KEY TERMS

appurtenance  
bill of sale  
chattel  
deed  
hereditaments  
highest and best use  
immobility  
improvements  

indestructibility  
land use controls  
land  
nonhomogeneity  
personal property  
personality  
real estate  
real property  

REALTOR®  
realty  
scarcity  
situs  
specific performance  
tenements

LEARNING OBJECTIVES

At the conclusion of this chapter, you should be able to:

1. Describe the characteristics of real estate, including classes of property, physical characteristics of land, and economic characteristics of land.
2. Describe the concepts of land use and investment, including highest and best use, land use controls, investment objectives, scope of the real estate business, and the real estate market.

IN THIS CHAPTER

This text is designed to help you master the fundamentals of real estate by introducing information in a step-by-step format that requires no real estate background. This chapter provides an overview of the entire real estate business. Each topic introduced in this chapter is discussed in more detail in the following chapters.

You should use this chapter to become familiar with the format of the book, including objectives, summary of important points, and questions. Each of these sections is designed to help you study the
material efficiently to master this information. Finally, this text offers advice on preparation for the North Carolina Real Estate Licensing Examination.

**BASIC REAL ESTATE CONCEPTS**

Real property has certain physical and economic characteristics that set it apart from other marketable commodities. These characteristics are so interrelated that they have a definite effect on one another and are sometimes difficult to separate in a practical sense. This chapter discusses these characteristics and their effects on real property value.

**Basic Terminology and Definitions**

**Real estate, real property, realty, and land**—These terms often are used interchangeably to describe the combination of land, improvements, and rights and privileges. Title (ownership) is conveyed by **deed**.

**Personal property, personalty, or chattel**—Anything that is *not* considered to be real property. Title is conveyed by **bill of sale**.

The first thing students will have to master in this course is the concept that all property is either real or personal. The concept of real property is made up of three components: land, improvements, and rights and privileges. (These components are addressed in more detail in the forthcoming chapters, but the following gives a brief introduction.)

**Land**—The surface of the earth with the boundaries extending downward to the middle of the earth extended back upward to the highest heavens. Land consists of three components: surface, subsurface, and airspace.

This concept shows us that much of what is considered “land” is, in fact, made up of air. In common usage, the term “land” often is used in much the same way as the terms real estate, real property, and realty.

**Improvements**—Anything used to better or “improve” the use of the land. These are artificially attached items and are considered to be real property and not personal.

**Appurtenance**—Any right or privilege that is considered to *run with the land*.

Not all rights and privileges are considered to run with the land and may be “personal” in nature. The concept of runs with the land is that the right or privilege is an integral part of the property, much like structures or other improvements, and are conveyed as a normal part of the deed transferring title to the real property. For example, municipal water and sewer lines are an example of a right or privilege the government has to place the pipes to provide utility service to the property and likely others. When the title is conveyed to a subsequent owner, that
right remains intact. The same would apply if a property owner has the right to
cross over adjoining property to access theirs. Most likely, this would be a perma-
nent right that would convey upon transfer.

**Tenements**—Ownership interest in anything immobile and is considered part of
the real property.

**Hereditaments**—Any rights capable of being inherited.

**Economic Characteristics of Land**

**Scarcity**

An important economic characteristic of real property (Figure 1.1) is its availabil-
ity or **scarcity**. Land is a commodity that has a fixed supply base. No additional
physical supply of land is being produced to keep pace with the ever-increasing
population. The problems created by an ever-increasing demand for the limited
supply of land, however, have been eased substantially by an increase in the eco-
nomic supply of land. This increase has come about as a result of the greater utiliza-
tion of the existing physical supply of land. Farmers are continuing to increase
the use of land in the agricultural area. Greater crop yields per acre are being
achieved as a result of scientific and technological advances. Today, the agricul-
tural industry is producing more cattle per acre and more bushels of crops per
acre than it did just a few years ago.

In urban areas, land is being utilized to a greater extent through high-
density development. Advances in science and technology result in the creation
of high-rise office buildings, apartment complexes, and multilevel shopping cent-
ers. Consequently, 1 acre of land serves many times the number of people who
could use the land in the absence of these improvements.

**Modification by improvement** is another factor that has increased the economic
supply of land. These modifications can include the construction of highways,
bridges, water reservoirs, purification plants, and public utilities. The improve-
ments and expansions of public air and land transportation systems also make
a significant contribution in this regard. These accomplishments in the fields of

<table>
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<th>1. Scarcity</th>
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<tr>
<td>2. Permanence of investment</td>
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<td>3. Location</td>
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**FIGURE 1.1** Economic characteristics of real property.

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construction and transportation have converted land that had not been accessible and useful in a practical sense into land that can now be used. A substantial increase in the economic supply of land has resulted from these improvements to the land (rather than improvements on the land).

**Permanence of Investment**

Because of the physical characteristics of immobility and indestructibility of land, the investment of capital and labor to create improvements to the land and improvements on the land is a long-term investment. It takes many years to recoup the investment made to improve the value and quality of land. If a developer misjudges the demand for land-specific improvements or if economic conditions, including real estate market conditions, change dramatically, the developer may never recoup his full investment.

**Location (Situs)**

The location of land, or situs, is an extremely important economic (or more precisely, socioeconomic) characteristic of land, and it is the characteristic that has the greatest effect on property value. The physical characteristic of immobility dictates that the location of a parcel of land is permanent. Therefore, if the land is located in an area where demand is high, the land will have a substantially increasing value. Conversely, if the land is inaccessible from a practical standpoint or is located in an area with little or no demand, its economic value will be depressed.

Although the location of land cannot be changed, the value of the location (and consequently, the value of the land) can be increased by improvements to access and other modifications. Additionally, the value of the location can change as the result of the changes in preferences of people. In the 1950s there was a great flight from the urban centers to the suburbs. This resulted in property value reductions in urban areas. This trend has moderated in recent years. People are rediscovering the inner cities, rehabilitating older properties, and restoring lost urban property values.

**Physical Characteristics of Land**

**Immobility**

An essential physical characteristic of land (Figure 1.2) is its immobility. That land cannot be relocated from one place to another is an obvious feature of land as a commodity and is the primary distinguishing feature between land and personal property. The physical characteristic of immobility is the reason the economic characteristic of location significantly affects land value, thus making the market for land a strictly local market. This requires brokers and agents to have specific
knowledge of their local real estate market to serve buyers and sellers in their respective market areas.

**Permanence (Indestructibility)**

Another unique feature of land is its physical characteristic of **indestructibility**. *Land is a permanent commodity, and it cannot be destroyed.* It may be altered substantially in its topography or other aspects of its appearance, but its geographic coordinates remain. Land values can change positively or negatively as a result of changing conditions in the surrounding area and are said to suffer from **economic obsolescence** when such changes adversely affect the value of land. For example, the construction of an interstate highway can radically affect land values. Do not confuse economic obsolescence with physical depreciation, which is a loss in value from deterioration of the improvements on the property itself (see Chapter 13).

The permanence or indestructibility of land makes it attractive as a long-term investment, but an investor should be alert to changing conditions that can affect the value of the investment.

**Uniqueness (Nonhomogeneity)**

An important feature of the land is that no two parcels are identical, in either a physical or a legal sense. For example, two tracts of land are quite different from two cars that come off an assembly line. Two cars may be nearly identical, and one could be substituted for the other; this is clearly not the case with real estate. Even two apparently identical adjoining parcels differ in aspects such as soil, drainage, view, and vegetation, to name a few.

This **uniqueness**, or **nonhomogeneity**, of each parcel of land gives rise to the concept of **specific performance**. *If a seller contracts to sell her real property, the law does not consider money a substitute for this duty.* Thus, if a seller tried to breach the contract and pay financial damages instead, *the buyer could refuse to accept the money and insist on taking title to the land as the only acceptable performance of the contract.* For example, one might sign a purchase agreement for a home in a particular neighborhood because it was next to friends, family, or schools. If the seller changed her mind and offered another, better home on the other side of town, the buyer could hold the seller to specific performance of the original contract for the unique advantages of that property.

“Other textbook resources list four economic characteristics of land: scarcity, location, improvements, and permanence and three physical characteristics: immobility, indestructibility, and uniqueness.”

—Tim Terry, DREI
CHAPTER 1  Basic Real Estate Concepts

GENERAL CONCEPTS OF LAND USE AND INVESTMENT

The Highest and Best Use Concept

The concept of highest and best use is of extreme importance and considers all the physical and economic factors affecting the land. The **highest and best use** of land is that use that will provide the property owner the best possible return on an investment over a specified time period, resulting in the highest possible present value of land. **Present value** is defined as the value at the time of the appraisal; therefore, highest and best use can and does change with time. The use must be legal and must comply with zoning ordinances, government regulations, legally enforceable private deed restrictions, and restrictive covenants. The highest and best use of land is attained by the intelligent use of capital, labor, and other resources to improve the land and its productivity.

The task of coordinating and combining capital, labor, and resources to create an improvement is performed by an expert in real estate. The expert may be an individual developer or may be a general partner in a limited partnership with the other investors providing the capital as limited partners. The expert must determine the use of the land that will provide the necessary income from the land after labor and capital have been paid. For example, the expert will establish the optimum size of a building to be constructed on a particular site. The space should not be overimproved or underimproved. The building must not contain more space than can be rented in the market, nor should it fail to provide the space that the market demands. An overimprovement or an underimprovement does not provide the optimum income to the land, and as a result, the land is not put to its highest and best possible use.

A particular parcel of land has only one highest and best use at any particular time. The loss of residual income to the land resulting from failure to employ the land to its highest and best use causes the value of the property to diminish.

