceptance, and performance. The previous lesson discussed offers and acceptances. This lesson will cover the two types of agreements that affect performance: forbearance agreements and performance agreements. We will also cover performance of a contract by novation and assignment.
Performance of a Contract

A contract aims to create a specific state of affairs desired by both contracting parties. The obligations a contract imposes on the contracting parties are the actions required to make this desired state of affairs a reality. Thus once an offer has been made and accepted, the terms of the contract need to be carried out in order to complete (or “execute”) the contract. This means what is legally called “performance” the contracting parties need to successfully complete their contractual obligations and duties. The terms of a contract have not been met until performance occurs, i.e., until the parties fully carry out their responsibilities.

Example:
Once Seller A accepts Buyer B’s offer and they sign a real estate purchase contract, Seller A performs his or her contractual duties by transferring the title to Buyer B, and Buyer B performs his or her contractual duties by making full payment to Seller A.

Time is of the Essence

All contracts should contain language emphasizing all promises are to be completed in a timely fashion. They may include the specific statement “Time is of the essence.” This phrase essentially means the specified times and dates in the contract are mandatory, and failure to meet these deadlines may result in being held liable for compensatory damages.

Typically, contracts also contain a section similar to the following paragraph:

_The Seller and the Purchaser will make full settlement in accordance with the terms of this Contract (“Settlement”) on, or with mutual consent, before, __________ (“Settlement Date”) except as otherwise provided in the Contract._
This section establishes a fixed date, which serves as a set point for making judgments about what counts as timely performance. Writing a date into the contract helps to make “timely” a more objective notion.

Emphasizing timely performance helps to ensure all parties perform according to the terms of the contract within the allotted period of time. If one party fails to meet the deadline, he or she is subject to whatever penalties are established for breaching the contract. He or she may also face various kinds of legal liability, depending on the nature of the contract and the events resulting from breaching it.

**Forbearance Agreements**

Forbearance agreements require one or more of the contracting parties to refrain from actions he or she is otherwise legally entitled to perform.

For Example, if a borrower cannot repay a loan within the agreed-upon time period, then he or she can ask the lender for a forbearance agreement. In this case, if the lender granted a forbearance agreement, the lender would effectively be promising not to take action against the borrower for non-payment during the period covered by their agreement. The lender has the legal right to pursue this debt, but the lender waives this right when he or she makes a forbearance agreement with the borrower.

**Performance Agreements**

Performance agreements require the contracting parties either to perform certain actions or to uphold certain contractual promises. Performance agreements exist in addition to the contract itself. They do not require the performance of contractual duties, but do require the parties to carry out actions facilitating the successful completion of their contractual duties.

For Example, imagine a tenant enters into a lease agreement. Within this lease agreement, the tenant is responsible for damages made to the apartment during her tenancy. The tenant also enters into a performance agreement that prohibits pets living
in the apartment. The purpose of this performance agreement is to reduce the likelihood of damages to the apartment and facilitates the landlord’s goal of keeping tenants from doing any significant damage to the apartment.

**Assignment**

Sometimes, one or more of the parties involved in a contract want to withdraw from it without actually terminating the contract. In cases like these, the contracting parties have the option of transferring their rights and duties to a third party. This transferral is known as “assignment.” When these duties and rights are transferred (or assigned) to another party, the party who originally assumed the contractual obligations usually remains secondarily liable for the terms in the contract, unless the original party is expressly released from those duties. This means, if the individual to whom the rights and obligations are transferred fails to fulfill those obligations, then the other parties to the contract can demand performance from the original party.

For Example, a buyer agrees to purchase a home already under an existing loan, often referred to as an agreement to “take on payments.” The person who originally assumed the loan contract transfers the loan responsibilities to the new buyer; however, the person who initially took on the loan remains as a party to the agreement in case the new buyer defaults on the loan.

**Novation**

Novation is an alternative to assignment. It is the act of substituting one obligation for another or replacing one contracting party with a new contracting party. Legally, it is understood to be the exchange of one contract for another.

For Example, a contractor has a loan with Bank B. Bank B is acquired by Bank C. The contractor’s loan is now with Bank C. The contract with Bank C replaces the contract with Bank B.
A new contract under these circumstances is generally understood to be subject to the same promises and obligations as the original contract.

**Promissory Estoppel**

**Estoppel:** Refers to a legal limit on enforcing a claim or right at odds with what was previously said or done.

**Promissory estoppel:** Connected to the basic concept of estoppel; aims to stop a party from altering or rescinding a promise.

Promissory estoppel is used to force all parties to continue to be held legally liable to their contractual obligations made without consideration exchange. This legal doctrine is used to force all parties to honor a contract that does not satisfy an otherwise important condition of a legally valid contract.

In general, it is used to keep parties from defaulting on reasonable contracts if it results in a serious injustice to the other party. If courts judge the person making the promise could reasonably have expected the other contracting party to rely on the promise, and the party did rely on the promise, then courts often force the promise-maker to perform rather than let the other party suffer significant damages simply for taking the promise-maker at his or her word.

**Non-Performance of a Contract**

If one or more of the contracting parties either partially or completely fails to fulfill the contractual obligations, this is referred to as breach of contract. When this occurs, the injured party can seek compensation for any damages created by the breach. The injured party also retains the option of discharging the contract. When a contract is discharged, the terms and conditions of the contract are either cancelled or satisfied. Most contracts contain a section discussing when a discharge is allowed and the full consequences of a breach of contract.
Discharging a Contract

There are several situations in which one or more of the contracting parties can usually discharge a contract:

- **Partial performance:** Occurs when one or more of the contracting parties perform only a portion of the agreed-upon contractual duties. The party who suffers damages by the other party’s failure to perform can seek legal restitution or discharge the contract.

- **Substantial performance:** Created when a party performs the majority of the contract’s requirements but does not perform according to the contract’s stipulations. The injured party has usually performed enough of contract’s obligations to gain legal enforcement of the other party to complete the contract.

- **Non-performance due to legal issues:** Requires one or all parties involved to act illegally. Any party called upon to perform illegal acts is not required to meet the terms of the contract and can discharge the contract.

- **Mutual agreement:** Occurs when all parties mutually agree to cancel the contract.

- **Operation of law:** Occurs when a contract is not legally valid or becomes unenforceable due to a statute of frauds, a statute of limitations, or other legal regulations. Enforcing such contracts is a violation of the law.

Breach of Contract

A breach of contract occurs when the terms or conditions of a contract are violated. When one of the contracting parties violates the contract’s terms, he or she assumes the consequences of defaulting, which are generally set out in the contract itself. In these cases, the party who has honored his or her contractual obligations has the right to seek compensation for any damages suffered as a result of the other party’s breach.
Consequences of a Breached Contract

When there is a breach of contract, the non-breaching party or the party who fulfills (or wants to fulfill) his or her part of the contract has four options:

1. **To forfeit**: There is no longer any contractual relationship. This means the seller is entitled to keep the earnest money and all other payments collected from the prospective buyer.

