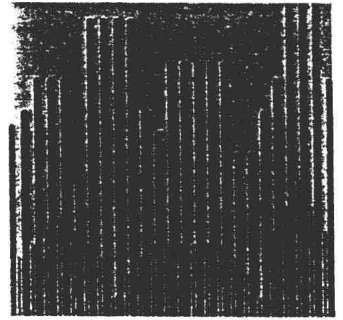


Real Estate

Principles

SIXTH EDITION

Real Estate Principles



BRUCE M. HARWOOD
CHARLES J. JACOBUS, D.R.E.I.



Regents/Prentice Hall, Englewood Cliffs, New Jersey 07632

Library of Congress Cataloging-in-Publication Data

Harwood, Bruce M.

Real estate principles / Bruce Harwood, Charles J. Jacobus. -- 8th ed.

p. cm.

ISBN 0-13-785934-2

1. Real estate business--United States. I. Jacobus, Charles J.

II. Title.

HD1375.H28 1993

333.23'0973--dc20

92-17209

CIP

Editorial/production supervision: *Penelope Linskey*
Interior design: *Peg Kenselaar, Linda Rosa, and Laura Ierardi*
Cover design: *Anne Ricigliano*
Manufacturing buyer: *Ilene Levy, Ed O'Dougherty*



© 1993, 1990 by Regents/Prentice Hall, Inc.
A Division of Simon & Schuster
Englewood Cliffs, New Jersey 07632

All rights reserved. No part of this book may be reproduced, in any form or by any means, without permission in writing from the publisher.

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

ISBN 0-13-785934-2

Prentice-Hall International (UK) Limited, *London*
Prentice-Hall of Australia Pty. Limited, *Sydney*
Prentice-Hall Canada Inc., *Toronto*
Prentice-Hall Hispanoamericana, S.A., *Mexico*
Prentice-Hall of India Private Limited, *New Delhi*
Prentice-Hall of Japan, Inc., *Tokyo*
Simon & Schuster Asia Pte. Ltd., *Singapore*
Editors Prentice-Hall do Brazil, Ltda., *Rio de Janeiro*

This book is dedicated
to the memory of Bruce Harwood,
and his commitment to excellence
in real estate education.

Preface

Is your goal a full-time or part-time career in real estate? Do you own or plan to own your home or an investment property? Are you a student of real estate desiring to broaden your knowledge of this subject? If you answered "Yes" to one or more of these, the contents of this book will be of immense help to you.

In this book you will learn about real estate brokerage, appraisal, financing, contracts, closings, and investing. Additionally, you will learn about land descriptions, rights and interests, fair housing, taxes, leases, condominiums, zoning, careers, and licensing and the use of computers in real estate. You will find particularly valuable the attention given to such timely topics as a real estate agent's liability and professional obligation to buyers and sellers, brokers who represent buyers, advance fee listings, errors and omission insurance, foreclosure, and timesharing. Included throughout the book are numerous examples from actual practice, including important decisions in several recent court cases.

Throughout this book emphasis is placed on an easily readable style of writing that will take and lead you through the chapters in a pleasant and enjoyable experience. You will find emphasis placed on explanations that combine "how" things are done in real estate with "why" they are done. Numerous tables, sketches, and diagrams will help you to visualize real estate rights and interests, financing techniques, appraisal methods, closing statements, and map reading. Simplified, plain English examples of real estate documents are used so their key elements can be easily identified and not lost in a maze of legal language. Warranty deeds, grant deeds, quitclaim deeds, trust deeds, title

insurance policies, promissory notes, and mortgages are among the documents so treated.

Starting with Chapter 2, key real estate terms are listed and defined at the beginning of each chapter in addition to being explained in the chapter. Correspondingly, you will find end-of-the-chapter vocabulary reviews plus questions and problems to test your comprehension of the material just read. Also presented at the end of each chapter are additional readings you may wish to use in furthering your real estate education.

The appendices of this book contain easy-to-understand residential construction illustrations plus sample questions typical of those found on real estate license tests. You will also find a real estate math review and answers to the chapter-end vocabulary reviews, questions, and problems. Lastly, there is a combined index and glossary that allows you to simultaneously find a short definition of a word and a page reference for further information.