Public and Private Land Use Restrictions

Even though most land in the United States is privately owned, there is a vested public interest in land because the type of property use affects surrounding property owners and the general public. Because of this interest of the general public and of other property owners, the use of land requires regulation for the benefit of all. The need for **land use controls** has existed since the country’s founding. This is especially true in areas of extremely dense population, where land uses radically affect a great number of people.

**Public land use controls exist in the form of city planning and zoning, state and regional planning, building codes, suitability for occupancy requirements, and environmental control laws.** Additionally, there is substantial public control of land use as a result of government ownership. Examples of government ownership include public buildings, public parks, watersheds, streets, and highways.
Regulation of land use in the private sector exists in the form of *protective* or *restrictive covenants* established by developers, restrictions in individual deeds (private deed restrictions) requiring the continuation of a specified land use or prohibiting a specified land use, and use restrictions imposed on a lessee in a lease contract.

### Real Estate Investment Objectives

Real estate investors come in many varieties, ranging from the individual who buys one rundown property and fixes it up for resale or rental to the individuals or corporations who buy large commercial complexes such as shopping centers and factories.

The primary purpose of any investment is to produce income or profit, balancing the profit the investor desires against the risk he is willing to take. Real estate offers the opportunity to make a profit in three ways: appreciation, positive cash flow, and tax advantage.

*Appreciation* is the increase in market value during the time the investor holds the property. If an investor buys a property for $100,000 and it increases 3% in value annually, and he holds the property for 10 years, the property will have appreciated to a value of $134,391.46.

*A positive cash flow* exists when the gross effective income produced by the property exceeds the total of operating expenses. (See Chapter 13, “Real Property Valuation,” for the discussion of gross effective income and expense.)

*Tax advantages* may result from appreciation or gains being taxed at a capital gain rate lower than the investor’s marginal tax rate when the property is sold and from deductions of property taxes, insurance, and other expenses during the time the investor owns the property. Depreciation may provide an annual tax reduction, postponing the tax on the depreciated amount until the property is sold.

While appreciation, positive cash flow, and tax advantage are ways to make money on real estate investments, leverage allows more money to be made on less investment. For a simplified example, suppose an investor buys a $100,000 property with an initial investment of $10,000 for down payment and closing costs. The property appreciates $3,000 the first year, has a positive before-tax cash flow of $50 a month, and produces a tax savings of $400 for the year. This $4,000 is only 4% of $100,000, which is not a very good return on an investment. However, it is 40% of $10,000, which is an excellent return on an investment.

Real estate, like any investment, has risks. The real estate’s market value can decline, the property can deteriorate, or the area surrounding the property can change, adversely affecting the property value. Rent or income may not meet expectations. Plants or military installations nearby can close. An “oil glut” can change to an “oil bust,” leaving an overabundance of office space, homes, and so on. Environmental problems may adversely affect the property. If any of these things occurs, the effect may be compounded by the real estate’s lack of liquidity. The investor most likely cannot sell the property instantly for its full value.
SCOPE OF THE REAL ESTATE BUSINESS

The real estate business is extensive in scope and is a complex industry. Usually, when people think of the real estate business, they think only of residential brokerage. This is just one of several specializations within the real estate business, however. In fact, within the field of brokerage, there are several specializations, including farm and land brokerage, residential property brokerage, and commercial and investment property brokerage. In addition to brokerage, other specializations in real estate include property management, appraising, financing, construction, property development, real estate education, and government service.

Real estate transactions can be traced to early written records from biblical times, but those transactions were between the seller and buyer directly, without the participation of a real estate broker. The business of real estate brokerage is a product of the twentieth century. In the early 1900s, states began enacting licensing law legislation, and today all states in the nation require real estate brokers or salespeople to be licensed. North Carolina adopted its Real Estate License Law statute in 1957.

The establishment of the National Association of Real Estate Boards in 1908 was a major factor in the development of real estate brokerage. During the 1970s, the name of this trade group was changed to the National Association of REALTORS® (NAR). The term REALTOR® is a registered trademark of NAR, and it identifies licensees who are also members of the local, the state, and the national association.

It is important to remember that all licensees are not REALTORS® and that only the active members of these associations may use the term REALTOR® or REALTOR ASSOCIATE®. One of the most important accomplishments of NAR and its predecessor organization was the creation of a Code of Ethics in 1913. This code has contributed significantly to the professional stature of real estate brokerage. Strong parallels exist between licensing laws and this original Code of Ethics.

Defining Broker and REALTOR®

The general public has a poor understanding of the distinction between a broker and a REALTOR®.

The North Carolina Real Estate Commission issues real estate broker licenses and regulates broker’s practices. The term REALTOR® designates a licensee (broker) who is also a member of the local association of REALTORS® at the city or county level, a state association of REALTORS®, such as the North Carolina Association of REALTORS® (NCAR), and NAR. The REALTOR® association is in no way associated with or regulated by the Real Estate Commission, although the two groups work together for the advancement of professionalism in the real estate business.
Not all licensees are REALTORS®. North Carolina has approximately 94,500 licensees, of whom only roughly about one-third are REALTORS®. In addition to being answerable to the Real Estate Commission and to the civil and criminal courts for wrong-doing or failure of duty, the REALTOR® is also accountable under the Code of Ethics to the local association of REALTORS®.

Other significant contributions of NAR include efforts that have resulted in licensing laws being enacted in all states, legislative activity on the federal level to prevent unnecessary and harmful legislation from diminishing rights of private ownership in real property, and excellent programs of continuing education for members and nonmembers through NAR and its affiliated organizations.

Relocation is a growing part of the real estate business. A vast relocation network exists. Many corporations offer transferring employees generous relocation packages, including paying the closing costs for selling old homes and purchasing new homes. Some corporations have in-house relocation departments to assist employees with every aspect of their move. Others contract with third-party relocation companies to provide these services. Many corporations, relocation companies, real estate brokerage firms, appraisers, attorneys, and others who work with relocation belong to the Employees Relocation Council, which provides networking, research, education, and so on, to its members. In-depth coverage of relocation is beyond the scope of the text; however, new agents are advised to become familiar with the wants, needs, and expectations of relocating individuals, families, and employers, as well as relocation companies.

Real estate brokerage is the bringing together of buyers and sellers or landlords and tenants for the temporary or permanent transfer of an interest in real property owned by others through purchase, sale, lease, or rental by a real estate broker for compensation. In North Carolina, such brokerage activities require a North Carolina broker’s license.

The fact that real estate represents a growing percentage of the wealth in the United States illustrates the extremely broad scope and importance of the real estate business. The complexity of this business requires that agents have continual interaction with people in a variety of other professions. Today’s real estate practitioner needs a basic knowledge of the many functions performed by other members of the real estate and allied professions.

Real estate professionals must work with mortgage bankers or brokers to secure financing for their clients; appraisers to validate the value of the property; home inspectors and wood-destroying insect inspectors to determine the condition of the property; developers and contractors when selling new construction; attorneys, surveyors, and insurance agents when closing properties; and governmental officials, such as tax assessors, environmental health specialists, and city and county planners when necessary.
Successful real estate practitioners are also counselors and educators who must recognize the limits of their knowledge and guard against giving legal, accounting, or tax advice.

**The Real Estate Market**

A free market is one in which the buyer and seller negotiate a purchase and sale without undue pressure, urgency, or outside influence other than the principle of supply and demand. Although government regulations may indirectly affect the price of real estate or the costs of borrowing money to buy real estate, the government does not set real estate prices. The principle of supply and demand determines real estate prices; thus, the real estate market is an excellent example of the free market concept. Market value, which is discussed in Chapter 13, depends on the free market concept.

**Special Characteristics**

The physical characteristics of land create special characteristics of the real estate market that do not exist in other markets. As noted previously, the immobility of real estate causes the market to be local in character, requiring local specialists who are currently familiar with local market conditions, property values, and availability. The nonhomogeneity, or uniqueness, of each parcel of real estate also requires that the market be local. Each parcel of real estate is unique, primarily because of its location.

The physical characteristic of immobility also results in a market that is slow to react to changes in supply and demand. When supply substantially exceeds demand, existing properties cannot be withdrawn from a local market area and relocated to an area in which there is a higher demand. Conversely, when the demand exceeds supply, new supplies of housing and business properties cannot be constructed quickly. Therefore, after a recession, it takes many months for the supply to equal or exceed demand in the real estate market.

**Factors Affecting Supply and Demand**

Several factors affect supply and demand in the real estate market, on both the local and national levels. Examples of these factors include interest rates; availability of financing for purchase and construction; population migrations; variations in population trends and family formations; government regulations; local and national economic conditions; and the availability and cost of building sites, construction materials, and labor.

**Historical Trends**

Just as the economy as a whole is subject to peaks and valleys of activity that have recurred over the years with fairly reasonable regularity, the real estate industry,
as a part of this economy, is similarly subjected to recurring periods of recession and prosperity.

The real estate industry is often the first industry to feel the adverse effects of depressed conditions in the national and local economies. It may take the real estate industry longer than the economy as a whole to climb out of a recession because of the inability of the real estate industry to react quickly to radical changes in supply and demand. But that is not always the case. In recent times, real estate has sometimes remained strong during a recession or led the recovery from an economic downturn.

Another characteristic of the real estate cycle is that the real estate industry usually attains a much higher level of activity in prosperous times than does the economy in general.