2. **To rescind**: This means the non-breaching party can cancel the contract entirely. It also means the seller must return all payments received from the buyer.

3. **To sue for specific performance**: A court order requiring all parties to carry out the promises stipulated in a contract. This is a court enforcement of the original contract.

4. **To sue for compensatory damages**: The party who fulfilled the promises of the contract can take the breaching party to court in order to recover any damages suffered due to the breach. This does not force the parties to abide by the original contract, but it does require the party who breached the contract to compensate the party who did not.

Contingencies

Contingencies are stipulations or conditions that must be satisfied before the contract can be performed. Most real estate contracts should include at least two contingencies:

1. **Financing contingency**: Makes the purchase contract conditional upon the buyer’s ability to obtain financing.

2. **Inspection contingency**: Makes the purchase contract conditional upon the outcome of the home inspection report or appraisal report.

If contingencies are not met, the contract can be discharged. For Example, if a buyer agrees to pay $150,000 for a house, but the appraisal report concludes it is only worth
$120,000, the buyer can back out of the agreement. In this case, the contract should be discharged, and the buyer should receive his or her deposit back.

If the prospective buyer backs out of the contract for reasons not stipulated or allowed for in the contract, he or she has breached the contract and thereby forfeits his or her deposit. For Example, if the prospective buyer has signed the purchase contract, but decides at the last minute he or she does not want the property because he or she has found a better property, he or she will lose his or her deposit unless he or she honors the original contract.

**Lesson Summary**

This lesson covered the two types of agreements affecting the performance of a contract: performance agreements and forbearance agreements. In a performance agreement, one party promises either to perform or refrain from performing a specific action, generally one related to the successful completion of his or her contractual obligations. The failure to honor a performance agreement often leaves the individual vulnerable to various kinds of legal liability.

In a forbearance agreement, one party agrees not to take actions he or she would be legally entitled to take if the other party violated the terms of the contract. For Example, a forbearance agreement might create an understanding between a borrower and a lender when a borrower cannot repay a loan in the agreed-upon time period. If the lender grants a forbearance agreement, the borrower is given more time to pay the loan and is immune from legal action for nonpayment from the lender for the time period covered by the forbearance agreement.

Sometimes, one or more of the contracting parties wish to withdraw from a contract without actually canceling the contract. In these cases, those who wish to withdraw have two basic options: assignment and novation. The assignment method allows an individual to transfer his or her rights and obligations to a third party, who then takes on
the role originally played by the person who made the transfer. The novation method allows an individual to create a new contract and replace the existing contract with the new, modified one. Both of these methods require the other contracting parties to agree to the change.

Non-performance of a contract occurs when one or more of the contracting parties leave contractual obligations partially or wholly unperformed. When this happens, discharging the contract is one of the options open to those who have completed their obligations. A contract can be discharged when there is partial performance, substantial performance, or non-performance due to legal reasons on the part of either party. A contract can also be discharged by either party if it does not conform to the relevant laws. Finally, a contract can be discharged simply by mutual agreement, if both parties agree to cancel it.
Lesson 37: Real Estate Contracts

Lesson Topics

This lesson focuses on the following topics:

- Legal Forms
- Sales Contracts
- Listing Agreements
- Option Agreements
- Contract-for-Deed Agreements
- Leases

Lesson Learning Objectives

By the end of this lesson, you should be able to:

- Recognize the general features of a completed contract.
- Identify the different kinds of real estate contracts.

Introduction

Real estate professionals need to be familiar with the different contracts governing their industry. Whether they are listing a property, selling a property or closing a sale, contracts are involved and licensees need to be able to understand and evaluate them. These skills help to ensure real estate professionals provide their clients with comprehensive service; having a good grasp of contracts and the roles they play helps licensees foresee and correct oversights and mistakes affecting transactions, thereby protecting themselves against legal liability. This lesson discusses the most common legal forms used within the real estate industry.
Licensees are only authorized to fill out standardized contract forms created by their real estate commission or created by an attorney. They are not authorized to create contract forms or to provide any other kind of legal advice to their clients. This is practicing law without a license and the unauthorized practice of law is not only imprudent (because it makes a licensee vulnerable to serious legal liability), it is illegal. If a licensee thinks a special contract form should be created, or believes his or her clients need legal guidance, he or she should refer those clients to a licensed attorney.

**Legal Forms**

To help licensees develop a useful understanding of real estate contracts, this lesson will discuss sales contracts, listing agreements, option agreements, contracts-for-deed and leases.

- **Sales Contracts**, including:
  - Legal property description
  - Earnest money contract
  - Escrow account
  - Purchase-and-sale agreement addendum
  - Lead-based paint addendum
  - Terminating a sales contract

- **Listing Agreements**, including:
  - Exclusive right-to-sell listing
  - Exclusive agency listing
  - Open listing
  - Net listing
  - How to terminate a listing agreement
• Option Agreements
• Contract-for-deed agreements
• Leases, including:
  o Leasehold estates
  o Estate for years
  o Periodic estate
  o Estate at will
  o Tenancy at sufferance

When creating a contract with other parties, it is important to:

• Make sure you fully understand and accept all written terms and conditions for which you are to be held legally responsible.
• Make sure you fully understand the penalties for failing to abide by all terms written in the contract.
• Discuss any questions or doubts you have about the agreement before it is put into writing and especially before you sign it.

Written and signed contracts in the process of being carried out are to be used as a reference if any confusion arises throughout its execution. If a contract is going to cover all the bases and avoid any confusion or misunderstandings, then it should have the following characteristics:

• Well organized
• Well thought out
• Clear and concise language
• Avoid any legal jargon and complicated phrasing
• Include all five requirements of a legally valid contract
Contract Components

Most contracts generally have two sections:

1. The duties and obligations section:
   - Lists the expectations, terms and deadlines of the agreement
   - Establishes the requirements for contract fulfillment

2. The representations and warranties section:
   - Contains statements ensuring any goods and services described in the contract will be provided or performed according to the terms of the contract
   - Establishes a guarantee

Sales Contracts

Sales contracts, also called “purchase contracts,” are the most important documents in real estate transactions. They establish the details of an agreement between a buyer and a seller along with their rights and obligations. They are the prospective buyer’s written offer to a property owner to purchase a specific piece of real estate.

Sales contracts should include the following:

- The price the buyer agrees to pay
- The amount of earnest money the buyer will pay
- Mortgage details and any financing conditions the prospective buyer wishes to stipulate
- The deposit the buyer agrees to put down
- When and where the closing of the transaction will take place
• Inclusions and exclusions (that is, an itemization of personal property such as appliances, which may or may not be included in the selling price)
• An appraisal section and a termite and pest inspection section
• Warranties
• Acceptance procedures and deadlines
• Property disclosures

Sales contracts establish a relationship between the buyer and the seller. This relationship requires a little give and take of all the parties, usually involving the seller transferring the property title to the buyer and the buyer paying the negotiated price to the seller.

