LEARNING OBJECTIVES

Students will be able to

1. recognize the important legal considerations that affect real estate appraisal.
2. define and understand the differences among real estate, real property, personal property, and fixtures.
3. identify and understand the limitations on ownership of real estate including police power, eminent domain, escheat, and taxation.
4. identify and understand private restrictions on real estate including deed restrictions, easements, leases, mortgages, and liens.
5. define and understand encroachments and adverse possession.
6. understand the concept of fee simple ownership, as well as ownership interests that are less than fee simple such as life estate, leased fee estate, leasehold estate, air rights, and surface/subsurface rights.
7. understand the various forms of property ownership including joint tenancy, tenancy in common, tenancy by the entirety, as well as special forms of ownership such as condominiums, cooperatives, and timeshares.
8. understand the various forms of legal descriptions and how to identify property according to the specific form of legal description.
9. understand the types of title transfers including general warranty, special warranty, and quitclaim deeds.
KEY TERMS

adverse possession  general warranty deed  personal property
air rights  government (rectangular)  police power
bundle of rights  survey  purchase money mortgage
condemnation  joint tenancy  quitclaim deed
condo  lease  real estate
copc  leased fee estate  real property
easement  life estate  special warranty deed
easement in gross  limited warranty deed  surface/subsurface rights
eminent domain  lot-and-block system  taxation
tent  metes-and-bounds  tenancy
tent by the entirety  description  tenancy in common
tent in common  monument system  time-share

INTRODUCTION

Ownership of real estate in the United States of America is a direct function of constitutional guarantees. Our governmental heritage, especially related to the ownership of real estate, is English in its origin, and legal implications that affect ownership evolved from this heritage.

This Chapter focuses on the various legal considerations involved in the ownership of real property that a professional appraiser must understand. Covered in this Chapter are the following six legal considerations:

1. Fundamental definitions of legal interests
2. Limitations on ownership of real estate
3. Forms of legal interests
4. Property ownership forms
5. Four types of legal descriptions
6. Types of real estate transfers

PART ONE  Fundamental Definitions of Legal Interests

In understanding the ownership of real estate, a clear distinction must be made between real estate and real property:
REAL ESTATE

Real estate relates to the land and all improvements permanently attached to the land, either by nature or by people.

As discussed in Chapter 1, real estate has the following five unique characteristics that distinguish it from other asset types:

1. Unique in location
2. Unique in composition
3. Durable
4. Finite in supply
5. Useful

These five unique characteristics all relate to the physical attributes of land and/or improvements.

REAL PROPERTY

Real property relates to the interests, benefits, and rights inherent in the ownership of real estate.

Based on this distinction between real estate and real property, those involved in the valuation of real estate are technically real property appraisers as opposed to real estate appraisers.

Consistent with the concept of real property is the bundle of rights concept, a view of real property ownership suggesting that the rights inherent in the ownership of a parcel of real estate can be compared to a bundle of sticks whereby each stick represents a separate and distinct right in the ownership of that real estate.

Rights generally inherent in the ownership of real estate include but are not limited to the following six:

1. The right to sell
2. The right to lease
3. The right to mortgage
4. The right to sell or lease a partial interest
5. The right to build improvements thereon
6. The right not to do any of the above

The bundle of rights can be divided through various instruments including leases, easements, and mortgages. Through these instruments, one party owns or controls certain rights whereby another party owns or controls other rights.
For example, in a lease arrangement, the person leasing the property (lessee) generally acquires the right to use and occupy the premises for a certain reason, for a certain period of time, usually at a specified rental rate. The owner of the property (lessor) retains the right to receive rent for giving up the use of the property but also retains the right to the reversion, or the right to get the property back after the lease has ended.

**PERSONAL PROPERTY**

**Personal property** is an item that is not real property.

It usually falls outside the subject of an appraisal. Three examples of personal property that may appear to be related to the real estate are the following:

1. A portable microwave oven
2. A window air-conditioning unit
3. Furniture

**FIXTURE**

A **fixture** is an item that was once personal property that has become part of the real estate.