The Real Estate Practitioner

North Carolina defines only one real estate license category, broker, since it became an all-broker state on April 1, 2006, eliminating the “salesperson” license category. All individuals or entities who want to engage in real estate brokerage activities in North Carolina must first be licensed as brokers. Many current brokers have received their licenses under previous criteria of either education and experience (criterion one) and the passing of a state examination (criterion two). Some have been licensed based on reciprocal licensing arrangements in other states. Those who met the criteria for and were licensed as brokers before April 1, 2006, can remain brokers with no provisional status attached to their licenses. Those who were licensed as salespersons as of that date were licensed automatically as brokers at that time, although with provisional status. All new brokers licensed after April 1, 2006, were granted licenses on provisional status. To remove provisional status, all provisional brokers must complete three 30-hour post-licensing courses and pass the course exams.

A broker without provisional status is able to practice independently. A broker with attached provisional status is not. She must work under the supervision of a broker who is a broker-in-charge (BIC) until she has completed all post-licensing requirements to remove the provisional status and to practice independently. A provisional broker cannot become a BIC. A BIC must have a minimum of two years’ full-time real estate experience, which may be met as a broker regardless of provisional status or lack thereof; however, provisional status must be removed before becoming a BIC. Although the broker-in-charge is ultimately responsible for all actions of the provisional brokers she supervises, the provisional broker cannot escape responsibility for her duties and actions.

Relationships between brokers and clients/customers, as well as relationships among brokers, are discussed extensively in Chapter 7. They are mentioned in this chapter only to clarify the terminology used in this text. The word
broker or agent is used when the text is referring to a broker or a provisional broker when differentiation between the two is not required. The terms broker and provisional broker are used to differentiate the two categories of licensees, when necessary.

The successful real estate practitioner is not engaged in applying techniques of the “hard sell.” Rather, he is a counselor or an adviser working diligently to solve the problems of buyers, sellers, and renters of real estate. Everyone who contacts a real estate office has a problem. The problem involves real property—the need to buy, sell, or lease. The real estate practitioner’s ability to solve these problems for the benefit of others results in a successful career. Like any good counselor, the real estate practitioner provides information to, but does not make decisions for, the clients and customers. What information can and cannot be provided depends on several factors, but especially on the law of agency, which is discussed in Chapter 7.

A career in real estate can provide the practitioner with satisfaction from serving the needs of people and with accompanying financial rewards. Success in the real estate business is built on knowledge, service to others, and ethical conduct in all dealings.

The real estate practitioner must be knowledgeable in a variety of other subjects necessary to satisfactorily perform one’s obligations in real estate transactions. These other subjects, which are discussed in depth in later chapters, include property ownership and interests, transfer of title to real property, fundamentals of residential construction, valuation of real estate, land use controls, fair housing laws, property management, insurance, and federal income tax implications of real estate ownership and sale. The real estate practitioner also must understand the meaning of the various real estate and legal terms used in real estate transactions. Finally, the practitioner must have a basic understanding of the various arithmetic problems that are common in the activities of real estate brokerage.

Summary of Important Points

1. Real property includes the surface of the land, all improvements that are attached to the property, everything beneath the surface, and the airspace above the land.
2. Personal property (also called personalty or chattel) is the opposite of real property—that is, everything that is not real property is considered personal property. Things that are readily movable—that is, not attached to the land—are personal property.
3. Real property has the physical characteristics of immobility, permanence, and uniqueness.
4. Real property has unique economic characteristics based on its physical location (situs).

5. The principle of highest and best use of land is an all-important concept in land use. Failure to make the highest and best use of land results in a lower value.

6. Controls of land use are necessary to protect the vested interests of the general public as well as the interests of surrounding landowners. Land use controls can be private, such as private deed restrictions and restrictive covenants, or public, such as zoning ordinances.

7. The real estate business involves many specialties besides residential brokerage and requires knowledge of many fields, including finance, housing codes, government regulations, contract law, and appraisal.

8. A real estate market is local and is an example of the free market concept wherein buyers and sellers have adequate time and information to reach a purchase and sale agreement without undue pressure, and with factual knowledge of all important aspects of the transaction. The physical and economic characteristics of land create a market that is local and slow to react to fluctuations in supply and demand.

9. The effects of depressed economic conditions are sometimes felt by the real estate industry before other segments of the economy. Traditionally, the real estate industry has been slower to pull out of depressed economic periods, but typically it reaches higher peaks of activity and prosperity during prosperous times than many other segments of the economy. In recent times, however, the real estate market has remained strong during a recession and sometimes has led the recovery from an economic downturn.

10. The real estate agent acts as an advisor or problem solver for the benefit of one’s clients and customers. Because the purchase of a home involves the seller’s most important financial asset and creates long-term financial obligations for the buyer, the agent must be thoroughly knowledgeable, competent, and responsible.

11. Real estate investment offers the opportunity to earn profits through appreciation of the property value, tax advantages, and positive cash flow. Leverage allows an investor to earn a greater return on a smaller initial investment. Some of the risks involved in real estate investments are market value declines, property deterioration, and adverse changes in the surrounding area.
CHAPTER 1  Basic Real Estate Concepts

Review Questions

Answers to the review questions are in the Answer Key at the back of the book.

1. All of the following are separable ownerships in land EXCEPT:
   A. surface of the land.
   B. area below the surface.
   C. nonhomogeneity.
   D. air rights.

2. The characteristic of land that causes the real estate market to be essentially a local market is the physical characteristic of:
   A. indestructibility.
   B. immobility.
   C. availability.
   D. natural features.

3. The nonhomogeneity of land:
   A. is the basis for the legal remedy of specific performance.
   B. results from the uniqueness of every parcel of real estate.
   C. is a physical characteristic of land.
   D. all of the above.

4. An increase in the economic supply of land has resulted from:
   A. increased utilization of the physical supply of land.
   B. modification by improvements to the land.
   C. high-density development.
   D. all of the above.

5. The quality of the location of land and, consequently, the value of the land can be changed by:
   A. the principle of nonhomogeneity.
   B. relocation of the land.
   C. changes in the national scope of the real estate business.
   D. improvements to the land that result in accessibility not previously available.

6. The employment of the concept of highest and best use:
   A. includes consideration of the physical and economic factors affecting land use.
   B. results in the greatest present value of the land.
   C. must be a use feasible in the near future.
   D. all of the above.

7. An example of public land use controls is:
   A. restrictive covenants.
   B. zoning laws.
   C. deed restrictions.
   D. protective covenants.

8. Real estate investment offers the opportunity to produce a profit in the following ways EXCEPT:
   A. appreciation.
   B. positive cash flow.
   C. specific performance.
   D. tax advantages.

9. The real estate market may be described in all the following ways EXCEPT:
   A. a free market.
   B. a local market.
   C. a movable market.
   D. a market that is slow to react to changes in supply and demand.

10. The function of a real estate agent in dealings with buyers and sellers in the real estate market may best be described as which of the following?
    A. financier
    B. counselor or advisor
    C. contractor
    D. salesperson
11. The real estate agent must have specialized knowledge of a variety of subjects that include all of the following EXCEPT:
   A. financing.
   B. contracts.
   C. legal advice.
   D. valuation of property.

12. Economic characteristics of real property include which of the following?
   A. location
   B. immobility
   C. indestructibility
   D. nonhomogeneity

13. Which of the following has the greatest effect on real property value?
   A. tax rates
   B. location
   C. availability
   D. indestructibility

14. Which of the following is an example of the private control of land use?
   A. zoning
   B. restrictive covenants
   C. building codes
   D. environmental controls

15. The term REALTOR® designates:
   A. any real estate licensee.
   B. a real estate licensee who is a member of the national, state, and local association of REALTORS®.
   C. only licensees who hold broker’s licenses.
   D. all of the above.

16. Physical characteristics of land include all of the following EXCEPT:
   A. location.
   B. nonhomogeneity.
   C. permanence.
   D. immobility.

17. The National Association of REALTORS® is:
   A. a government organization.
   B. a trade group.
   C. an organization for buyers and sellers of commercial real estate.
   D. all of the above.

18. Factors affecting supply and demand in real estate include all of these items EXCEPT:
   A. government regulations.
   B. interest rates.
   C. local economic conditions.
   D. real estate investment trusts.

19. Scarcity and location are examples of:
   A. physical characteristics of the land.
   B. highest and best use.
   C. permanence of investment.
   D. economic characteristics of the land.

20. All of the following are public land use restrictions EXCEPT:
   A. building codes.
   B. protective covenants.
   C. zoning.
   D. regional planning.
CHAPTER 2

PROPERTY OWNERSHIP AND INTERESTS

KEY TERMS

air rights
alienation
appurtenance
appurtenant easement
bundle of rights
condemnation
condominium
cooperative
co-ownership
curtesy
declaration of restrictions
defeasible fee
dower
easement
easement in gross
embllements
eminent domain
encroachment
encumbrance
estate
estovers
fee simple absolute
fixure
foreshore
freehold estate
fruits of industry (fructus industriales)
fruits of the soil (fructus naturales)
hereditament
intestate succession
joint tenancy
judgment lien
land
lateral support
leasehold estates
levy
lien
life estate
life tenant
lis pendens
littoral rights
marital life estates
mineral lease
nonfreehold estate
North Carolina Condominium Act
partition
party wall
prescription
profit or profit à prendre
pur autre vie
remainderman
reversionary interest
riparian rights
severalty
subjacent support
survivorship
tenancy by the entirety
tenancy in common
tenements
time sharing
townhouse
Uniform Commercial Code (UCC)
LEARNING OBJECTIVES

At the conclusion of this chapter, you should be able to:

1. Define and give examples of real property and personal property.
2. Define and give examples of fixtures, as well as describe tests for determining whether an item is a fixture.
3. Define and list the freehold estates.
4. Define severalty and concurrent property ownership, including condominiums, townhouses, cooperatives, planned unit developments (PUDs), and time-share property.
5. List and define types of lien.
6. List and define types of easement.
7. Define encroachments and appurtenances such as water, air, and subsurface rights.
8. Describe real property taxation and special assessment systems in North Carolina.