Sales contracts protect both the buyer and seller by creating a legal framework that strongly encourages both parties to uphold their end of the bargain. Valid sales contracts must have all five requirements of a legally valid contract plus an additional, sixth condition: Sales contracts must contain a legal description of the property being conveyed.

**Legal Property Description**

A legal property description makes it clear to all parties exactly what property is being bought or sold. It can be used by the courts to clarify any disputes about the property.

A property’s street address provides identification, but it is not enough. It is insufficient because “123 Main Street” might be the address of any given property in any given town that happens to have a street called “Main Street.” If we spell out the address further, as “123 Main Street, Anytown, Anystate,” this does not tell us the size of the property or the specific boundaries of the property. Not all properties even have a street address. This requires a legal description, and we need a way of describing property that can apply to all real estate.
A legal property description must include:

- **Metes and bounds:** A legal land description method identifying a lot’s exact dimensions and location in reference to a fixed and permanent monument.
  
  - **Metes:** refers to the distance measurements used in the description.
  - **Bounds:** refers to the directions of the boundaries that enclose the parcel of real estate.

- **Rectangular survey system:** (also known as a government survey or U.S. public lands survey) Uses a more refined version of the longitude and latitude system of mapping with a surveyed grid of meridians, baselines, townships, and ranges to describe a particular piece of land.

- **Recorded plats:** (also known as the “lot-block-tract system,” the “recorded survey” or the “recorded map”) uses the metes and bounds method of land description to locate the borders of each parcel, and once the surveyor establishes the property’s perimeter, he or she records the dimensions on a plat (map) for easy reference. This map is filed with the proper local authority, such as the county clerk or the county records office.

Given this general overview, the important thing for the reader to remember is a sales contract must contain a legal property description uniquely identifying the property involved in the transaction.

**Earnest Money Contract**

Earnest money contracts are used to show a serious and able intent by the buyer to purchase a property while the actual sales contract is being put together. This is done in order to reserve a property the buyer is interested in purchasing. Once a purchase contract is signed, the buyer then begins to fulfill the earnest money contract as a step towards completing the sales contract.
What is earnest money?

- Earnest money is money a potential buyer pays as a deposit along with the offer in order to show serious intent.

Deciding what constitutes a reasonable amount of earnest money is made by mutual agreement between the buyer and the seller. A seller may stipulate a deposit, or earnest money, is nonrefundable in an effort to ensure a buyer is serious when he or she puts down a deposit. The amount of the earnest money can depend on the buyer's level of interest in the property. Earnest money also provides the seller with some compensation if the deal ultimately falls through in order to cover any expenses incurred by the seller or broker.

As you know, earnest money is not one of the five requirements of a legally valid contract. It also does not serve as consideration in a sales contract. It can be used to meet the terms of the sales contract, such as serving as a down payment.

Now, earnest money cannot be deposited until the offer is accepted and the seller notifies the buyer of the acceptance. There is usually a license law limiting the amount of time in which a licensee may make a deposit, or deposit earnest money, after the contract is executed. Two to three working days is generally the maximum time span. Licensees handling earnest money should be familiar with this section of their license laws.

Most states require that earnest money contracts:

- Be in writing
- Be signed by the parties bound by the contract
- Contain evidence of intent to convey ownership interest
- Identify the seller and the buyer
- Identify the property being transferred in the transaction
Usually, a title insurance company holds the earnest money, or “holds the check,” until the offer is accepted. When a broker is involved, license laws generally require these funds be deposited into an escrow account.

Placing money into an escrow account is placing earnest money into the custody of a third party until a contract is executed. Escrow accounts ensure the funds are available to be dealt with honorably, either to meet the terms of an agreement or to compensate the parties involved for their time and effort if there is a default.

**Purchase and Sales Agreement Addendum**
Addenda are additions to a completed contract. They are attached as requirements and/or supplementary information to the contract and also must be accepted by all parties involved.

Addenda contain items, such as additional agreements, disclosures, and contingencies. For Example, an addendum might state that if certain components of a home inspection, property appraisal or loan application do not work out the way one party expects, then either party has the right to withdraw from the contract without penalty.

Other common addenda include:

- Third party financing condition addenda
- Loan assumption addenda
- Lead-based paint addenda
- Seller financing addenda

Some states' license laws require the use of standardized contracts and addenda. Each state's real estate commission has their own addenda forms and standardized contracts, which are prepared by an attorney.
Lead-Based Paint Addendum
The lead-based paint addendum is the most common addendum, used with properties built before 1978. It establishes the seller’s knowledge of the use of lead-based paint on the property and ensures the seller has provided the buyer with any and all documents pertaining to the use of lead-based paint on the property. It often includes contingencies allowing the buyer to withdraw from the contract if an inspection shows there are any undisclosed lead-based paint hazards on the property.

Terminating a Sales Contract
Sometimes individuals enter into a contract and then later decide to withdraw from the contract. A sales contract is terminated under the same conditions as any other contract. There are also specific cases where a contract is simply cancelled.

Example:
If the buyer is uncertain as to whether he or she is going to obtain adequate financing, then the buyer must explain this to the seller when making an offer on a property. A financing addendum should be included in the sales contract, which allows the buyer to withdraw from the contract if he or she is unable to get a loan.

A sales contract can be discharged when:

- There is a breach of contract, giving the four choices discussed earlier
- There is non-performance due to illegal terms or other specific terms
- The parties involved mutually agree to its termination
- It is rendered unenforceable due to operations of the law, such as when the statute of limitations has expired
Listing Agreements

A listing agreement is basically an employment contract made between a seller or owner and a licensee. It is not a sales contract or lease agreement, even if the marketed property is sold or rented. It covers marketing the property and obtaining and submitting offers to lease or buy the property.

Again, most states require a listing agreement be in writing if it is to be enforceable in court, and provide standardized forms for listing agreements that comply with state regulations and multiple listing service standards.

Note:
In addition, the National Association of REALTORS® (the largest real estate trade organization) develops its own forms for REALTORS® (i.e., licensees who are members) to use. Even though many brokerages and services develop their own listing agreement forms, these forms share many of the same features, which are discussed later in this section.

Listing agreements create a relationship, called an “agency relationship,” authorizing a licensee to represent the principal (the seller or owner) and the principal’s property to third parties (buyers or tenants). It places a licensee in a position of trust or fiduciary duty, or an “allegiance.” In this case, the licensee owes the principal the duties of loyalty, confidentiality, obedience, full disclosure, care, diligence, and accountability for all funds entrusted to him or her.

The licensee generally agrees to provide all of the real estate services the seller requires until the property is actually sold or rented. A licensee might allow other people (such as salespeople) to help carry out his or her contractual duties provided they do so under his or her supervision.

The licensee is usually given the legal status of “special agent” for the principal. This means the licensee is under contract for one specific act or business transaction (i.e.,
finding a buyer or tenant). Each state’s license law discusses the specific requirements and duties of special agents. These laws can also define which parties (e.g., salespeople) may act on an agent’s behalf and under what circumstances. Real estate professionals should always consult their states’ laws for the specific details affecting their work.