Charles J. Jacobus received his Bachelor of Science degree from the University of Houston in 1970, and his Doctor of Jurisprudence degree from the University of Houston Law Center in 1973. He is Board Certified by the State Bar of Texas as a Specialist in both Commercial and Residential Real Estate Law. He is a member of the American College of Real Estate Lawyers, has served as President of the Real Estate Educators Association, and Chairman of the Real Estate Section of the Houston Bar Association. He is a frequent lecturer at various educational programs throughout the United States, is currently Editor-in-Chief of the Texas Real Estate Law Reporter, and Chairman of the American Bar Association's Committee on Real Estate Brokers and Brokerage.

Bruce Harwood completed his undergraduate work in real estate at the University of California, Berkeley, in 1963. In 1972 he completed doctoral studies in Business Administration, with a specialization in finance and real estate, at the University of Colorado. He has taught real estate at the college level in Florida, Colorado, California, and Hawaii. Dr. Harwood passed away on February 7, 1987 leaving behind a legacy which will benefit us all for many years to come.

Criticisms of and suggestions for improving this book are welcomed. They should be sent to the Real Estate Editor, College

Editorial Department, Prentice Hall, Englewood Cliffs, N.J. 07632.

A personal thanks to the following people who by written correspondence, telephone calls, or personal meeting have helped to shape this book:

ACKNOWLEDGMENTS

Floyd Adashek, Otis T. Amory, David F. Barry, Merlin Bauer, Sandy Berens, A. L. Bocchini, Sandra Bodie, Barry W. Bosiger, Arthur Bowman, Carolyn Bohling, Mark Brothers, Carolyn R. Burdette, Charles P. Cartee, Martin I. Caruso, Sandra Cece, Jerry C. Chaney, Lowell D. Clay, Tom Cook, John Cornelius, Robert Coulthard, Wallace Dean Davis, James O. Desreumaux, Keith Donaldson, Burnell Ellis, Jack Ellis, D. Delos Ellsworth, Bernard DiOrio, Charles E. Fadely II, Barney Fletcher, Carroll Gentry, Thomas E. Gillett, Helen L. Grant, Glen O. Grimmel, Steven Guice, Jr., Willis F. Gup-ton, Charles Haley, Ronald W. Halsac, Martin Hass, John W. Hill, Lynn Hoover, Anne Hruby, Joseph W. Isert, Jr., Ed Jutzi, F. Jeffrey Keil, Jack Kessinger, Jay Lamont, Cecil Lawter, David Lawter, Frank Lembo, Bruce Lindeman, Bernard W. Luster, Tom Lynch, Darline Mallick, Ralph K. Manley, Jerlyn L. Mardis, Ben Marilla, John Marshall, Jr., Roger Meade, Don Moseley, Susan Moseley, Narayanaswamy H. Nadig, Alan Natella, W. F. Orth, Gene Padgham, Leonard Palumbo, Linda Phillips, Lee Frew Platt, Hugh Prichard, Judith Rachap, Clyde W. Richey, Phil Sapp, Elaine Schiff, Rudy Schmidt, Malcolm Searle, Terry Selles, Laurence L. Shapiro, Carolyn Shea, Morris Sleight, Martie Stegall, Jean Tate, John P. Torbush, Brad Vincent, Hugo Weber, Jr., Wayne Weeks, A. P. Werbner, Dorothy Whetstone, Evonne Whitney, Kathleen Witalisz, and Michael Witt.

There are also those to who I owe a special debt in preparing this edition: Sherry Weeks and Barbara Appel.

Note to Readers ---

The author anticipates that as many women will read this book as men. However, it would make the sentences in this book harder to read if “he and she” and “his and her” were used on every possible occasion. Therefore, when you read, “he,” “his,” or “him” in this book, please note that they are being used in their grammatical sense and refer to women as well as men.

* * *

The forms in this text are for information only and are not intended for use as legal documents. In such matters, an attorney should be consulted.

Contents

Preface	xvii
---------	------

Note to Readers	xx
-----------------	----

1 Introduction to Real Estate	1
How to Read This Book	2
Transaction Overview	2
Career Opportunities	6
Residential Brokerage	6
Commercial Brokerage	6
Industrial Brokerage	7
Farm Brokerage	7
Property Management	8
Rental Listing Services	8
Real Estate Appraising	8
Government Service	9
Land Development	9
Urban Planning	10
Mortgage Financing	10
Securities and Syndications	10
Consulting	10
Research and Education	11
Full-time Investor	11
License Requirements	12
Additional Readings	12