IN THIS CHAPTER

This chapter begins the discussion of the various forms of real property ownership. Real estate is defined by (and is subject to) a complex and unique body of laws. Although you will be exploring a variety of legal terms, you should not give legal advice. Providing legal advice or opinions is defined as the practice of law, which only attorneys are authorized to do. It is, however, the duty of real estate agents to recognize basic concepts of law as they affect clients and customers and to see that they are properly informed of their rights and obligations through appropriate legal counsel.

THE CONCEPT OF PROPERTY

Property is an individual's, a group's, or an entity's ownership rights, interest, and legal relationship to something, tangible or intangible, to the exclusion of other individuals, groups, and entities. Property, therefore, may be considered a legally created and protected bundle of rights, which an individual, a group, or an entity has in a tangible item or an intangible concept. A bundle of rights includes the right to possession of the property; the right of quiet enjoyment of the property; the right to exclude others; the right to dispose of the property by gift, by sale, or by will; and the right to control the use of the property and profits within the limits of the law. The components of the bundle can belong to one owner or can be separated with rights or groups of rights belonging to different owners. Examples of separate ownership of various rights in the bundle abound. For example, Hertz, a corporate entity, owns cars (tangible property) but rents the right to use those cars (intangible property) to individuals; an owner of an office building leases office space (right to possess and use) to a corporation; and a landowner sells the mineral rights to his property while retaining all other rights. Note that ownership and lease rights may coexist within the same property at the same time.

“When you purchase a property, you get a bundle of rights. The items in the bundle can be remembered by the acronym DEEPC: Disposition, Enjoyment, Exclusivity, Possession, and Control.”
—Terry Wilson, DREI
CHAPTER 2  Property Ownership and Interests

Property is divided into real property and personal property. Real estate practitioners must have a thorough understanding of the differences between real and personal property. Different laws apply to each type of property. Most items of personal property do not require written documentation of transfer of ownership, but all transfers of ownership of an interest in real property must be in writing. Personal and real property are taxed differently. Owners’ and creditors’ rights differ depending on whether the property is real or personal.

Real Property

In Chapter 1, real property, also called real estate and realty, was defined as land and everything permanently attached to the land. A concept of the law of real property is that real property consists of lands, tenements, and hereditaments; therefore, everything included in the following definitions of these terms is a component of the property owner’s bundle of rights.

Land is the surface of the earth; the area below the surface to the center of the earth; and the area above the surface, theoretically, to the highest heavens.

Plants are either annuals or perennials. Annuals must be planted each year and are considered personal property. Annuals are also called fructus industriales.

Perennials do not require annual cultivation and are considered real property unless planted in a movable container. Perennials are also called fructus naturales.

Land includes structures and other improvements (such as fences, swimming pools, flagpoles, and retaining walls) that have been placed there with the intention that they be a permanent part of the land.

Tenements and Hereditaments

Tenements include all those things that are included in the definition of land and include both corporeal and incorporeal rights in land. Corporeal rights are tangible things—things that can be touched and seen. Incorporeal rights are things that are intangible. Tenements include buildings (corporeal). Tenements also include rights in the property of another, such as an easement (incorporeal). In addition, tenements include intangible rights in the land of another, such as the right to take minerals, soils, timber, fish, or game from that land. This right is called profit à prendre, or simply profit.

Hereditament is a term that includes everything in the term land and everything in the term tenements that is capable of being inherited. The land and buildings are
The Concept of Property

Things that grow in the soil may be included in the definition of real property. Growing things that do not require planting or cultivation but that grow naturally and are perennial are **fruits of the soil** (fructus naturales) and are designated in law as real property. Examples include forest trees, native shrubs, and wild berries. Growing things that require planting and cultivation are **fruits of industry** (fructus industriales) or **emblements** and are defined as **personal property**. These are usually annual crops, and examples include corn, wheat, melons, and soybeans. The term **emblements** also is used to denote the right of a tenant to reenter the property and harvest the emblements after the termination of the tenancy.

**Appurtenances**

An **appurtenance** is any right or privilege that is said to “run with the land.” Therefore, it transfers with title to the land. Several of the items discussed next are examples of common appurtenances, such as subsurface, air, and riparian (water) rights. These three examples illustrate that an appurtenance cannot exist by itself; that is, the easement must attach to the primary item, the land that it affects. Other examples of appurtenances include appurtenant easements and the benefits of restrictive (protective) covenants (discussed later in this chapter).

**Subsurface Rights**

A subsurface right, or mineral right, is an interest in real property that allows the owner to take minerals from the earth. The owner may conduct mining operations or drilling operations personally or may sell or lease these rights to others on a royalty basis. A **mineral lease permits the use of land for mineral exploration and mining operations**. (The Statute of Frauds, discussed in Chapter 4, requires that such a lease be in writing to be enforceable.) The lease may be for a definite term or for a period as long as the land is productive. A mineral royalty is income received from leases of mineral land.

**Air Rights**

Ownership of land includes **ownership of and the rights to the area above the surface of the earth** (air rights). The right of ownership of the airspace enables the landowner to use that space to construct improvements, to lease, or to sell to others.

The right of ownership and control of the airspace is limited, however, by zoning ordinances and federal laws. Zoning ordinances often restrict the height of improvements constructed on the land, and federal laws permit the use of the

"Mineral, oil, gas and subsurface leases must be in writing in North Carolina.”

—Melea Lemon, DREI
airspace by air traffic flying at an altitude specified by the government. As a practical matter, a property owner is entitled to claim only the area above his land that he might reasonably be expected to use.

**Water Rights**

The *appurtenant rights of an owner of property bordering a flowing body of water* are *riparian rights*. Riparian rights attach to the land but cannot exist by themselves. Generally, property adjacent to a river or watercourse affords the landowner the right to access and use the water for purposes such as drawing water for personal use and entering the water via a boat pier. Actual ownership of the water depends on a number of factors. North Carolina recognizes the distinction between a *navigable* and a nonnavigable watercourse. In the former, adjacent owners are limited to the banks of the watercourse, whereas the state owns the body of water and the right to use it. If one owner owns all of the land surrounding a nonnavigable body of water, that owner owns all of the land under the water. If more than one owner owns property surrounding a nonnavigable body of water, ownership extends to the center of the water, unless the deed states otherwise.

**Littoral rights** are *the rights of landowners whose property borders an ocean or a lake*. If the water levels fluctuate, as with ocean tides, the landowner owns to the mean high watermark. The state owns the *foreshore*, which is *the land between the mean high watermark and low watermark*.

An owner’s riparian property and property rights can be affected by changes in boundaries caused by the natural forces interacting with land and water. Although the geographic coordinates of land do not change, the part of the surface covered by the land and water can and do change over time.

The real estate practitioner should understand the following four natural processes that affect riparian boundaries.

1. Accretion is a gradual process in which the boundary of riparian land is extended by natural forces, usually water from a river, a lake, or an ocean depositing soil, sand, or rock onto areas previously covered by water. This acquired land becomes the property of the riparian property owner.

2. Reliction is also a gradual process and results from the permanent receding of the water that leaves the ground under it dry and exposed. This acquired land becomes the property of the riparian property owner.

3. Erosion, the reverse of accretion, is a natural process in which the flow or movement of water gradually produces a loss of riparian land—for example, beach erosion. The riparian property owner loses title to the land.

4. Avulsion, unlike accretion, reliction, and erosion, is not a gradual process. It is a rapid or sudden change in riparian land, either loss or gain, resulting from violent natural forces. There is no legal boundary change for land.
affected by avulsion. The owner can reclaim the lost land. Theoretically, an owner retains title to and can reclaim land lost through avulsion; however, environmental laws may limit or void his right to do so.

5. Doctrine of prior appropriation is based on the theory that the first person to use the water has a continued right to do so and the later owners can make reasonable use of what is left.

**Lateral and Subjacent Support**

Land previously was defined as the surface of the earth; the area below the surface to the center of the earth; the air above the earth, theoretically, to the highest heavens; and everything permanently attached to the earth. For purposes of understanding lateral and subjacent support, consider only the solid surface of the earth. The ground is surrounded by more ground or by water. Riparian rights, the rights of landowners whose property borders water, are well defined in law. The solid surface of land can be gained or lost by forces of nature or by man's activity. What would happen if your neighbor decided to excavate the dirt from her land bordering your property for a project elsewhere? Unless your land is solid rock, the solid surface could shift, perhaps destroying or undermining the support of improvements on your land. Your neighbor cannot remove the dirt because you have a right of lateral support, which means the right of land to be supported in its natural state by adjacent land.

Now consider the part of the land that is below the surface of the earth. Suppose you sell the mineral rights. The owner of those subsurface rights can mine beneath your surface, but she must support your surface rights from below. She cannot cause the surface of your land to collapse. **Subjacent support** is the right to have one's land supported from below.

**Personal Property**

Personal property (also referred to as chattel or personalty) is anything that is not real property; therefore, it is not land or anything permanently attached to land. Unlike real property, it is readily, although not necessarily easily, movable. Some personal property can be severed, or removed, from the property (such as crops) and other property becomes a part of the real property by attaching or annexation (such as planting trees obtained from a nursery). Once attached, it becomes part of the real property unless excluded. Factory-built homes are another example of personal property unless steps have been taken to permanently affix it to the land including the requisite paperwork needed to convert it to being considered real property. Its “bundle of rights” is not identical to that of real property. Some property can be classified as real or personal property, depending on circumstances. Ownership of personal property is conveyed by a bill of sale.
A **fixture** is an item of personal property that is attached to the land or a permanent improvement on the land in such a manner that the law deems it to be part of the real property to which it is attached. Fixtures cause many problems because of misunderstandings by the parties involved. Real estate practitioners can avoid problems by thoroughly understanding the criteria for a fixture and paying careful attention to detail when listing and selling property.