Four common types of listing agreements are:

1. Exclusive right-to-sell agreements
2. Exclusive agency listing agreements
3. Open listing agreements
4. Net listing agreements

**Exclusive Right-to-Sell Listing Agreement**

In an exclusive right-to-sell listing agreement, one brokerage firm is exclusively granted the right to offer the property for sale. It even requires the seller to pay the brokerage firm a commission on the selling price of the property regardless of who sells the property. Many brokerage firms limit their listing agreements to this type of contract.

**Exclusive Agency Listing Agreement**

In an exclusive agency listing agreement, one brokerage firm is exclusively authorized to be the principal’s agent. Unlike the exclusive-right-to-sell listing, the seller retains the right to sell the property himself and pay no commission.

**Open Listing Agreement**

Open listing agreements allow property owners to employ one or more brokerage firms to market their property. The property owner still retains the right to sell the property herself and pay no commission. The brokerage firm that procures the sale is entitled to receive the commission. Open listing agreements are most commonly used by builders and developers who work with many firms in the marketing of new homes and lots.
Net Listing Agreement

Net listing agreements allow brokerage firms to keep the amount of the selling price that is more than what the seller is asking for the property, minus the closing costs. This agreement is rarely used because it creates a conflict of interest between the brokerage firm’s interests and the property owner’s interests.

For Example, if the property owner is not aware the property is worth quite a bit more than the asking price, a licensee who is aware of the actual property value stands to benefit a great deal from a net listing agreement. That is, if the licensee withheld this information from the property owner.

Licensees are required by their fiduciary duty to provide a property owner with all and accurate information required to protect the property owner’s interests. Because net listing agreements present such an opportunity for dishonesty, they are illegal in most states. Licensees should always consult their state laws before entering into net listing agreements.

Multiple Listing Service

Some states have a multiple listing service option in which brokers agree to share their listings with other brokers by pooling the information in a database in exchange for a share of the commission earned by a transaction. The most common form of such an arrangement is brokers being members of a board of REALTORS® or real estate agents with all members agreeing to be bound by rules governing that organization.

As part of agreeing to be a member, such entities usually have their own listing agreement form with a stipulation clause giving the listing broker both the authority and an obligation to share the listing with other brokers by submitting the property information into the MLS database, unless the seller specifically requests that the property not be listed in MLS. (There is usually an option for this in the agreement.) And, as part of being advertised in the MLS system, the seller’s broker advertises a fee or commission that will be paid to the “cooperating” broker in a sales transaction.
The **cooperating broker** is the other broker or salesperson that shows the listed property to a buyer who subsequently purchases the property, entitling the cooperating broker to the fee or commission as the “procuring cause.” The amount offered to a cooperating broker is at the sole discretion of the listing broker. If the cooperating broker or salesperson represents the buyer, the listing agent must receive authorization from the seller in order to share a part of the commission, although this is usually covered in the original listing agreement.

A multiple listing service offers advantages to the owner/seller, brokers, and buyers. The owner/seller receives greater exposure of their property through the MLS system and the property is, in turn, shown by a larger number of brokers and salespeople to a larger audience of buyers. As a result, the increased exposure of the property gives the broker more opportunity to sell the property, earning the commission. The buyer also benefits by having a wider selection of properties from which to choose.

MLS systems have set rules established by the member brokers as to how soon a broker must enter the property listing into the system, thereby keeping the broker from attempting to “hide” the listing so other member brokers do not have a chance to help show it. Other rules are also set by each system to allow for fairness among members.

**Terminating a Listing Agreement**

Listing agreements may be terminated:

- If the property is not sold within the specified time period stated in the original contract (i.e., expired contract).
- By unilateral revocation by the owner or licensee for just cause.
- For Example:
  - A seller refuses to cooperate with licensee in order to show the property
  - The seller wants to terminate the agreement due to lack of activity
If there is any type of falling out between the seller and the listing licensee, it is usually prudent to terminate the listing agreement rather than exacerbate hard feelings and/or risk ending up in litigation.

More specific reasons for terminating a listing agreement include:

- The fulfillment of the listing agreement (i.e., the property sells).
  - The property owner declares bankruptcy. A bankruptcy court has the right to block the sale of a property and assign a trustee over the bankrupt property to assist with obtaining court approval to proceed with selling a property. This automatically stays any further action by law.

- The property being destroyed or damaged beyond repair.
- The death or incapacity of the property owner or broker.
- A mutual agreement between the licensee and the property owner—usually required to be documented in writing.
- A change in the permissible use of the property, such as a zoning change; for example, a property previously zoned for commercial use is located in an area no longer permitting commercial operations or a licensee originally retained to sell a property as commercial can no longer legally execute such a contract.

**Option Agreements**

An option agreement is also referred to as a “lease purchase,” “lease option,” or lease-option-to-buy.” This kind of agreement combines the components of a basic lease contract with an option-to-purchase contract. In an option agreement, the optionee (a buyer or tenant) pays the optioner (a seller or landlord) an option fee (a nonrefundable deposit), which is ultimately applied to the purchase price of the property. The option fee
in effect “buys” the optionee the choice to buy or not to buy the property at the end of the lease agreement.

Once the option fee is paid, the corresponding monthly payments are usually applied towards the purchase price of the property or considered as a down payment on the property. The optionee retains the option of purchasing the property (according to the terms of the option agreement contract) during the term of the lease. Once the lease expires, the option expires.

A legally enforceable option agreement must define the following elements:

- **The option fee**: This is the deposit the optionee must make in order to have the option to purchase the property during the lease term. The option fee is nonrefundable and is applied to the purchase price of the property only if the optionee decides to purchase the property.

- **The option term**: This is the amount of time the optionee has to exercise his or her right to purchase the property; the contract should specify the final date by which the optionee must either exercise the option or lose the option.

- **The methods for exercising the option**: This part of the contract should describe the steps the optionee must take in order to exercise the option to purchase. Most option agreements require the optionee to send the optioner a written intent to purchase the property.

- **The payment agreement**: Often, rent payments (monthly payments) are credited towards the purchase of the property. The option agreement should clearly address the guidelines for these types of situations.

**Contract-for-Deed Agreements**

A contract-for-deed agreement is also known as a “land contract,” “installment contract,” or “contract of sale.” A contract-for-deed agreement is a conditional agreement
regarding the sale of real estate that requires the buyer to uphold certain promises after taking possession of the property.

For Example, a contract-for-deed agreement might allow a buyer to defer a portion of the purchase price, still taking possession of the property but paying out the remaining balance over time, in installments. Effectively, this makes the buyer a long-term renter who actually receives legal title after paying a certain amount of money to the seller.

What sets apart a contract-for-deed agreement from a regular sales agreement is the seller retains the legal title of the property while the buyer takes possession of the property and holds the “equitable title” to the property. Even though there is an exchange of payment, there is not a transfer of the property title until all conditions of the contract are satisfied.