When a dishwasher has been delivered to a construction site and is awaiting installation, it is personal property. When installed, however, it becomes a fixture and is considered part of the real estate. Following are four examples of fixtures:

1. Light fixtures
2. Stoves
3. Basketball goals (permanently installed)
4. An irrigation system

In deciding whether or not personal property has become a fixture, there are generally the following three tests:

1. The manner in which the item is attached
2. The intent of the parties
3. Tradition/character of the item

A builder removes a ceiling fan from the box, installs it on the ceiling, and sells it along with the house. This item has satisfied all three tests for becoming a fixture. But what about curtains and other window treatments? In many cases, a purchaser of a home has been disappointed to find out the curtains he or she assumed would go with the house
have been removed once the premises become vacated. The purchase contract should specify what the buyer and seller are considering as a fixture or personal property.

Although furniture is generally considered as personal property, motels and hotels are usually sold with room furnishings included. In this instance, furniture is considered a fixture and part of the real property.

When confronted with uncertainties as to the treatment of property, the appraiser should address the problem, consult the client, and agree upon proper treatment.

PART TWO Limitations on Ownership of Real Estate

The purest and most complete form of real estate ownership is **fee simple**. Yet, even though an individual may own a parcel of real estate in fee simple with no mortgage encumbrance, he or she does not have exclusive use of that property. There can be private restrictions placed on the property by the previous owner. Such restrictions may require a minimum floor area, architectural controls, and placement of improvements.

There can also be governmental controls. When purchasing real estate, one should recognize that the purchase is being made subject to these restrictions which are inherent in the ownership of the property.

### PUBLIC RESTRICTIONS ON REAL ESTATE OWNERSHIP

There are four public or governmental restrictions known as the four powers of government. These limit the ownership of all real property in the United States. The four powers are as follows:

1. Police power
2. Eminent domain
3. Escheat
4. Taxation

**Police Power**

**Police power** is the right of government to regulate land use for the public good. There are numerous examples of police power, but the most obvious ones are zoning and building codes.

**Zoning** is intended to promote orderly development of land. Zoning may allow commercial development along a major highway but may restrict adjoining land to single-family residential usage. By promoting orderly development, zoning generally tends to maximize and maintain an individual parcel’s value.
Building codes are intended to protect the consumer from inappropriate or faulty construction. The requirement of sprinkler systems in office buildings over four stories high may have a significant impact on construction costs and rental rates. The requirement to reinforce foundation footings may insure the viability of a residential structure for years to come whereas the average consumer may be unaware of its importance.

Eminent Domain

Eminent domain is the right of governments to acquire private property for public use, such as a road widening. The process of acquiring private property for public use is called condemnation, whereas the right of government to acquire the property is eminent domain. Whether we agree or disagree with this right as individuals, it is inherent in the United States Constitution.

Laws in many states recognize the power of eminent domain but go on to state that just compensation must be paid to the owner. Examples in which the power of eminent domain is employed may include the following:

1. Highway construction
2. Parks
3. Governmental building sites
4. Airport expansion
5. Reservoirs
6. Utility construction

Escheat

Escheat actually means going to the state. If a person dies without a will, that person is said to have died intestate, and that person’s property transfers to the state.

Taxation

Governments are granted the right of taxation, that is, they are allowed to levy taxes on properties. In many communities, property taxes are the primary funding basis for local operations including schools. If property taxes are not paid, governments have the right to acquire the properties, although proper legal procedures must be followed.

■ PRIVATE RESTRICTIONS ON REAL ESTATE OWNERSHIP

In addition to governmental restrictions, individuals may place private limitations on property, and these restrictions may or may not transfer with the property when it sells.

Following are five examples of private restrictions:
1. Deed restrictions
2. Easements
3. Leases
4. Mortgages
5. Liens

**Deed Restrictions**

A *deed restriction* is a limitation on the use of real estate through a written legal document that is usually recorded. The recording document is usually referred to or stated in the transfer agreement such as a deed. While a zoning restriction usually applies to many parcels, a deed restriction usually relates to a specific parcel or even a defined subdivision or planned use development. When deed restrictions are in conflict with zoning, usually the more restrictive prevails.

One of the most common deed restrictions is a subdivision *restrictive covenant*. A subdivision deed restriction may state that the minimum size of a home must be 2,000 square feet, even though zoning may only require a minimum of 1,500 square feet. Usually deed restrictions have time limitations, but under certain circumstances, they can be extended.