**Total circumstance test.** This test, composed of four criteria or factors, may be used to determine an item's identification as a fixture in the absence of a contractual agreement by the parties.

1. *Intention:* Did the person making the attachment intend to make a permanent improvement? Would it be evident to a reasonable, rational person that the annexor's intention was that the improvement be permanent? For example, the owner of a property installs a ceiling fan in the family room. This criterion should be used in conjunction with the other criteria. If the owner expressly states her intention that the attachment is permanent, such as the sales contract stating the item is considered a fixture, and all parties involved are aware of the express intention, the express intention will rule without regard to the other three criteria.

2. *Relation of the attacher:* An owner is presumed to make a permanent improvement, whereas a renter may be presumed to make a temporary attachment. However, the real estate agent should not presume anything about the annexor's ownership but should ask questions if a tenant is involved. If the real property owner has permanently attached personal property to his real property during his ownership, the attached property is usually considered real property. (See the paragraph “Effect of the Uniform Commercial Code” for an exception.) Once the item becomes real property, its ownership passes to the new owner when the present owner sells or otherwise disposes of the property, absent a contract or an agreement to the contrary. Take the example regarding the ceiling fan. If a tenant instead of the owner of the property were to install the fan, would his intention be that the ceiling fan remain with the property or would he plan to take down the ceiling fan he had purchased and replace it with the original fixture?

3. *Method:* Does the method of attachment mean that removal of the item will damage the property? Answering this question is a bit tricky. What constitutes damage? Is a small nail or screw hole damage? What is “permanently attached”? It may not actually need to be attached. This criterion absolutely
must be used in conjunction with the other circumstances. A small picture hanger on a wall likely does not constitute substantial or permanent attachment, but a pair of thousand-pound statues sitting on custom-made concrete pillars may.

4. **Adaptation:** How is the item being used? Is the item adapted to the real property to which it is attached? An example would be blinds custom made to fit nonstandard windows. The more “site specific” an item is the less obviously attached it needs to be in order to be considered an attachment.

Courts have not been consistent in their application of the total circumstance test. If the courts cannot agree, buyers, sellers, and real estate agents are unlikely to always agree. Although real estate agents must understand these criteria, they should not give legal advice as to what is or is not a fixture in a given circumstance. That would be practicing law without a license. They can avoid, however, most problems in this area by using and understanding the North Carolina Bar Association/North Carolina Association of REALTORS® (NCBA/NCAR) Standard Form No. 2-T, Offer to Purchase and Contract, found in Chapter 10, page 276. Familiarizing the seller with this form at the time of listing and the buyer at the initial buyer interview, or at least by the time of the offer, is an excellent way to prevent misunderstandings.

<table>
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<tr>
<th>Test Tip!</th>
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<td>For an excellent list of fixtures that are important for testing purposes, refer to paragraph 2 of the Offer to Purchase and Contract (Chapter 10, Figure 10.2).</td>
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The practitioner must ensure that all parties understand all contracts. This can be accomplished by clearly identifying fixtures and personal property in both the listing and the sales contracts. Real property can become personal property by contract. For example, a chandelier is personal property until it is installed in the house and then becomes a fixture upon installation. If the contract provides for the chandelier to be replaced with a less expensive one, the original chandelier again becomes personal property upon removal according to the contract, and the new, less expensive chandelier, which is personal property when it is purchased, becomes real property when it is installed according to the contract. If the contract were silent about the chandelier, the buyers could reasonably expect the chandelier to be a fixture and to convey as real property. In some instances, something is considered a fixture simply because the contract states that it is a fixture even though the item does not appear to meet the standards for a fixture listed previously, such as a stove. Simply stated, if the contract says that an item is a fixture, then it is a fixture.
Trade fixtures. A special category of fixtures is recognized for the items of personal property that are used in the course of a business operating in a leased property. For example, a merchant may rent a store and install shelves to display merchandise. These shelves are a temporary attachment necessary for the operation of the business. A more complex situation would arise in the operation of a restaurant in a rented space. Consider all the items required in this operation, including stoves, ovens, grills, chairs, tables, and so on. Such attachments are recognized as trade fixtures, and they retain their personal property classification such that the restaurant tenant can remove them at the termination of the lease. The tenant remains liable for any damages caused by the removal of the trade fixture at the expiration of the lease.

Again, the agent must ensure that all understandings of the parties are supported by terms of a rental contract. Recall, however, that only attorneys can draft contracts. Real estate practitioners would exceed their authority and be entering the prohibited practice of law if they attempted to write legal clauses in a contract.

Agricultural fixtures. Agricultural fixtures are those fixtures installed by a property owner for the purposes of agricultural use. Although historically treated differently, they are now treated the same as trade fixtures.

Effect of the Uniform Commercial Code. A special situation occurs when an owner has financed the purchase of an item installed in her property. The Uniform Commercial Code provides for the lender to retain a security interest in a chattel (personal property) until the lender is paid in full. An instrument called a security agreement, which is put on the public record by the filing of a notice called a financing statement, creates the security interest. This notice is filed in the office of the Register of Deeds. The filing of the financing statement provides constructive notice to the world that a security interest exists in the item. As a result, the attached item is not legally classified as a fixture, or a part of the real property, until the security agreement has been satisfied by full payment. It is treated as personal property of the homeowner until such time as it has been paid for in full. Before that time it can be repossessed by the creditor to satisfy repayment.

Consequently, the lender can remove the item in the event the buyer/borrower defaults in payment, even though the item has been attached to real property. Subsequent purchasers, as well as a subsequent lender, are bound by the filing of the financing statement. Therefore, a purchaser of the home or a lender accepting the property as security for a mortgage must complete the payments or permit the removal of the item by the lender in the event the property owner does not satisfy the debt.

Improvements

Numerous improvements must be made to and on raw land to make it accessible and suitable for the various uses people have for it. An improvement is anything of value that is added to real property or anything that alters real property in
such a way as to increase its utility or value; however, these improvements do not include repairs and replacements. The definition has two parts: (1) private improvements, usually done on the land by the property owner; and (2) public improvements such as streets, sewers, water, and sidewalks done to the land by government or quasi-government organizations. From a practical point of view, the agent should make certain that all parties understand the meaning each party intends to convey when using the terms improvements, improvements to the land, improvements on the land, improved land, or improved lot.

Improvements on the land done by property owners include structures such as buildings, paved driveways and walkways, tennis courts, fences, walls, and swimming pools. They do not include routine maintenance, repairs, or replacements.

Improvements to the land done by government or quasi-government entities may include the following:

1. Roads, highways, and bridges built to make the land accessible.
2. Utilities such as electric power, water, sewer, gas lines, and phone lines brought to the site.
3. Modifications or improvements such as clearing, grading, and draining to make it suitable for its intended use.

“Improved land” or “improved lot” could mean the land or lot has had improvements to it to prepare it for a building, or it could mean that improvements such as buildings have already been constructed on it. The important thing is for the agent to make certain that the meaning is clear when listing, advertising, and negotiating offers to purchase and in all other aspects of the transaction.

Test Tip!

For the National Exam section, the student should treat an improvement as an appurtenance.

Factory-Built (Manufactured) Housing

Just like many components of a house today that are manufactured in a factory so is the case for entire homes. Although historically these type homes have been viewed as “less desirable” than a stick-built home, the reality is that manufacturing tolerances and conditions are superior to that of many site-built structures. The absence of weather-related delays, reduced theft, and the ability to literally work around the clock make this type of construction attractive in many ways.

The reference to a “manufactured” home is a modern term for what many people traditionally have called a mobile home or house trailer. Today’s manufactured home is built according to rigid U.S. Department of Housing and Urban Development (HUD) standards and will have a HUD certification label affixed to the exterior of the structure. This type of housing can be considered either personal or real property depending on the steps taken by the owner. Initially the manufactured
home is considered personal property and will be titled with the North Carolina Department of Motor Vehicles (DMV) much the same as an automobile is registered. One of the characteristics of the manufactured home is that it will be constructed on a permanent nonremovable steel chassis, although brokers need to be aware that some modular homes may utilize a steel chassis as well.

The owner can convert a manufactured home to real property status by removing the wheels, axle, and moving hitch and affixing the structure to a permanent foundation owned by the homeowner. Once this work has been completed, the owner can file an affidavit of conversion that cancels the title with the DMV, which will finalize the conversion from personal to real property. Once this is done, the owner will need to change the tax listing to show the unit is now real property and the bill of sale and lien will need to be changed to a deed and deed of trust as applicable. Unlike many other situations involving attaching personal property so that it may be considered real property, the manufactured home does not automatically convey to real property merely upon attachment. Until the appropriate paperwork has been completed and filed, the unit will remain personal property.

Many people confuse modular housing as merely a type of manufactured housing. Although both examples are clearly built in a factory, the modular home is built in accordance with state building codes and once constructed on the permanent foundation will be considered real property. These type of units also will have an identifying label, including a serial number, that typically is affixed next to the electrical panel, under the sink area, or on the back of the unit.

Most subdivision protective covenants that prohibit the construction of a manufactured home will not affect the ability of the property owner to construct a modular home on the lot.