In a contract-for-deed agreement the seller must provide the buyer with:

- Copies of a current survey
- A tax certificate
- An insurance policy
- Property condition disclosures
- Information regarding utilities, liens, and financing terms

**Leases**

A lease is an agreement with a reversionary right between a tenant (lessee) and a landlord (lessor) allowing the tenant to occupy the landlord’s property for specified payments to be paid at a specified rate for a specific period of time. A comprehensive lease agreement defines the tenant’s rights and obligations as well as the landlord’s rights and obligations, the time period covered by the contract and the amount of money the tenant must pay to the landlord for use of the property.
Lesson Summary

To provide skillful service, real estate professionals must understand the different real estate contracts that codify and regulate transactions in their field. This lesson discussed five types of contracts vital to the practice of real estate: sales contracts, listing agreements, option agreements, contract-for-deed agreements, and leases.

The sales contract, which is also referred to as the “purchase contract,” is generally the most important document in a real estate transaction. It establishes the details of the agreement between the prospective buyer and the seller, and it identifies their legal rights and obligations with respect to the transaction being made between them. The sales contract also includes important information, such as the price the buyer has agreed to pay, the amount of earnest money he or she will give, and any other conditions the prospective buyer wants to stipulate. The sales contract is essentially the prospective buyer’s written offer to purchase a specific piece of real estate.

A listing agreement is a contract made between a seller and a licensee. It is an employment contract under which the licensee markets, as opposed to sells, real property. This contract is not legally connected to a sales contract, even if the property being marketed is later sold. Listing agreements create a special kind of fiduciary relationship between a licensee and the person who owns or is selling a property (the principal), authorizing the licensee to act as an agent on behalf of the principal. Each state’s license law discusses the specific requirements and duties imposed on licensees who act as agents; these laws also generally define which parties (e.g., salespeople) may act on an agent’s behalf and in what circumstances. In addition, most states require a listing agreement be in writing if it is to be enforceable in court.

An option agreement combines the components of a basic lease contract with an option-to-purchase contract. It is a contract between a tenant and landlord giving the tenant the option of purchasing the property at the end of the lease period. Option agreements require the tenant to pay an option fee, which is a non-refundable deposit applied to the final purchase price if the tenant chooses to buy the property. The tenant
must tell the landlord whether he or she wishes to purchase the property before the lease expires.

A contract-for-deed agreement is a conditional agreement between a seller and a buyer regarding the sale of real estate. In a contract-for-deed agreement, the sale of the property (i.e., the conveyance of legal title to the property) is generally contingent upon the buyer meeting certain requirements after he or she takes possession of the property. Though many contract-for-deed agreements establish an arrangement in which the buyer pays part of the purchase price to the seller after taking possession of the property, this kind of arrangement does not define contract-for-deed agreements. They are distinguished by the fact they are conditional. Under a contract-for-deed agreement, the seller retains legal title to the property until the conditions of the agreement are met, even though the buyer often takes possession of the property (and holds what is called “equitable title” to the property) before those conditions are fulfilled.

A lease is an agreement between a tenant (lessee) and a landlord (lessor) allowing the tenant to occupy the landlord’s property, generally for a specified period of time and at a fixed rate. A comprehensive lease agreement usually defines the tenant’s and landlord’s rights and obligations, the time period covered by the contract, and the amount of money the tenant must pay to the landlord for use of the property. The tenancy periods specified in lease agreements vary widely, creating different kinds of leasehold estates.
Lesson 38: Real Estate Practice

Lesson Topics
This lesson focuses on the following topics:

- Insight into Contracts
- Field Applications of Contracts

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Identify the purpose of specific aspects of contracts on the basis of scenarios.
- Recognize the validity of contractual agreements given in case study scenarios.

Insight into Contracts
We have covered a lot of specific information over a relatively short period of time. To ensure a comprehensive understanding of these details, we will now integrate the information with questions and case studies. The first half of this lesson presents comprehensive questions and dilemmas. The second half of this practice presents brief case studies that illustrate the principles and ideas related to contracts.

This section presents you with comprehensive questions and dilemmas that will require you to apply the information you have learned in this course.

Question 1: Why should licensees follow the requirement imposed by most states’ statutes of frauds and put all real estate contracts in writing?
**Answer:** Putting real estate contracts in writing helps to prevent misunderstandings and provides each party with a clear description of his or her role in completing the contract. If the parties have a detailed contract, they will often not need to go to court to settle disputes, because they know the terms of their contract will be upheld in a court of law. Parties cannot dispute an accepted contract that defines its terms clearly.

It is also helpful to have a written contract because fixing the terms and conditions of the contract in this way means neither of the contracting parties can change the terms of the agreement without the other parties’ consent.

**Question 2:** What is the difference between an express contract and an implied contract?

**Answer:** The primary difference between an express contract and an implied contract can be deduced from their names. An express contract is an agreement in which the terms are clearly stated (*expressed*). The parties to an express contract understand the terms and obligations of the agreement, and have openly accepted them. An implied contract, on the other hand, is an agreement in which the terms are not openly stated, but are instead inferred from the parties’ actions. Therefore, an express contract can be distinguished from an implied contract by determining whether the contract’s terms and conditions are actually stated outright or are merely implied.

**Question 3:** What is the difference between a *void* contract and a *voidable* contract?

**Answer:** A *void* contract, for various reasons, has no legal validity. For Example, an agreement does not meet the minimum requirements of a contract would have no legal effect or impact. A contract that is not legally valid cannot be enforced against any of the contracting parties. A *voidable* contract, on the other hand, contains the essential components of a valid, enforceable contract but also contains provisions allowing the contract to be terminated or rescinded by one or both parties.
Question 4: Why might a principal grant power of attorney to another party?

Answer: Individuals (known as “principals”) give another person the power of attorney when they grant the person the power to act on their behalf (either in general or in some limited realm of their affairs). People grant limited power of attorney for a variety of reasons—for example, some individuals might grant other people power of attorney over their financial affairs because they feel they do not have the expertise needed to make necessary decisions. More sweeping power of attorney is often granted when a person loses (or anticipates losing) the mental or physical competence needed to oversee his or her own affairs.

Question 5: What are the differences between a leasehold estate and a freehold estate?

Answer: There are two basic terms used to describe land ownership, “freehold estate” and “leasehold estate.” In a freehold estate, the property owner has actual ownership and possession of the land (or real estate), and his or her ownership lasts for an unspecified period of time. In a leasehold estate, the tenant has possession of the property (but does not own it), and his or her estate in the property lasts for a limited period of time.

Question 6: What is the purpose of the statute of frauds?

Answer: In most states, the basic function of the statute of frauds is establishing the features of a valid contract. For example, a state’s statute of frauds will generally require certain types of contracts be set out in writing and written contracts be signed by all the parties bound by the contract. Licensees should acquaint themselves with the specific requirements set out in their states’ statutes because there are frequently subtle differences between one state’s statute of frauds and those of another state.
Field Applications of Contracts

Please consider the following case studies. After reading the situations, decide how one could resolve the dilemma or complication.

