

Real Estate

Buying or selling real estate may be the largest single investment — and one of the greatest satisfactions — of your lifetime. Along with a substantial financial commitment, such transactions usually involve risks, technicalities and legal considerations.

This pamphlet is intended to provide you with general information about the basics of buying and selling real estate. It explains essential steps in the process and suggests guidelines for avoiding pitfalls, but it does not attempt to provide specific legal advice. Therefore, if you are not knowledgeable or experienced in negotiating terms, arranging financing, analyzing tax consequences, or handling related details, you may want to consult a lawyer.

Starting the Process

Before signing any document or paying any money, you should carefully examine your requirements, resources and needs for professional help.

An experienced, reputable real-estate broker may be indispensable. Although the seller ordinarily hires the real-estate broker and agrees to pay the fee, it is possible for a buyer to make such arrangements.

The Washington Administrative Code requires agents to disclose whether they represent the buyer or seller (or both). Verbal and/or written disclosure is required before showing homes for sale. In addition, the disclosure must be confirmed in a separate paragraph in a written purchase and sale agreement.

When you buy or sell real estate you may also come into contact with bankers or other lenders, title and mortgage officers, inspectors, or other authorities whose function you should understand. Of all your advisers, your lawyer is probably in the best position to assist you with each phase of the transaction.

Types of Documents Used

Various documents are used to specify rights and obligations in real-estate transactions. Preprinted forms, individually drafted forms, or a combination may be used; your lawyer can assist you in determining which are best for your situation. Typical documents include **listing agreements**, **purchase and sale agreements**, and **financing agreements**.

Listing Agreements

The usual form of contract between a seller and broker is a **listing agreement**. It is usually a printed form, but the amount of commission, the duration of the agreement and duties of the broker are all items that may be negotiated. There are several forms of listing agreements, with great variation in terms, liability, duties and services rendered.

Most brokers request an **exclusive listing** (or "exclusive right to sell"), a written agreement entitling the listing agent to a commission regardless of who sells the property. The agreement may also provide for a commission even after the listing agreement has expired, if the property is sold to a prospect produced by the broker during the term of the contract.

An **exclusive agency listing** designates one broker as the "exclusive agent" with entitlement to a commission unless the owner effects a sale without assistance from any broker.

An **open listing** contract may be given to any number of agents, and often allows the property owner to sell the property directly. In the event of a sale, only the broker who has found a buyer receives a commission.

A **multiple listing association** enables participating brokers to pool listings and share commissions in order to give maximum exposure to the property.

A broker who produces a purchaser who is ready, willing and able to buy the property on the terms specified in the listing agreement (or otherwise acceptable to the seller) is normally entitled to a commission. The fee (typically a negotiated percentage of the selling price) should be stipulated in the agreement.

Although contracts may sometimes provide for payment of a commission only if a sale is completed (or "closes"), the seller usually must pay a broker who performs according to an agreement, regardless of whether the sale was ever

consummated. In other words, if a sale fails to close because a seller reneges, the seller generally must pay the commission.

A broker's role may be negotiated by the parties to the agreement, but the broker is usually the seller's agent. In representing the seller's interests, a broker must report all offers and proposals. The broker or agent sometimes acts as an intermediary, delivering offers and counteroffers between the buyer and seller. Rates, terms and services vary with the type of listing, geographical area and other factors.

Purchase and Sale Agreements

Often called the "earnest money agreement," a **purchase and sale agreement** is prepared to specify all the terms and conditions of the transaction. This document states the price and terms under which the buyer is obligated to buy and the seller is obligated to sell. It is a legally binding contract which establishes the respective rights and responsibilities of the purchaser and seller. An agreement for the sale of real estate is void and unenforceable unless it is in writing and signed by the buyer and seller.

The buyer often makes a deposit, known as an **earnest money deposit**. This "evidence of good faith" is usually in the form of a cash deposit, but it may also be a promissory note (or signed acknowledgment to repay a debt at a later date). The amount can vary and the deposit is usually applied to the down-payment obligation or to the buyer's share of the closing costs.