**Easements**

An *easement* conveys the right to use part of the land for a specific purpose. Easements thus divide the bundle of rights.

Utility companies have to acquire easements to extend utility lines through property. In order to widen an existing highway, a governmental authority may have to acquire a *temporary* easement alongside the highway for construction purposes.

In Figure 2.1, a parcel that would otherwise have no access or be *landlocked* has attained access through an access easement across the adjoining property. In Figure 2.1, the owner of Tract B has given an easement to the owner of Tract D.

An easement typically does not convey ownership of the majority of the rights in the bundle of rights; easements relate to specifically identified rights usually identifying a temporary or perpetual use. An easement that runs with the land and can be conveyed from a seller to a buyer is called an *easement appurtenant*. An easement that serves only one person that cannot be conveyed from a seller to a buyer is called an *easement in gross*.

**Leases**

A *lease* is a contractual agreement between a property owner (lessor) and a tenant (lessee). It specifies the use of a property for an identified period of time. The tenant acquires the right to occupy and use a property. The owner usually receives the right to
collect rent from the tenant and also has the right of reversion, that is, the right to get the property back at the end of the lease. Usually, sales of property do not nullify leases. This concept is particularly important when valuing properties that are subject to leases as will be discussed later in Chapter 15.

**Mortgages**

When real estate is purchased, there are usually some borrowed funds involved as part of the purchase price. When part or all of this money is borrowed from a lending institution, a mortgage instrument is usually created.

A **mortgage** is a loan or promissory note that is secured by the real estate. If the loan is not paid back according to the agreed upon terms and conditions, the lending institution providing the funds can acquire title to the property through foreclosure.

Frequently, the seller of real estate takes back a mortgage as part of the purchase price. This form of *seller financing* is often referred to as a **purchase money mortgage**. The terms and conditions are often more advantageous to the buyer than the terms and conditions available for borrowed funds from traditional lending institutions.

**Liens**

A charge against a property in which the property is security for payment of a debt is called a **lien**. There are many forms of liens such as a mechanic’s lien, materialman’s lien, or liens which may be placed on a property through a condominium association for nonpayment of mandatory association fees. All mortgages are liens, but all liens are not mortgages (mechanic’s lien).
• RELATED TERMS

Encroachments

An **encroachment** is a trespass on another’s land. If a fence has been installed over the property line onto the adjacent property, an encroachment has been created. A house that extends over a property line is also an example of an encroachment. In most cases, the person doing the encroaching can be forced to correct the encroachment.

Adverse Possession

Adverse possession is a method of acquiring ownership through possession: If a person utilizes another person’s property openly for an extended period of time, that property may be transferred as to ownership. Several requirements are necessary for one to acquire title through adverse possession. Possession must involve all of the following:

a. Be apparent (open and visible)
b. Be continuous and uninterrupted for a certain period of time
c. Be exclusive
d. Be claimed, i.e., the person who has the apparent possession must make a claim to that possession
e. Be hostile with denial or opposition to the original owner’s title

A frequent situation where property is claimed through adverse possession involves abandoned railway lines. If a rail company abandons a rail line and removes the rail, and an adjacent property owner fences in the area and utilizes it for agricultural purposes for an extended period of time, that property owner may have claim to the abandoned railway line through adverse possession.

• **PART THREE** Forms of Legal Interest

Several forms of ownership of real property exist, varying from state to state. As noted previously, because we are technically appraising real property rather than real estate, we must have a clear understanding of the ownership interest being appraised.

• **FEE SIMPLE ESTATE**

The most complete form of ownership is a **fee simple estate**. Although the purest form of ownership without any claims by heirs or private restrictions, a fee simple estate is limited by the aforementioned four powers of government. Usually, an appraisal of any interest less than fee simple begins with an analysis of the fee simple value.
PARTIAL INTERESTS

Any interest less than a fee simple interest is known as a partial interest. Several forms of partial interests are discussed in the following paragraphs.

Life Estate

A life estate is created when an owner of real property grants the right to another to use the property for his or her life. To illustrate, say a grandmother wants to live in her house until her death. She could sell the property to another but retain the right to occupy the house until her death. In this case, all of the bundle of rights have not transferred because the grandmother will continue to use and occupy the property for some duration.