Case Study 1

Patient A visits Doctor B for an annual examination. During the exam, Doctor B checks over Patient A’s heart rate, cholesterol level, and physical condition. At the end of the exam, Doctor B tells Patient A he is in great condition. As Patient A leaves the examination room, the receptionist hands Patient A a bill for $200. Patient A looks over the bill and tells the receptionist he is not responsible for the bill because he never agreed to receive the doctor's services. In fact, Patient A says Doctor B never explained what he would be charged—he claims, therefore, he does not have to pay for Doctor B’s services. The receptionist explains to Patient A all clients must pay for the doctor's services, whether they received shots, exams, or medicine. **Who is correct in this situation?**

Patient A is incorrect in this case, because there does not have to be a verbal exchange in order to create a binding contract.

Many of our daily interactions create or rely upon *implied contracts*. No words or written documents must be exchanged for an implied contract to be created. The terms and conditions of this kind of contract are inferred from the parties’ conduct. All legally binding contracts involve the exchange of consideration, i.e., the exchange of something valuable, such as money or a promise, which is given to show acceptance or acknowledgement of a contract. In this case, Doctor B provided Patient A with his services, which have a known market value. Although Patient A did not gain from this interaction materially (e.g., the doctor did not pay him or give him anything tangible), he still gained the satisfaction of knowing he was in good health.
Case Study 2

Seven years have gone by since Client C failed to pay proper commission to Broker B. Finally, Broker B decides to file a lawsuit against Client C to collect the unpaid balance. When Broker B attempts to file this claim, he is told the statute of limitations for collecting debts in that state is six years. The clerk explains to Broker B he now has an unenforceable contract and cannot force Client C to pay. Broker B replies that the contract contains all the components of a legally enforceable contract, and Client C should therefore be forced to pay the debt. Is Broker B correct?

Broker B is mistaken. His contract may well be legally valid, which is to say it meets the following conditions:

- Legally competent parties
- Mutually agreeable to all parties
- Lawful objective
- Consideration
- Comply with the requirements imposed by the statute of frauds

The validity of Broker B's contract is not at issue here. Even if the contract were valid when it was made, the problem is that the statute of limitations for enforcing the contract has expired. This means the contract is now unenforceable; Client C cannot be forced to pay Broker B's commission because enforcing the contract would violate the state's statute of limitations.

Case Study 3

Principal A has granted her son power of attorney because she wants him to be able to take over her affairs if some event renders her incapable of making her own decisions. After talking to her lawyers, Principal A decides to grant her son a springing power of attorney, and she and her son sign all the legal paperwork needed to create this agreement. One week later, the son walks into Principal A's bank asking the bank
transfer $20,000 to his account so he can place a down payment on a house for Principal A.

The bank clerk explains to the son he does yet not have a functional power of attorney; Principal A must be mentally or physically impaired before he can exercise his springing power of attorney. The son tells the bank that having the power of attorney allows him to make executive decisions for Principal A, regardless of whether she could make those same decisions herself. **Who is correct?**

The bank clerk is correct in this case.

A springing power of attorney allows the person who receives this power (the attorney-in-fact) to take over control of the principal’s affairs only if the principal becomes incapable of making decisions—that is, it springs into effect at this time. When establishing a springing power of attorney, the principal will usually specify an event or a type of event which, if it occurs, will mark the beginning of the power of attorney and empower the attorney-in-fact to act on the principal’s behalf. For Example, a principal might indicate he or she wants the attorney-in-fact to take over if he or she suffers a stroke or becomes paralyzed. Until this event occurs, however, the attorney-in-fact does not have any power to make decisions for the principal.

**Case Study 4**

Homebuilder A calls Tile Supplier B and asks for an estimate of the cost of tiles for a building project. Homebuilder A tells Tile Supplier B he can only afford to pay $5,000 for tiles. Tile Supplier B tells Homebuilder A his company can provide the kind and number of tiles Homebuilder A needs for $5,000. Homebuilder A agrees to this price and Tile Supplier B says he will deliver the order in two weeks. Two weeks later, as Homebuilder A is nearing completion of his home, Tile Supplier B delivers the tile order to Homebuilder A. He says he will have to charge an extra $5,000, due to unexpected import tax increases. Tile Supplier B says Homebuilder A is responsible for any
additional costs. Homebuilder A refuses to pay the extra $5,000. Tile Supplier B replies that unless A pays, he will take him to court to recover his losses. **Who would probably win this case in court?**

It is very unlikely Tile Supplier B could win this case in court. There was a spoken understanding between A and B about the cost of the tile, but they did not exchange any consideration, which means their agreement lacks one of the important features of a legally valid contract. Promissory estoppel is a legal doctrine that can be used to force a party to keep a contractual promise without the exchange of consideration—that is, the doctrine can be used to force a party to honor a contract that does not satisfy one of the important conditions of a valid contract.

In general, this doctrine is used to keep people from defaulting on otherwise reasonable contracts when their doing so would result in serious injustice to the other contracting party. If courts judge the person making the promise could reasonably have expected the other contracting party to rely on the promise, and that party did rely on the promise, then courts will often force the promise-maker to perform rather than let the other party suffer significant damages simply for taking the promise-maker at his or her word.

In this case, it is clear A would suffer a significant and totally unanticipated detriment if B is permitted to force A to pay this additional charge. Homebuilder A has already started his project, working under the assumption Tile Supplier B would deliver tiles at the quoted price of $5,000. Homebuilder A explicitly stated he could not afford to pay more than $5,000, and would thus suffer a significant loss if he had to pay Tile Supplier B $10,000.

In a court of law, Tile Supplier B would be held accountable for his original quote of $5,000. He cannot rescind his original quote without renegotiating his agreement with Homebuilder A. Homebuilder A received a quote of $5,000 from Tile Supplier B, and Homebuilder A accepted. For Tile Supplier B to collect $10,000 from Homebuilder A, he
would have to make a new offer of $10,000 to Homebuilder A, and Homebuilder A
would have to accept this new offer.

Case Study 5
Buyer B owes Seller A $2,000, which must be paid before they can proceed with their
sales contract. A and B created a payment agreement under which Buyer B was to pay
Seller A five payments of $400 each. Buyer B made two payments to Seller A, but has
defaulted on the last three payments. Because Buyer B is not honoring the terms of
their agreement, Seller A now has four options: he can rescind the contract, he can
forfeit the contract, he can sue for specific performance, or he can sue for
compensatory damages. In this case, Seller A decides to rescind the contract. Buyer B
contacts Seller A and explains to A since A rescinded the contract, A needs to return
the $800 B has given him. Seller A explains to Buyer B he does not owe B anything
since B defaulted on the contract. Who is correct?