**ESTATES IN REAL PROPERTY**

**Definition of Estate**

An estate in real property is an interest in the property sufficient to give the owner of the estate the right to possession of the property. It is essential to understand the difference between the right of possession and the right of use. The owner of an estate in land has the right of possession of the land in addition to the right to use it. An easement owner, in contrast, has the use of the land but not the right to possess it; therefore, the easement is a nonpossessory interest in land. The Latin translation for the word estate is “status.” This indicates the relationship in which the estate owner stands with reference to rights in the property, and it establishes the degree, quantity, nature, and extent of interest a person has in real property.

**Types of Estate in Land**

Estates in land are divided into two groups: estates of freehold and estates of less than freehold (also called leasehold estates and nonfreehold estates). Two estates
can exist simultaneously in land. The owner (lessor) of a property has a freehold estate. If she leases the property, the tenant (lessee) has a leasehold estate. Each of these two major divisions contains various groupings or subheadings.

Freehold Estates

Freehold is defined as an interest in land of at least a lifetime and therefore generally is identified with the concept of title or ownership. Freehold estates may be fee simple estates or life estates (see Figure 2.1). Fee simple estates are inheritable; most life estates are not.

Freehold estates are divided into two categories: estates of inheritance and estates not of inheritance.

I. ESTATES OF INHERITANCE

Estates of inheritance last a lifetime and continue after the death of the titleholder as they are passed on to one’s heirs.

A. Fee simple estates
   1. Fee simple absolute. The estate of fee simple absolute provides the greatest form of ownership available in real property.

   This estate may be described as fee simple absolute, fee simple, or ownership in fee. Ownership in fee simple absolute provides certain legal rights usually described as a bundle of rights. The owner in fee simple absolute may convey a life estate to another, may pledge the property as security for a mortgage debt, may convey a leasehold estate to another, may grant

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"Freehold’ means that you are ‘free to hold’ the property. You are the owner of it. A leasehold estate is anything less than ownership.”

—Jim Hriso

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<tr>
<th>FREEHOLD ESTATES</th>
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<tbody>
<tr>
<td>I. Inheritable</td>
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<tr>
<td>A. Fee simple estates</td>
</tr>
<tr>
<td>1. Absolute</td>
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<tr>
<td>2. Determinable</td>
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<td>3. Conditional</td>
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<tr>
<td>B. Life estate pur autre vie (inheritable during measuring lifetime)</td>
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<tr>
<td>II. Not inheritable</td>
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<tr>
<td>A. Conventional life estate</td>
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<td>B. Marital life estate</td>
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<td>Note: Freehold estates provide title.</td>
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<th>NONFREEHOLD ESTATES (LEASEHOLD ESTATES)</th>
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<tbody>
<tr>
<td>A. Estate for years</td>
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<td>B. Estate from year to year</td>
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<td>C. Estate at will</td>
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<tr>
<td>D. Estate at sufferance</td>
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<td>Note: Provide possession and control, but not title.</td>
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<th>RIGHTS IN THE LAND OF ANOTHER</th>
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<tr>
<td>A. Easements</td>
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<td>B. Profits</td>
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<td>Note: Provide a right, but not title or possession.</td>
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FIGURE 2.1 Estates and rights in real estate property (in descending order of importance).

Source: © 2019 OnCourse Learning
an easement in the land to another, or may give a license to conduct some activity on the property to another. Some of these rights may be removed from the bundle, leaving the other rights intact. For example, if the owner conveyed a lease or an easement to another, the owner’s remaining rights would be a fee simple subject to the lease or easement. Fee simple ownership should not be confused with the quality of title. Ownership in fee means that the grantee owns it forever, not that it is free of title defects. Certainly an owner cannot expect to live forever, so the ownership consists of two periods of time, from receipt of title until the owner dies, and the period of time after the owner dies. The owner has the rights of ownership and use during his lifetime and then the ownership shall convey to his heirs (either by will or by the law of descent.).

The word “fee” denotes ownership that is inheritable. Fee simple absolute, also known as fee simple or fee, means ownership forever or for at least a lifetime. Because the ownership is considered “for at least a lifetime” the use of the term “fee” does not mean that ownership is free and clear of any liens. It speaks more to the quantity of title (at least a lifetime) than to the quality (free of liens).

2. Fee simple determinable. This defeasible fee or qualified fee estate is also an inheritable freehold estate in the form of a fee simple estate; however, the grantor can terminate the title under certain conditions. An example of a fee simple determinable is a situation in which a grantor conveys title to a college and in the conveyance stipulates that the title is good “so long as” the property is used for scholastic purposes. Title received by the college can be for an infinite period of time. If the property is not used for the purpose specified in the conveyance, however, the title will automatically terminate and revert to the original grantor or the grantor’s heirs.

3. Fee simple subject to a condition subsequent. The fee simple subject to a condition subsequent can continue for an infinite period, as is the case with the fee simple absolute. The fee simple subject to a condition subsequent also can be defeated and, therefore, is a defeasible title. The fee simple subject to a condition subsequent is created by the grantor (the one conveying title), who restricts the future use of the property in some way. For example, a grantor may convey property with the condition that it can never be used as a landfill. As long as the property is never used for this purpose, the title will continue indefinitely in the name of the initial grantee or any subsequent grantee. Any use of the property for a landfill will violate the covenant in the deed and the original grantor or her heirs may reenter the property and take
A grantor may want to convey a title this way for several reasons. In the case of the landfill, the owner may be protecting the property he owns that is close to the landfill. In the case of the college, the grantor may be highly committed to education but may not want to give up ownership of the property for any other reason. Notice that in the case of a fee simple determinable, the estate in the grantee automatically terminates in the event the designated use of the property is not continued or a prohibited use is undertaken. This is contrasted with the fee simple subject to a condition subsequent, in which the termination is not automatic. In the latter case, the grantor and/or the heirs must either reenter the property or go to court to obtain possession of the property and to terminate the estate in the grantee. It should be noted that qualified fee or use conditions based on race, color, sex, national origin, familial status, handicap, or religion are void because they are against public policy; therefore, if a qualified fee or use condition based on any of these factors appears as a condition of title, the title is really a fee simple absolute.

B. Estates pur autre vie (for the life of another). These estates are measured by the lifetime of a person other than the person receiving the title. They may be willed or inherited by heirs of the life estate grantee if the grantee dies before the person who is the measuring life. These rights should not be confused with the more traditional, and noninheritable, conventional life estates. The pur autre vie is an inheritable right, should the life interest person die before the measuring life person deceases.

For example, Dad may grant title to his son for as long as Mom (his widow) is still alive. If the son dies before Mom, the title to the life estate pur autre vie would pass to the son’s heirs, such as a grandson or a granddaughter. Therefore, the life estate is not only for the duration of the son’s life, but will last until Mom’s death, as hers is still the measuring life. At Mom’s death, the life estate terminates.

II ESTATES NOT OF INHERITANCE

Estates not of inheritance are good only for the life of the tenant (freehold) and do not pass on to his heirs, but rather are disposed of by some other method.

In addition to being created by an intentional conveyance, life estates also can be created by operation of law. Life estates created by act of the parties are called conventional life estates, whereas life estates created by operation of law are called marital life estates.

A. Conventional life estates (estate for tenant’s own life). A life estate is a non-inheritable freehold estate. It is created only for the life of the named life
tenant; that is, one who holds a life estate. The question arises as to what will happen to the estate at the death of the life tenant. If nothing else is specified in the conveyance of the life estate, it will revert to the grantor or to his heirs at the death of the life tenant. The grantor or his heirs thus would have a reversionary interest in this case (see Figure 2.2). Alternatively, the conveyance of the life estate could specify that the estate pass on to someone other than the grantor or his heirs. This person would be called a remainderman and has a remainder, or future, interest in the property. After the death of the life tenant, the remainderman would then have title in fee simple absolute (see Figure 2.3).

B. Marital life estates. A marital life estate is created in North Carolina by the intestate succession statutes governing the distribution of property of one who dies intestate, that is, dies without leaving a valid

“Do not memorize that a remainderman means a 3rd party. It is better to remember that any time a life estate ends and the reversionary interest does not return to the grantor then a remainder interest exists.”
—Len Elder, DREI

FIGURE 2.2 Life estate in reversion.
Source: © 2019 OnCourse Learning

FIGURE 2.3 Life estate in remainder.
Source: © 2019 OnCourse Learning
will. This statute allows the surviving spouse to choose a life estate in one-third of the real property owned in severalty (sole ownership) by the deceased spouse at any time during the marriage under certain conditions. If the surviving spouse is entitled to any property of the deceased spouse through a will or intestate succession statutes and the surviving spouse has not joined in the transfer of such property by signing the deed, the surviving spouse must forfeit any interest in the deceased spouse’s property resulting from a will or an inheritance to claim her marital estate. Few surviving spouses elect the marital life estate option because it is seldom advantageous for them to do so. Several important points pertain to marital life estates:

- A will cannot defeat the marital interest of a surviving spouse.
- Statutes do not apply to property owned as tenants by the entirety.
- A surviving spouse has a choice of either marital life estate or property of the deceased spouse willed to the surviving spouse.

From these requirements, you can see that it is extremely important for both husband and wife to join in the conveyance of any property owned by either of them while they are married. Otherwise, the grantee’s title could be affected by a marital interest of the surviving spouse.

Some states still provide dower and curtesy rights to a surviving spouse. **Dower** is the wife’s right and **curtesy** is the husband’s right to a life estate in the property owned by a deceased spouse during the marriage. North Carolina’s intestate succession statutes abolished dower and curtesy rights and provided a substitute, which sets forth the manner in which the property of an intestate (one who has died without leaving a valid will) is distributed to the heirs.