Leased Fee Estate

A landlord’s (lessor’s) interest in a property when there is a lease encumbering the property is called a leased fee estate. The lease document itself has divided the bundle of rights.

The landlord usually retains the right to receive rent in exchange for giving up use of the property for a specified period of time; the landlord also retains the right to get the property back at the end of the lease (reversion). In such an arrangement, the obligations accruing to the landlord and the obligations accruing to the tenant are usually specified by the lease.

For example, either the landlord or the tenant can be contractually obligated to pay the taxes, insurance, heating and cooling equipment maintenance, structural maintenance, grounds maintenance, etc.

Leasehold Estate

In contrast to the leased fee estate, the tenant’s (lessee’s) interest in a leased property is called a leasehold estate. The tenant usually obtains the right to use and occupy the property but assumes the obligation to pay rent. A leasehold estate can have a positive value (tenant has an advantage) if the contract rent (rent specified in the lease) is less than economic or market rent (rent which could be achieved in an open market). A leasehold interest can have a negative value (tenant is at a disadvantage) if the contract rent is more than the economic or market rent.

Air Rights

Air rights are particularly important in urban areas. In many cases, buildings are constructed within an identified air space.
Air rights do not extend indefinitely. There are height limitations imposed by the Federal Aviation Administration related to air traffic control.

Surface/Subsurface Rights

Surface/subsurface rights also come into play more in urban areas. A government agency may acquire (through eminent domain) subsurface rights for the construction of an underground rapid rail system. An owner of a parcel of land may retain the surface rights for use as parking and sell the air rights for an overhead walkway connecting to adjacent buildings. Often, a seller may transfer his land but retain the subsurface mineral rights.

As appraisers, we are concerned with the valuation of an ownership interest (real property) in specified real estate. The bundle of rights relates to real property and, as discussed, can be divided. In addition to understanding rights, an appraiser should also understand the various types of ownership.

- **INDIVIDUAL (SEVERALTY)**

  This is the most common form of ownership where one person or corporation owns the entire bundle of rights, still subject to governmental and private restrictions.

- **TENANCIES AND UNDIVIDED INTERESTS**

  Tenancy is created when the bundle of rights is divided, and in real estate generally has the following two meanings:

  1. The possession of title or other ownership form
  2. The right to use and occupy property

  As discussed, the second meaning relates to leased property in which the lessee has the right to use and occupy the property, and the landlord has the right to receive rent and get the property back at lease termination.

  Related to the ownership of real property, there are several important ownership forms that warrant explanation. They relate to an “undivided interest” in the real property. The undivided interest concept is difficult for many people to comprehend. What this means is that the property itself cannot be divided, only the ownership interest.
Following are the three most common forms of tenancies related to ownership:

1. Joint tenancy
2. Tenancy in common
3. Tenancy by the entirety

**Joint Tenancy**

Ownership by joint tenancy occurs when two or more persons have inseparable or undivided interests in property. Upon the death of one of the owners, title to the deceased owner’s portion of the property automatically passes to the surviving owner(s). This is referred to as the *right of survivorship*.

**Tenancy in Common**

The tenancy in common form of ownership also relates to two or more persons who have undivided interests. The undivided interest may or may not be equally distributed to the estate holders. This form of ownership is different from joint tenancy in that there is no right of survivorship. In other words, if one owner dies, title would pass to that owner’s heirs rather than to the surviving owner(s) automatically.

**Tenancy by the Entirety**

Tenancy by the entirety relates to a husband and wife who own a particular property. In this case, neither party can sell his or her interest individually; the property can sell only as a unit. This ownership interest is usually reserved for married couples.

### SPECIAL FORMS OF OWNERSHIP

The following three special types of ownership evolved in recent years as the bundle of rights separated in more creative ways:

1. Condominium
2. Cooperative
3. Time-share

**Condominium**

The term condominium describes a type of ownership, not a type of building. This is a form of ownership in which an owner has an interest (usually fee simple) in a certain
unit defined such as the space between the interior walls, the ceiling, and the floor of that unit; the owner also owns a pro-rata share of the common areas (drives, grounds, recreational amenities, etc.) within the development.