Buyer B is correct here. In this case, Seller A must return all payments to Buyer B.
When a seller rescinds a contract, he or she is required to return any payments he or
she has received from the buyer. When a seller opts to rescind a contract, this means
he or she cancels or voids the contract; the situation is then as if the agreement never
existed. If Seller A wanted to keep the payments, he should have forfeited the contract.
This would have allowed him to keep any earnest money, payments, or deposits he
might have received.

Case Study 6
After viewing Seller A’s property, Buyer B makes an offer on the property. Seller A tells
Buyer B he will consider the offer and will let Buyer B know in two weeks; however, two
weeks pass by without Seller A contacting Buyer B; Buyer B assumes Seller A has
rejected his offer, so he makes an offer on another property. Three days later, Seller A
contacts Buyer B to accept the offer. Buyer B tells Seller A since he did not contact him
within two weeks, he assumed Seller A declined the offer. Seller A tells Buyer B the
offer was never officially rejected, because he never expressly informed Buyer B he was
rejecting his offer. Seller A claims Buyer B must honor his offer on Seller A’s property, but Buyer B thinks Seller A is mistaken. **Who is correct?**

Buyer B is correct here. There are two ways an offer can be rejected: it can be rejected outright or the offer can be allowed to expire, in which case it is understood to have been implicitly rejected. When an offer is made, the seller is generally given a specific amount of time to accept the offer expressly and officially. Once the time period is up, the offer is understood to have been rejected. In this case, Seller A specifically stated he would let Buyer B know about the status of his offer within two weeks, which means Buyer B can assume the offer has been rejected (by expiration) after two weeks. He is not bound to his offer.

After Buyer B made the offer on A’s property, even though he had heard nothing regarding the status of the offer, it would have been in everyone’s best interest for him to retract his original offer before making an offer on another property. Buyer B has the right to retract his offer if he has not heard of its express acceptance, as was true in this case.

**Case Study 7**

Tenant A is an independent contractor for a consulting company, a job that requires him to relocate frequently. Tenant A approaches Landlord B and explains he is looking for a small apartment to rent, but he does not know how long he will be able to stay in that particular city. Tenant A asks Landlord B if he can create a lease under an estate for years. Landlord B suggests they create a lease under a periodic estate. **Which type of lease agreement would be more beneficial to Tenant A?**

A lease agreement creating a periodic estate would probably be most beneficial for Tenant A. A periodic estate (also known as a “periodic tenancy”) is created by a lease agreement that defines tenancy as automatically continuing for consecutive periods of time, for example month-to-month leases. This kind of lease is generally understood to be automatically renewed at the end of each lease period until the landlord or tenant
takes special action (such as submitting a written request) to terminate the lease agreement. For Example, in a month-to-month lease, both the tenant and the landlord generally have the option of terminating the lease agreement at the end of any particular month. If neither party expressly terminates the lease, then it is usually understood the lease is renewed for another month.

This arrangement fits better with Tenant A’s unpredictable schedule than does a lease agreement creating an estate for years. With an estate for years lease the period is fixed. Because Tenant A is unsure how long he will be in the area, a fixed period of any kind might prove to be either too long or too short to meet his needs. A lease creating a periodic estate gives Tenant A greater flexibility; it also means Tenant A will not have to meet with his landlord to renew or otherwise renegotiate his lease. He can simply stay until he needs to leave, providing his landlord with proper notice he is terminating their lease agreement.

Case Study 8
Buyer B takes a tour of Seller A’s property and decides to make an offer on it. Seller A tells Buyer B he will consider the offer and make a decision in three weeks. In order to show he is making a serious offer in good faith, Buyer B gives Seller A $3,000 as earnest money. He signs an earnest money contract, which stipulates if he withdraws from the contract, his earnest money is not refundable. One week later, Buyer B finds another property he likes better, and retracts his offer on Seller A’s property. Buyer B asks Seller A to return the earnest money since Seller A never accepted his offer. Seller A explains to Buyer B the earnest money is non-refundable and he is entitled to keep it.

Who is correct?

In this case, Seller A is entitled to keep the earnest money.

Earnest money is generally used to show the buyer is making a serious offer in good faith. It is also often used as a kind of “marker” to reserve the property while the final contracts are being drawn up or the offer is being considered. Usually, earnest money is
kept in an escrow account or is held by a title insurance company to ensure there are funds available to compensate for any losses a seller or broker might suffer if the buyer withdraws from the contract.

In this case, Seller A has a signed agreement with Buyer B stipulating that the earnest money is non-refundable. It is true Seller A had not yet expressly accepted Buyer B’s offer, but it is also true Buyer B had no reason to think A had rejected his offer. In addition, the fact he had deposited earnest money with A indicates A was giving his offer serious consideration. If B wanted to reclaim his earnest money, the simplest way of doing this would have been to wait for three weeks—the time period within which A said he would make a decision regarding B’s offer. At that point, B could reasonably infer A had rejected his offer, and it would have been A, not B, who had withdrawn from the contract, in which case the stipulations making B’s earnest money non-refundable would not apply.

**Case Study 9**

Minor A signed a contract with Homeowner B agreeing to mow Homeowner B’s lawn for the entire summer. In return, Homeowner B agrees to pay Minor A the flat rate of $200 for the whole summer. One month later, Minor A tells Homeowner B he no longer wants to mow Homeowner B’s lawn. Homeowner B tells Minor A that he has signed a legal contract and he is bound by the terms of contract. Homeowner B says if Minor A does not complete the contract, he will take him to court to force performance. Minor A tells Homeowner B since he is not yet 18, he is not legally capable of entering into contracts, and the fact he is a minor makes their contract legally void. **Who is correct?**

Minor A is correct.

A void contract is a “contract” that has no legal effect—but because it has no legal power, it is a contract only in name. A contract may fail to meet the legal requirements that define a valid contract and the stipulations and conditions cannot be legally
enforced. A void contract cannot impose any obligations, establish any legal rights, or otherwise perform any of the functions of a legally valid contract.

For these reasons, if Homeowner B were to take Minor A to court in an effort to have the contract legally enforced, Homeowner B would lose. Minor A is not legally capable of entering into contracts and A cannot be bound by the terms of the contract. Minor A can hold Homeowner B accountable for any labor wages he accrued during the summer, and Homeowner B will most likely have to compensate Minor A for the amount of work he did during the summer despite the fact A did not fulfill the entirety of their agreement.

Case Study 10
Salesperson A shows Buyer B an oceanfront property. Buyer B asks Salesperson A if the beach in front of the property is part of the lot she would be purchasing if she bought the home. Salesperson A tells Buyer B it is, even though he knows it is not. Relying on Salesperson A’s claims, Buyer B places an offer on the property. Three days later, the offer is accepted, and three weeks later, Buyer B moves into the property. Soon thereafter, Buyer B discovers the area in front of the beach does not belong to her. Instead, it is city property. Buyer B files a lawsuit against Salesperson A claiming fraud. Is she likely to win?

Presuming she can show Salesperson A knowingly gave her false information, Buyer B is likely to win this case.