The importance of the purchase and sale agreement cannot be overstated, and it is advisable to have a lawyer review the document before signing. If this is not possible, a condition can be included to provide that the transaction is subject to the approval of the buyer's (and/or seller's) lawyer within a specified number of days.

A buyer may lose the deposit and be liable for damages if an agreement is signed and he or she fails to abide by its terms. A seller who fails to perform after signing the agreement may also be liable for damages.

A preprinted form is frequently used for purchase and sale agreements, with specific terms added by completing blanks on the form. A specially prepared agreement or addendum may also be used in place of, or to supplement, a preprinted contract.

In addition to naming the parties, price and terms of the purchase, a purchase and sale agreement should also include the following items:

- legal description of the property;
- condition of the title (or legal right to ownership) and assumed debt;
- warranties of title (restrictions, rights or limitations)
- condition of property and of zoning or use rights (if applicable);
- prorations of taxes, special assessments, obligations and prorations regarding insurance premiums
- stipulation of who bears costs for such items as transfer fees, state revenue stamps, etc.;
- financing, if it is a contingency of the purchase
- complete terms and documents to be used if the seller is supplying financing and receiving security for such financing (with copies of any such documents attached);
- items of furnishings, fixtures or appliances to be included or excluded;
- right of inspection (if any) given the buyer;
- date of possession; and
- conditions under which an offer may be canceled, as well as provisions for return or forfeiture of the deposit.

In the purchase and sale of an existing home, the sellers must complete a **disclosure** statement regarding the home. Disclosures cover a variety of topics, including the condition of legal title, the availability of essential services to the home such as sewer and water, and a listing of the history of significant repairs or changes in the condition of the house. Unless the buyer waives review of this statement, the seller must deliver a completed statement to the buyer for review within a certain time after the purchase and sale agreement has been signed by both parties. The buyer then may elect to terminate the transaction by giving timely and appropriate notice to the seller. If the buyer does not object, then the disclosures are deemed to be acceptable to the buyer.

Financing Agreements

Banks, savings and loan associations, mortgage or insurance companies, some credit unions and other institutions are in the business of lending money to finance the purchase of real estate. Some financing, such as FHA-insured and VA-guaranteed loans, is insured by the federal government and may offer lower financing charges or extended terms of repayment.

As an alternative to a conventional lending institution, a buyer may find a seller who is willing to finance the transaction. Under these arrangements, a seller receives a promissory note from the buyer and uses a mortgage, deed of trust, or similar instrument to secure payment and guarantee performance.

Other financing options, such as the use of a land sales contract, assumption of the seller's mortgage, graduated payment plans, and adjustable-rate loans may also be worth investigation.

Specific terms and requirements for loans vary widely and are influenced by money market conditions, the quality of the borrower's credit, income sources or assets, and other factors. Loan costs can also vary, and may include service charges, appraisal fees, survey costs, title insurance, escrow and legal fees.

If financing is required to complete a transaction, a buyer should be sure the purchase and sale agreement specifies that requirement as a condition of the purchase. Furthermore, the buyer usually has the responsibility for finding a financing commitment by a certain date.

The agreements used to secure a debt with real property are usually lengthy and complex. Such agreements affect the payment of money to a seller, a lender, or both, and establish a security interest in your real property or home. Even with a "standardized" form, legal advice may be necessary to fully understand the details, obligations and legal consequences of the documents. It may also be necessary for your lawyer to tailor certain items to meet your requirements.

Use of Security Instruments

Several methods and various security instruments may be used for real-estate loans, each with different obligations and consequences.

A **mortgage** and a **deed of trust** are security instruments that pledge to the lender an interest in your real estate to secure payment of a **promissory note**. A mortgage is the instrument, usually held by the lender, by which the property is pledged to secure the payment of a debt or obligation. A deed of trust has similar functions, but is usually held "in trust" by a trustee. The promissory note acknowledges a borrower's formal obligation to repay the loan. Under some types of security instruments, a buyer who fails to pay on time can lose the pledged property or may be required to pay additional amounts on the loan.