**Rights and responsibilities of life tenants.** A life tenant has the right of **alienation.** That is, the life tenant can transfer her title to another person or pledge the title as security for a debt. Of course, the individual cannot give a title for a duration longer than her life or the life of the person named in the creation of a life estate to establish its duration. The life tenant also has the right to the net income produced by the property, if any. The life tenant can legally mortgage the life estate. It is unlikely that a lending institution would accept a life estate as security for a mortgage, however, because the estate terminates on the death of the life tenant. If the life tenant were able to do this, however, she would be responsible for the principal and interest on that mortgage note. An outstanding mortgage on the property is the responsibility of the grantor or the remainderman, and the life tenant must pay the interest but not the principal.

A life tenant has certain responsibilities. He must not commit waste and must preserve the estate for the benefit of the remainderman or for the person who holds the reversionary interest. Otherwise, the life tenant is not answerable to the future holder of the estate. The life tenant has a legal right called the right to **estovers,** which allows him to cut and use a reasonable amount of
timber from the land to repair buildings or to use it for fuel, but does not allow
the tenant to cut and sell the timber for profit. A violation of the right of este-
ers is called an act of waste.

A life tenant has an obligation to pay the real property taxes on the property
in which he has a life estate. The tenant also has the duty to pay any assessments
levied against the property by a county or municipality for improvements to the
property. Assessments are levied against land for improvements made to the land,
such as paving streets and laying water and sewer lines.

The life tenant also has a duty to make repairs to the improvements on the land.
He cannot permit the property to deteriorate because of lack of repairs and thus
cause depreciation to existing improvements.

Many states recognize the primary home as a sort of life estate that can pro-
vide some degree of protection from creditors. The North Carolina Hom-
estead Exemption Law protects an amount of interest, or equity, in the debtor's
personal residence, whether it is real or personal property, from creditors in
the event of lawsuits, including bankruptcy filings. The current amount of
protection is $35,000, which was increased from $18,500 in December 2009.
Additionally, this act increases the amount of protection to a maximum of
$60,000 in cases in which the resident is over the age of 65 and the property
was previously owned in tenancy by entireties, or in joint tenancy with rights
of survivorship, in which one of the former co-owners is now deceased. The
property owner is helped by this act in the event of judgment liens obtained
against her. The owner still would be obligated to pay property taxes and any
mortgage balances due.

Homestead exemptions in other states are relatively similar, although many are
more extensive than those in North Carolina.

Nonfreehold Estates

The nonfreehold estates, also known as less-than-freehold or leasehold estates,
confer a rental interest in real property. Four estates are recognized:

1. **Estate for years** is for any fixed period of time and automatically terminates
   at the end of that period.

2. **Estate from year to year** is a periodic estate that automatically renews at the
   end of its period if the parties do not provide otherwise.

3. **An estate at will** is for an indefinite time and may be terminated by either
   party instantaneously by giving notice to the other party.

4. **An estate at sufferance** is not truly an estate but rather a holdover situa-
   tion created when the tenant’s lease has expired and she fails to vacate the
   premises.

These nonfreehold estates are described in more detail in Chapter 15.
OWNERSHIP OF REAL PROPERTY

Ownership in Severalty

When title to real property is held in the name of only one person or entity, it is called ownership in severalty. Not to be confused with the word several, the concept of severalty is actually a derivative from the word “sever.” The person holding title is the sole or only owner. This is the form of ownership that a corporation likely would have even though the corporation has many owners or stockholders (i.e., IBM Corporation). The fact that title is held in severalty does not eliminate the possibility of marital rights. This is the case when a single person acquires title to a property in severalty and later gets married. Even though the new spouse does not have his names on the title to the property, he still would obtain marital rights upon marriage.

Concurrent (Joint) Ownership

Simultaneous ownership of real property by two or more people is called concurrent ownership or co-ownership. There are various types of co-ownership, and the rights of the owners depend on the type of ownership they have. The types of co-ownership are tenancy in common, joint tenancy, and tenancy by the entirety.

The co-owners may hold title in the same manner as owners in severalty—for example, fee simple absolute, fee simple subject to a condition subsequent, and fee simple determinable.

Tenancy in Common

Tenancy in common is characterized by two or more persons holding title to a property at the same time, with no right of survivorship. Anyone can hold title as a tenant in common. The concept of unity of possession means that each owner holds an undivided interest in the entire property, rather than one specific part of it. Upon the death of a tenant in common, the deceased’s share goes to his heirs.

A tenant in common may sell his share to anybody without destroying the tenancy relationship. Each tenant in common may also pledge her share of the property as security for a loan. This creates an encumbrance against that share only, not against the entire property. Tenants in common do not need to have the same amount of interest in the property. For example, one tenant may hold a 50% interest, with two other tenants holding 25% each. If the deed does not specify the interest each holds, their interest will be considered equal.

A tenant in common may bring legal action to have the property partitioned so each tenant has a specific portion of the property exclusively. If this can be done fairly with a piece of land, each tenant receives title to a tract according to his share of interest. If the land cannot be divided to the satisfaction of the co-owners, the court may order its sale, with appropriate shares of the proceeds distributed.
to the tenants. Tenancy in common is also the form of concurrent ownership that is recognized when either a joint tenancy, or tenancy by entireties, is destroyed but when there are still multiple owners, such as the case when a married couple obtains a divorce but remains in a co-ownership position.

**Joint Tenancy**

This form of co-ownership requires the four unities of time, title, interest, and possession. People with *joint tenancy* must have the same interest in the property, must receive their title at the same time from the same source, and must have the same degree of undivided ownership and right to possession in the property. For example, if there are three joint tenants, each must own an undivided one-third interest in the property, they must all receive their title from the same source at the same time, and they must continue to hold possession concurrently.

If a joint tenant sells her share of ownership, the sale violates the requirement of unity of time, title, interest, and possession as far as the new buyer is concerned. Upon the sale of an interest by a joint tenant, the person buying this share does not become a joint tenant with the other tenants, but rather joins them as a tenant in common.

Other states, but not North Carolina, provide the concept of automatic rights of *survivorship* in joint tenancies, wherein the surviving partners automatically take over the share of a deceased partner. Today, the automatic right of survivorship is not favored in law except in joint ownership by husband and wife as tenants by the entirety.

As indicated in the previous paragraph, North Carolina tends not to recognize the automatic rights of survivorship, but rather requires the parties to specifically indicate in the deed that it is to be joint tenancy with the rights of survivorship. A common illustration might be “to Sam Smith and Tracy Jones as joint tenants with rights of survivorship,” which shows a specific intent. Examples such as “to Robert Bellamy and Sally Browne jointly” or to “Angie Smith and Stephanie Clark as joint tenants” fail to expressly provide for survivorship and therefore will not be recognized as joint tenancy but rather tenancy in common. Additionally, in contrast to the more “national” interpretation of joint tenancy, in 2009, North Carolina provided for the ability to have unequal ownership interests in joint tenancy as long as the right of survivorship was clearly addressed.

The concept of joint tenancy, with rights of survivorship, is increasing in popularity among unmarried couples, many of whom are not able to partake in tenancy by entireties, as a means to acquire title and have the ownership automatically go to the surviving member of the couple and therefore avoid the risks, costs, and consequences of an inheritance.
Test Tip!

Joint tenancy ownership requires the following four unities:

- Time—Must acquire interests at the same time
- Title—Must acquire title on the same document (deed)
- Interest—Considered equal shares unless stated otherwise
- Possession—Has the right to use and possess the entire property

Tenancy by the Entirety

Ownership through tenancy by the entirety is limited to husband and wife. To receive a title as tenants by the entirety, there must be a legal marriage at the time that the husband and wife receive title to the property. It is not necessary for the deed to read “to husband and wife as tenants by the entirety” to create a tenancy by the entirety. The deed only needs to convey the property “to John A. Jones and Mary A. Jones, who are husband and wife,” and a tenancy by the entirety is automatically created. Tenancy by the entirety does contain the right of survivorship. The surviving spouse receives title to the property automatically by operation of law. Creation of tenancy by the entirety requires the five unities of time, title, interest, possession, and marriage.

A husband or wife owning land as tenants by the entirety may not legally convey property to a third party without the other spouse joining in the deed. There can be no partition of real property held by tenants by the entirety.

Tenancy by the entirety exists as long as the tenants hold title to the property and are legally married. Tenancy by the entirety is abolished by decree of divorce or in the event of death of one of the owners. A mere legal separation is not sufficient. When a final decree of absolute divorce is obtained, however, the ownership is automatically changed to tenancy in common by operation of law, eliminating the right of survivorship. In the event of death, the remaining spouse will now be considered to hold title in severalty.

Married people may, if they elect to do so, own property as tenants in common. It is not necessary for them to take title as tenants by the entirety.

In North Carolina, one spouse can purchase a property, but it usually takes the signature of the husband and the wife to convey and give a clear title to a grantee, regardless of how the property is held. If a mortgage or deed of trust is given to secure a note for a property being purchased by one spouse, the lender usually requires the other spouse to sign the deed of trust or mortgage but does not require the nonpurchasing spouse to sign the note unless that spouse’s income is used to qualify for the loan.

Many times a property is owned by one spouse before the marriage. Upon marriage, title will remain in severalty but coupled with a marital right. In another

“In North Carolina a married individual can take title in his or her name alone without the spouse having an interest in the property. The document which waives and relinquishes the spouse’s interest is called a Free Trader Agreement.”
—Tim Terry, DREI
situation, a couple may have acquired title to a property together as co-owners, such as tenancy in common or joint tenancy, before their marriage. As in the illustration regarding severalty ownership just mentioned, the ownership does not convert to tenancy by entireties upon marriage. The deed would have to be conveyed by the couple, to the couple, after marriage to make it tenancy by entireties.