Fraud occurs when an individual purposefully deceives another individual to gain something of value. Usually fraud consists of a failure to disclose vital information, making a false promise or telling a lie. In this case, Salesperson A knowingly told Buyer B the property she was considering included the beach area. Since Salesperson A intentionally deceived Buyer B, he is liable for any damages and losses Buyer B suffered as a result of deception.
It is also worth noting fraud can invalidate an otherwise-legal contract. So if, for example, Salesperson A and the person selling the beachfront home conspired to deceive Buyer B, her contract with this buyer would almost surely be legally invalidated and she would not be bound by any of its terms.
Lesson 39: Contracts in Texas

Lesson Topics
This lesson focuses on the following topics:

- The Statute of Limitations
- The Uniform Commercial Code
- Promulgated Contract Forms
- Contracts for Deed

Lesson Learning Objectives
By the end of this lesson, you should be able to:

- Distinguish the differences in the various contracts for the purchase of real estate in the State of Texas.
- Explain the statute of limitations.
- Explain what is meant by “promulgated.”

The Statute of Limitations
Each state has a statute of limitations, which places a limit on the amount of time that an individual has to take legal action against another individual in order to recover any losses and/or damages. In Texas, the statute of limitations is four years for written contracts and two years for oral contracts.
The Uniform Commercial Code

The Uniform Commercial Code strives to standardize commercial and business transactions throughout the country. Currently, all states, except for Louisiana, have adopted the UCC; each state has its own version of the Code. In Texas, real estate professionals should refer to Section 9 of the Texas Business and Commerce Code. This section relates to using personal property to secure a loan or credit purchase.

Section 9 requires that real estate sales transactions use a security agreement, which is a document that contains a description of the loan collateral. The security agreement essentially establishes the lender’s right to confiscate the collateral if the borrower defaults on the loan. Section 9 also requires that a financing statement, which is the final contract documenting the negotiation process between the lender and borrower, be filed at the county clerk’s office. The financing statement also contains a notice of the security agreement. Once the financing statement has been recorded, it serves as notice to subsequent buyers and mortgagees of the security interest in that property.

Promulgated Contract Forms

The Texas Real Estate License Act established the Texas Real Estate Broker-Lawyer Committee; this Committee is in charge of drafting and revising standard contract forms that are used by real estate professionals. By having the Committee create and modify contract forms, all real estate professionals will be able to use the same forms for the same types of real estate transactions. Once the Committee has created a contract form, the Texas Real Estate Commission (TREC) decides whether or not they will mandate those forms for their salespeople and brokers. TREC can promulgate contract forms, addenda, and temporary residential lease forms. If TREC decides to mandate that a certain form be used for a specific transaction, real estate professionals must use that particular form.
There are four exceptions when a real estate licensee does NOT have to use a form mandated by TREC:

- Transactions where the licensee acts as the principal, and not an agent.
- Transactions where the government requires that a different form be used for a particular real estate transaction.
- Transactions where the seller has created and supplied the contract forms.
- Transactions where there are no standard contract forms mandated by TREC, and the licensee uses a form prepared by an attorney approved by the Texas Real Estate Broker-Lawyer Committee.

**Contract Forms Promulgated by TREC**

The following is a list of contract forms that real estate licensees in Texas must use in their real estate transactions:

- One to Four Family—Resale, All Cash, Assumption, Third-Party Conventional or Owner Financed
- One to Four Family FHA Insured
- VA Guaranteed Loans
- Unimproved Residential Property
- New Home, Incomplete Construction
- New Home, Completed Construction
- Farm and Ranch
- Condominium (Cash, Assumption, Conventional)
- Condominium (FHA & VA)

Anyone can obtain these forms from TREC; however, only licensed and/or certified salespeople and brokers should complete these forms because they are trained and experienced with handling contract forms. TREC has established specific guidelines that oversee the preparation of contracts by real estate licensees. Section 16 of the
Texas Real Estate Licensing Act (TRELA) covers a licensee’s ability to prepare legal documents. Essentially, Section 16 states that a licensee should not create legal documents that define a principal’s legal rights. Real estate licensees should use the appropriate TREC approved forms for the appropriate contract situations.

When filling out the TREC contract forms, licensees should only include information that they know is factual and truthful. The licensee should only include the information that is mandated by the form. If the licensee needs to add more information and there is a contract addendum, lease, or form promulgated by TREC for that information, the licensee must use that form.

**Contracts for Deed**

Texas currently does not have a promulgated contract for deed; therefore, real estate licensees should suggest that both parties obtain the services of an attorney to create or review a contract for deed. Parties should always ensure that terms of the contract are clearly established and that they understand those terms. Having an attorney review the contract prior to its signing prevents each party from being responsible for any obligations and damages of which he or she is unaware.

When the buyer defaults on a payment, the seller has the right to forfeit the contract, which allows him or her to keep all payments received and evict the buyer. In Texas, the seller must give the buyer a specific statutory notice before forfeiture or cancellation if the subject property is going to be the buyer’s residence.

The notice period depends on how much the buyer has paid towards the purchase price.

- If the buyer has paid less than 10% of the purchase price, the notice period must be 15 days.
• If the buyer has paid 10% of the purchase price, the notice period must be 30 days.
• If the buyer has paid 20% or more of the purchase price, the notice period must be 60 days.

Repossession
In some installment contracts, there are clauses that allow the seller to recover possession of the property if the buyer defaults. These clauses disallow the buyer from recording the title without the seller’s consent. If the buyer records the sales contract with the public recorder, he or she shows that he or she has an interest in the property; this places a cloud on the seller’s title. When this happens, this makes the process of repossession difficult for the seller because another party has shown ownership interest in the property. Most states outlaw these types of clauses; however, it is not illegal in Texas.

Federal Clauses
The government requires that specific clauses be added to contracts in two particular instances.

• Before a buyer receives an FHA Appraised Value or a VA Certificate of Reasonable Value on the property, an amendatory language clause must be added to the sales contract. This clause ensures that the buyer can terminate the contract without suffering a loss if the agreed purchase price exceeds the appraised value. The amendatory language clause can be found in the TREC form for FHA insured or VA guaranteed financing; it must be used verbatim, which means the clause must be stated as it is found on the form.
• When there is an earnest money contract, the Federal Trade Commission (FTC) requires that all new home builders and sellers must include insulation disclosures with the contract. Insulation disclosures should describe the type, thickness, and R-value of the insulation used in the home. The insulation
disclosure may be found in the TREC promulgated New Home Insulation Addendum.

**Lesson Summary**

The statute of limitations relating to written contracts is four years and two years for oral contracts. If the incident is based on Deceptive Trade Practices, the aggrieved party would have two years from a reasonable timeframe for discovery of the deceptive act.

The Broker-Lawyer committee drafts and revises contract forms and addenda for the Commission's approval for use and/or promulgation. This standardizes the performance of preparing purchase agreements and minimizes the unauthorized practice of law.

*Please return to the course player to take the quiz and then the final exam.*