2 Nature and Description of Real Estate	14
Land	15
Improvements	16

Fixtures	16
Appurtenances	18
Water Rights	18
Land Descriptions.....	19
Grid Systems	33
Vertical Land Description	33'
Lot Types.....	34
Physical Characteristics of Land	35
Economic Characteristics of Land	37
Vocabulary Review	39
Questions and Problems.....	40
Additional Readings	41

3 Rights and Interests in Land	42
Feudal and Allodial Systems	43
Government Rights in Land	44
Protecting Ownership	47
Fee Simple	47
Encumbrances	48
Qualified Fee Estates	56
Life Estates	57
Statutory Estates	58
Freehold Estates	60
Leasehold Estates.....	60
Overview.....	62
Pictorial Summary	64
Vocabulary Review	68
Questions and Problems.....	69
Additional Readings	69

4 Forms of Ownership	70
Sole Ownership.....	71
Tenants in Common.....	72
Joint Tenancy.....	74
Tenancy by the Entirety	76
Community Property	79
Partnership	80
Corporations.....	83
Trusts	84
Limited Liability Companies	87
Syndication	88
Caution	88

Vocabulary Review	88
Questions and Problems	89
Additional Readings	90

5 Transferring Title	91
Deeds	92
Conveyance After Death	105
Adverse Possession	107
Easement by Prescription	109
Ownership by Accession	111
Public Grant	111
Dedication	111
Forfeiture	112
Alienation	112
Vocabulary Review	112
Questions and Problems	114
Additional Readings	114

6 Recordation, Abstracts, and Title Insurance	115
Need for Public Records	116
Requirements for Recording	119
Public Records Organization	121
Chain of Title	123
Abstract of Title	125
Title Insurance	127
The Torrens System	133
Marketable Title Acts	135
Vocabulary Review	136
Questions and Problems	137
Additional Readings	137

7 Contract Law	138
How a Contract is Created	139
Essentials of a Valid Contract	140
Performance and Discharge of Contracts	150
Breach of Contract	151
Statute of Limitations	153
Implied Obligations	154
Vocabulary Review	154
Questions and Problems	155
Additional Readings	156

8 Real Estate Sales Contracts	157
Purpose of Sales Contracts	158
Purchase Contracts	158
The Binder	172
Letter of Intent	173
Practicing Law	174
Installment Contracts	174
Equitable Title	177
Lease with Option to Buy	178
Right of First Refusal	181
Exchange Agreements	181
Typical Trade Contract	185
Vocabulary Review	185
Questions and Problems	186
Additional Readings	186
9 Mortgage and Note	188
Promissory Note	189
The Mortgage Instrument	192
Mortgage Satisfaction	197
"Subject To"	197
Assumption	198
Novation	198
Estoppel	198
Debt Priorities	199
The Foreclosure Process	200
Judicial Foreclosure	202
Strict Foreclosure	205
Power of Sale	205
Entry and Possession	206
Deed in Lieu of Foreclosure	206
Installment Contract Foreclosure	207
Deed of Trust	207
Equitable Mortgage	209
Deed as Security	209
Choice of Security Instrument	210
Vocabulary Review	210
Questions and Problems	211
Additional Readings	212
10 Deed of Trust	213
Parties to a Deed of Trust	214

Reconveyance	215
Deed of Trust Document	216
Jurisdictions Using Deeds of Trust	221
Advantages of the Deed of Trust	223
Vocabulary Review	223
Questions and Problems	224
Additional Readings	224

11 Lending Practices 225

Term Loans	226
Amortized Loans	227
Budget Mortgage	230
Balloon Loan	232
Partially Amortized Loan	232
Earlier Payoff	233
Loan-to-Value Ratio	235
Equity	235
Loan Points	236
FHA Insurance Programs	237
Department of Veteran Affairs	244
Private Mortgage Insurance	249
Farmer's Home Administration	250
Truth in Lending Act	250
Loan Application and Approval	262
Overview	269
Vocabulary Review	269
Questions and Problems	270
Additional Readings	271

12 Sources and Types of Financing 272

Primary Market	273
Savings and Loan Associations	273
Commercial Banks	277
Mutual Savings Banks	278
Life Insurance Companies	278
Mortgage Companies	279
Mortgage Brokers	280
Municipal Bonds	281
Other Lenders	281
Secondary Market	282
FNMA	285
GNMA	287