A **real estate installment sales contract** or a **land sales contract** is an agreement between the seller and buyer that states the purchase price and method of payment, as well as other rights and duties.

The buyer usually does not receive a deed (or legal title) to the property until all required payments are made. In the event of default, payments may be forfeited, and the buyer's interest in the property may be lost.

Expenses

In addition to the loan, there may be other costs involved in buying property. These costs will usually be itemized at the time of closing. In general, estimates can be provided at the outset of a transaction or before service is rendered. Along with understanding what fees and expenses are owed, you should also be aware of when the amounts are payable and who (buyer or seller) is responsible for specific charges. Typical items include: lender's fees, appraisal fees, inspection fees, title search, insurance, taxes, escrow and lawyer fees.

Taxes

Every real estate transaction has certain tax effects upon the parties involved. Steps may be taken when negotiating the initial purchase and sale agreement to reduce or adjust tax obligations or postpone payments. Federal income tax, estate taxes, excise taxes and other consequences are complicated and the laws frequently change. Whether buying

or selling real estate, advice from your lawyer or accountant is essential in understanding and dealing with tax considerations.

Real Estate Title

Real-estate title is evidence of legal ownership. When buying real estate, it is important to assure your right to occupy, use or eventually resell it without interference. Previous ownership and a title's "marketability" can be verified by a title search. Multi-unit ownership (such as condominiums, cooperatives and time-sharing arrangements) may involve special considerations.

Title insurance offers protection against financial loss and expense of defending your title in court. Issued by a title insurance company following a search through records of previous ownership, such policies have various terms, provisions and types of coverage. Some risks, such as unrecorded easements or zoning and use restrictions, may not be covered by title insurance. A lawyer can explain policy exceptions and conditions and may help a buyer determine whether additional protection is desirable.

Closing the Sale

The final stage in the purchase of real estate is called **closing** or "settlement." This sometimes complex procedure occurs when the parties submit the final documents required to complete the sale according to terms of the purchase and sale agreement. Money and documents are usually exchanged at the time of closing, and the function may be attended by the parties and their lawyers.

Mortgage brokers, private escrow or title insurance companies, and lawyers usually provide **escrow services**. Under Washington state's limited-practice rule, certified nonlawyers can prepare and complete certain court-approved forms for use in closing a loan, extending credit, and the sale or other transfer of real property.

Escrow services by a neutral third party are essential to the proper closing and recording of instruments and delivery of monies. It should be remembered, however, that escrow agents obtain information and take their instruction from the parties; they do not guarantee or protect the rights of either party in assuring that documents are consistent with purchase and sale agreements or either party's understanding of the transaction.

The escrow agent must prepare and obtain approval by the parties of "truth in lending" and "closing" statements as required by the federal Real Estate Settlement Procedures Act (RESPA). These forms and disclosures are required to advise borrowers of the cost and interest rates in the transaction. You may wish to have your lawyer review the documents and explain the content and consequences.

One of the most important instruments for closing is a **deed**, which transfers ownership of property from the seller to the buyer. There are several types of deeds, such as "warranty deed," "special warranty deed," "bargain and sale deed" and "quit claim deed." The type of deed affects the buyer's rights against the seller. The manner in which the buyer's name appears on the document is also important, since it may affect the form of ownership and the tax liability of the owner.

Filing Documents

All documents of ownership of real property and those reflecting a security interest in real property should be recorded (officially filed) in the county where the property is located. This procedure is necessary to protect one's ownership of property. To be eligible for recording, the documents must meet certain statutory requirements. For example, the document must contain a legible and correctly stated legal description and an official acknowledgment (notarization) of the signatures. All documents pertaining to your transaction should be kept in a secure yet accessible location, such as a safe-deposit box. These important papers may be useful when preparing tax returns or if planning to sell that property.

This pamphlet was prepared as a public service by the Washington State Bar Association. It contains general information and is not intended to apply to any specific situation. If you need legal advice or have questions about the application of the law in a particular matter, you should consult a lawyer.