For example, assume Martha owns a condominium within an 80-unit development. Martha would own the interior of her unit and \( \frac{1}{80} \) of the common areas.

**Cooperative**

A *cooperative* is a form of ownership in which a corporation owns the land and improvements, and the residents own stock in the corporation. Then, the corporation signs an exclusive lease with the tenant-stockholder. Cooperatives are common in certain regions of the country. This type of ownership allows tenant-stockholders to select their neighbors, voting on whether to allow or deny a prospective buyer to be allowed into the corporation, and thus occupancy of a unit in the building.

**Time-Share**

A *time-share* is a partial form of ownership in which other time-share owners (tenants in common) purchase the right of use/occupancy for a specified period of time, say one week per year. Typically, 50 weeks per year are sold, with the other two weeks reserved for maintenance. Thus, an owner who buys one week will have a 2 percent ownership \( (\frac{1}{50}) \) in the unit, but his ownership/occupancy may be restricted to a certain period or week of the year. A Miami time-share week is likely more expensive in January than is a week in July; hence, a buyer cannot purchase an inexpensive week in July and expect to use it during a more expensive January week.

**PART FIVE**

**Forms of Legal Descriptions**

Legal descriptions are methods of describing real estate so that each property can be recognized from all other properties, recognizing its unique characteristics with regard to location. Because land is a unique commodity in that it is immobile, it must be described specifically. Following are the four types of legal land descriptions:

1. Metes-and-bounds description
2. Government (rectangular) survey system
3. Lot-and-block system
4. Monuments system
**METES-AND-BOUNDS DESCRIPTION**

A *metes-and-bounds description* begins at a point of beginning (POB), and the terms metes and bounds relate to distance and direction. From the POB, the reader of the legal description is walked around the perimeter of the parcel using angles and distances, eventually returning to the POB. A basic understanding of plane geometry is needed in this system because of the emphasis on angles and distances.

In addition to defining the geometric shape, a metes-and-bounds description also makes reference to a specific land lot, within a district, within a county.

Generally, all counties are divided into several districts for identification purposes, with the districts being subdivided into land lots of 20-acre to 40-acre plots identified by a predetermined grid system.

Figure 2.2 is an example of a metes and bounds legal description.

**GOVERNMENT (RECTANGULAR) SURVEY SYSTEM**

The *government (rectangular) survey* description utilizes a predetermined governmental survey of a county. In this system, horizontal and vertical boundary lines have been surveyed by the federal government and are assumed to be permanently in place. Townships are six miles square (36 square miles). Each township is divided into 36 sections (one square mile each). Each section has 640 acres. These predetermined lines form the basis for describing a parcel of land.

**LOT-AND-BLOCK SYSTEM**

Under the *lot-and-block system*, a certain plot of land is subdivided. The key is the recording of the subdivision plat into public records. Within each subdivision, the lots

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**FIGURE 2.2**  ■ Example of Metes-and-Bounds Description

All that parcel of land lying within Land Lot 23 of the 6th District, in Fulton County, Georgia, and more particularly described as beginning at a point located at the northeast corner of the intersection of Jones Street and Smith Street (POB); running thence north 90 degrees, 0 minutes along the east right-of-way of Jones Street, 100 feet to a point; thence east 90 degrees, 0 minutes, 200 feet to a point; thence south 90 degrees, 0 minutes, 100 feet to a point along the north side of Smith Street; thence west along the north right-of-way of Smith Street 200 feet to the point of beginning.
and blocks are identified, making reference to the recorded plat. Figure 2.3 shows an example of a legal description utilizing the lot-and-block system.

**MONUMENT SYSTEM**

The **monument system** utilizes natural and human-made landmarks to describe land. It is similar to a metes-and-bounds description; however, the points of reference are human-made or natural landmarks such as rivers, lakes, or human-placed monuments. The monument system is generally no longer used.

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**PART SIX Types of Title Transfers**

Title is conveyed by deeds. A deed is an instrument that conveys ownership of property. Title refers to the right to possess or control property. In real estate title is a concept rather than a written document. The following are three types of deeds:

1. General warranty deeds
2. Special warranty deeds
3. Quitclaim deeds

**FIGURE 2.3** Example of Lot-and-Block System

All that parcel of land being described as Lot 23, Block B, of the Highlands Subdivision, as recorded in Plat Book 23, Page 11, of the Monroe County records.
Deeds are recorded in most states for the conveyance to be legal and valid. In some states, however, the transfer is valid when delivered by the grantor and accepted by the grantee.