FHLMC.....	288
Farmer Mac.....	289
Private Conduits	290
Computerization.....	290
Mortgage Networks	291
Availability and Price of Mortgage Money	292
Due-on-Sale	294
Prepayment.....	294
Adjustable Rate Mortgages	294
Graduated Payment Mortgage.....	299
Shared Appreciation Mortgage.....	299
Equity Sharing.....	300
Package Mortgage	301
Blanket Mortgage	302
Reverse Mortgage.....	302
Construction Loan	302
Blended-Rate Loan	303
Buy-Downs	303
Equity Mortgage.....	304
Seller Financing.....	305
Wraparound Mortgage.....	305
Subordination.....	306
Contract For Deed	307
Option.....	307
Creative Financing.....	308
Overly Creative Financing?	309
Investing In Mortgages	310
Rental.....	311
Land Leases	311
Financing Overview	312
Vocabulary Review	313
Questions and Problems.....	314
Additional Readings	314
13 Taxes and Assessments	316
Property Taxes	317
Unpaid Property Taxes.....	320
Assessment Appeal	320
Property Tax Exemptions.....	321
Property Tax Variations.....	322
Special Assessments	323
Income Taxes on the Sale of One's Residence.....	326
Lifetime Exclusion	329

Taxable Gain.....	330
Installment Method	330
Property Tax and Interest Deductions	331
Interest Deduction Limitations.....	332
Below-Market Interest.....	332
Impact on Real Estate.....	333
Agent's Liability for Tax Advice	333
Conveyance Taxes	334
Vocabulary Review	334
Questions and Problems.....	335
Additional Readings	336

14 Title Closing and Escrow	338
Buyers' Walk-Through	339
Title Closing.....	340
Closing or Settlement Meeting	340
Escrow	343
Delays and Failure to Close	346
Loan Escrows.....	347
Prorating at the Closing	348
Sample Closing	351
Settlement Statement.....	353
Real Estate Settlement Procedures Act.....	358
Vocabulary Review	362
Questions and Problems.....	362
Additional Readings	363

15 Real Estate Leases	364
The Leasehold Estate.....	365
Creating a Valid Lease	366
The Lease Document.....	366
Landlord-Tenant Laws	370
Setting Rents	371
Option Clauses.....	372
Assignment and Subletting.....	372
Ground Lease	373
Vertical Leases.....	373
Contract Rent, Economic Rent.....	373
Lease Termination	374
Rent Control	375
Property Management	377
Tenant Selection	378

Security Deposit.....379

Tenant Retention.....380

Collecting Rents381

On-site Management.....383

Off-site Management384

Job Opportunities385

Vocabulary Review386

Questions and Problems.....388

Additional Readings388

16 Real Estate Appraisal 390

Market Value391

Market Comparison Approach392

Cost Approach404

Income Approach408

Choice of Approaches.....414

Appraiser’s Best Estimate.....414

Appraisal Regulation415

Characteristics of Value.....420

Principles of Value.....420

Multiple Meanings of the Word Value422

Buyer’s And Seller’s Markets.....423

Professional Appraisal Societies423

Vocabulary Review424

Questions and Problems.....426

Additional Readings426

17 Licensing Laws and Professional Affiliations 428

Rationale for Licensing429

Persons Required to be Licensed430

Broker431

Salesperson431

Sales Associate432

Qualifications for Licensing.....432

Licensing Procedure.....434

Examination Services.....436

Nonresident Licensing.....437

Licensing the Business Firm438

Real Estate Regulation439

License Suspension and Revocation440

Bonds and Recovery Funds441

Securities License	442
Affiliating with a Broker	443
Independent Contractor Status	446
Franchised Offices	447
Professional Real Estate Associations	448
Code of Ethics	450
Vocabulary Review	454
Questions and Problems	455
Additional Readings	456

18 Principal-Owner Relationship — Employment 457

Listing Agreement	458
Exclusive Right to Sell Listing	462
Exclusive Agency Listing	462
Open Listing	463
Net Listing	463
Advance Fee Listing	463
Multiple Listing Service	465
Exclusive Authority to Purchase	465
Broker Compensation	469
Terminating the Employment Contract	470
Bargain Brokers	471
Perceived Value	472
Vocabulary Review	473
Questions and Problems	473
Additional Readings	474

19 Principal-Owner Relationship — Agency 475

Agency	476
Broker's Obligations to His Principal	478
Broker's Obligations to Third Parties	482
Court Case Examples	483
Owner Disclosure Statement	485
Buyer Agency	486
Errors and Omission Insurance	487
Puffing	488
Principal's Obligations	489
Broker's Sales Staff	489
Cooperating Broker	490
Property Disclosure Statements	497
Antitrust Laws	498
Vocabulary Review	499