■ GENERAL WARRANTY DEED

The general warranty deed conveys a covenant of warranty in which the seller guarantees to the buyer that the title is unclouded, or clean of any prior claims or heirs.

■ SPECIAL WARRANTY DEED

A special warranty deed warrants to the grantee by the grantor that the seller will defend the buyer against all claims by the actions or omissions of the grantor, but not any claims that precede the grantor’s ownership; thus, the warranty is limited to the seller’s ownership period and not prior to the time before the seller obtained title. This type of deed is also frequently referred to as a limited warranty deed.

■ QUITCLAIM DEED

A quitclaim deed is a conveyance in which the grantor ceases any claim against the property to the grantee. The grantor relinquishes his or her claim against the property, if any. In effect, the grantor conveys whatever interest he or she may have in the property.
1. Which of the following is NOT one of the three tests of when personal property becomes a fixture and thus part of the real estate?
   a. Cost of the item
   b. Manner of attachment
   c. Intent of the parties
   d. Character of the item

2. A fee simple interest in a property is an example of
   a. real property.
   b. real estate.
   c. personal property.
   d. emblement.

3. A window air conditioner that is permanently attached to a home and built-in with caulked, side/top/bottom molding and screwed to the window frame is an example of a(n)
   a. trade fixture.
   b. fixture.
   c. personal property.
   d. encroachment.

4. Which of the following is NOT a form of a private limitation?
   a. Lease
   b. Mortgage
   c. Severalty
   d. Easement

5. A tenant or lessee may most likely possess which type of interest?
   a. Life estate
   b. Leased fee estate
   c. Lien
   d. Leasehold estate

6. Which of the following is NOT a form of an ownership limitation?
   a. Lease
   b. Tenancy
   c. Mortgage
   d. Easement

7. Which of the following is NOT a type of special ownership?
   a. Escheat
   b. Condominium
   c. Co-operative
   d. Time-share

8. Which type of title transfer offers a guarantee of the title from the seller to the buyer?
   a. Quitclaim
   b. Title insurance
   c. General warranty
   d. Adverse possession

9. Real property is
   a. the same as real estate.
   b. different than unreal property.
   c. an intangible interest in real estate.
   d. the bricks and mortar.

10. Real estate is
    a. the tangible bricks and mortar and land.
    b. different than unreal estate.
    c. an intangible interest.
    d. a microwave sitting on top of a kitchen counter.

11. Which of the following is used in determining when personal property becomes a fixture?
    a. Weight of the item
    b. Size of the item
    c. Cost of the item
    d. Manner of attachment

12. A ceiling fan installed in a home is
    a. personal property.
    b. a trade fixture.
    c. a fixture that is now part of the real estate.
    d. real property.
13. Building codes and zoning represent which of the four powers of government?
   a. Police power  
   b. Eminent domain  
   c. Escheat  
   d. Taxation

14. A lease and a mortgage are considered to be
   a. deed restrictions.  
   b. powers of government.  
   c. personal property.  
   d. private restrictions.

15. A toolshed that is partly on a neighbor’s lot is known as a(n)
   a. lien.  
   b. encroachment.  
   c. deed restriction.  
   d. easement.

16. A leased-fee estate is an interest controlled by the
   a. mortgagee.  
   b. management company.  
   c. landlord.  
   d. tenant.

17. A leasehold estate is created by a(n)
   a. mortgage.  
   b. lease.  
   c. easement.  
   d. life estate.

18. Which is the most common form of ownership?
   a. Severalty  
   b. Joint tenants  
   c. Tenants by the entireties  
   d. Tenancy in common

19. A condominium is known as
   a. tenancy in common.  
   b. partial ownership.  
   c. joint tenancy.  
   d. a type of special ownership.

20. Which is NOT a form of a legal description?
   a. Metes-and-bounds method  
   b. Special warranty deed  
   c. Monument system  
   d. Government survey system