**Combination (Hybrid) Forms of Ownership**

**Condominiums**

Condominium ownership is a form of ownership in real estate that is now recognized in all states. North Carolina statutes define this type of ownership, set forth the requirements for the creation of a condominium, and set special restrictions on the offering of a condominium for sale.

A condominium purchaser receives a fee simple title to an apartment. Condominium unit owners can hold ownership of their units in the same ways owners of any freehold estate hold ownership—that is, in severalty, as tenants in common, as joint tenants, or as tenants by the entirety. Individuals, groups, and business entities can hold ownership in condominium units in the same ways they can hold ownership in other freehold estates, providing they meet the criteria for the specific type of ownership. For example, only a married couple can own real estate as tenants by the entirety. The owner can convey title by deed or leave it to an heir by will. Condominium ownership includes ownership of the airspace of the individual unit as well as co-ownership in the common areas of the condominium along with the other unit owners. This co-ownership is as a tenant in common in the common areas, including the corridors, grounds, parking areas, and recreational facilities. The right to partition is waived in this tenancy in common ownership of common areas (see Figure 2.4).

North Carolina statutes prescribe the manner in which a condominium is to be created. This includes a declaration, bylaws, and a copy of the construction plans. To be valid, the declaration, articles, and bylaws must be recorded on the public record in the Register of Deeds office in the county where the property is located.

The declaration includes a legal description of the property; a plat of the property with the location of the buildings, plans, and specifications for the buildings and the various units; a description of the common areas; and the degree of ownership in the common areas available to each unit owner. It also includes covenants, conditions, and restrictions affecting the property. It also may include a “right of first refusal” clause, giving the association the first opportunity to purchase a unit if the owner wishes to sell.

The articles of association establish an association to provide for the maintenance and management of the common areas and other services for the

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Ownership of Real Property

Owner-members. Owners, as members of the association, are assessed to pay for these necessary services. Such assessments are usually in the form of monthly dues, but periodic special assessments also can be levied. The bylaws set forth the various officers in the association and the way they are elected, and they set forth the requirements for amending the bylaws.

The creation of a condominium is not limited to residential purposes. Virtually anything can utilize the condominium form of ownership. Other purposes may include office space, parking space, and an industrial park. Indeed, it would seem as the potential uses of a condominium form of ownership are limited only by the developer’s imagination. The purpose of the condominium must be set forth in the declaration as required by state statute.

Condominiums can also be one-story, attached, or detached units, but the individual owner still owns only the airspace that constitutes his unit. All ground and common areas are still owned as tenants in common.

A condominium unit can be mortgaged just as any other property. Federal Housing Administration (FHA) financing has been available for condominiums since 1961, and the Department of Veterans Affairs (VA) guarantees mortgage

FIGURE 2.4 Condominium ownership.
loans for the purchase of condominiums. A condominium project must have FHA or VA approval before FHA will make loans on any of the units. FHA further requires that condominium projects have a specified percentage of owner-occupancy before FHA will make a loan on any of the units. The occupancy rate is monitored. That percentage can vary by region.

The **North Carolina Condominium Act** (1986) sets specific requirements on offering for sale or resale a condominium created on or after October 1, 1986, although these rights can be waived, and typically are, when the condo is used for nonresidential purposes. Essentially, the act offers the following consumer protections (these protections apply only to condominiums, not to townhouses or PUDs).

1. *Public offering statement:* The developer must provide a public offering statement to the prospective buyer of a new condominium before the contract is signed. The North Carolina Condominium Act requires that the developer disclose certain information pertaining to the condominium project, including the purchaser’s right to cancel. The public offering statement is not required for resale of units.

2. *Purchaser’s right to cancel:* A purchaser has the right to cancel, absolutely and without penalty, the purchase of a new condominium unit from the developer for any reason during the first seven days after signing the contract. Title cannot pass during this seven-day period. Like the public offering statement, the purchaser’s right to cancel does not apply to resale units.

3. *Escrow of deposit:* Any deposits made by the purchaser must remain in the developer’s or his agent’s escrow account the full seven days, unless the purchaser cancels the contract earlier. In that case, the money is to be refunded to the purchaser. All escrow accounts must be held in an insured bank or savings and loan in North Carolina.

4. *Resale certificates:* When reselling a condominium built on or after October 1, 1986, the unit’s owner or owner’s agent must provide a resale certificate to the purchasers that discloses monthly assessment for the common areas and other fees for which unit owners are responsible. A public offering statement or a right to cancel is not required for resale of a unit.

5. *Warranties:* There is an implied warranty that the unit is constructed in an acceptable manner, free from defects, and suitable for the purpose intended unless there is an agreement to the contrary or the warranty has been disclaimed in such a manner as to make it void.

The agent must provide his client with a public offering statement if the client is purchasing a new condominium or a resale certificate if reselling a unit subject to this statute. Failure to do so violates the agency relationship and, therefore, the Real Estate License Law. It also leaves the agent potentially liable to the purchaser in civil court.
Test Tip!

- New condominium sales require a public offering statement and contain rescission dates.
- A resale condominium requires a property disclosure statement and a resale certificate and does not contain rescission dates.

Townhouse Ownership

The townhouse form of ownership is somewhat different from the condominium form in that the townhouse provides for the ownership of the unit as well as the specific portion of land upon which the individual unit is located.

Because each unit rests on its own foundation and its own piece of land, it cannot have another unit above it. A townhouse is, therefore, a vertical structure that is attached horizontally to other units, which also rest on their own foundations. The townhouse may be two or three stories, but all the stories are part of one unit. This is in contrast to condominium units, which are attached vertically but whose horizontal stacks of units share a foundation and ground.

There is another significant difference in the ownership of the common grounds. Because the townhouse owner owns the land of his specific unit, the owners association owns the remainder of the common areas, such as the walks and swimming pool, in severalty. This is different from condominium ownership, in which the owners association owns nothing itself because the owners own the common elements together as tenants in common. Maintenance is provided by periodic fees and assessments that are charged to the individual unit owners.

Cooperatives

Ownership in a cooperative (co-op) results from ownership of shares of stock in a corporation that owns a building containing cooperative apartments. The right of stockholders to occupy an apartment is provided by a proprietary lease and therefore there is no deed. The only real property interest of the stockholders is a leasehold estate providing the right to possession of an apartment. The stockholders, as lessees, pay no rent but do pay an assessment to cover the cost of maintaining and operating the building, real property taxes, and debt service if there is a mortgage against the building. The owners’ rights and obligations are specified in the lease and the stock certificate. Proprietary lease tenants do not “own” real property. The cooperative ownership requires that prospective purchasers are voted
on to determine whether they will be allowed to purchase the share of stock and be allowed to occupy the unit. Because the purchaser is purchasing only shares of stock, as opposed to actual ownership of real property, this is not in violation of federal fair housing laws. Co-ops involving ownership of real property are not a popular form of ownership in North Carolina but are a common form of ownership in some larger metropolitan areas around the country.

**Time Sharing**

Time sharing is a fairly recent innovation. North Carolina has specific statutes defining and regulating time-shares. **Time sharing** is defined as *any right to occupy a property for five or more separated time periods over a span of five or more years*. Any interest meeting this definition is classified as real property, and the laws pertaining to real estate transactions apply. Article IV of the Real Estate License Law sets specific regulations on the sale of time-share property. The developer must obtain a registration certificate from the Real Estate Commission before offering the units for sale to the public, and all people selling an interest in a time-share must have a real estate license. Additionally, purchasers must be given a public offering statement meeting North Carolina Real Estate Commission guidelines before a contract is signed and must have a five-day right of rescission after executing such a contract. See Appendix C for rules and regulations for time-shares and real estate laws.

Time sharing is a type of real estate innovation that allows participants to acquire the right to occupy a unit of real estate, most likely a resort, for a brief period of time. Because most people are unable to take more than a week to few weeks of vacation time each year this has become a popular method for people who prefer to pay only for the time they use. Unfortunately, this type of conveyance has created many problems, including high-pressure sales tactics that have left many people regretting the purchase almost immediately afterward. Numerous examples exist in which conveyances were never recorded and liens were not paid off. As a result, North Carolina has adopted numerous laws and rules pertaining to time-shares.

### Test Tip!

**Students should be aware that time-shares are tested in two different areas of the exam. They may be tested on for Chapter 2 as well as under License Law. Because of that importance, the following list gives the most important elements of these rules.**

**Key Time-Share Facts for North Carolina**

- A time-share is considered to be five or more separate time periods spread over a period of at least five years.
- All time-shares are considered real property.
Ownership of Real Property

- All persons selling, or attempting to sell time-shares in North Carolina must have a valid active real estate license.
- There is no separate time-share license.
- There is no exemption for employee of developer status.
- The developer must obtain a certificate of registration from the North Carolina Real Estate Commission.
- The developer must record a time-share instrument (1) no less than 6 days nor more than 45 days from date of purchase, and (2) no more than 180 days from the date of sale if monies were paid to an independent escrow agent at the end of the 10-day period.
- The developer must give the purchaser the public offering statement by the date of purchase.
- The time-share contract is voidable without penalty for five days from contract of sale.
- Monies collected on the time-share purchase must be deposited immediately within 10 days upon receipt.
- Such payments are considered to belong to the purchaser and not to the developer during this period.
- If the developer, or his or her agent, fails to give the purchaser a copy of the public offering statement by the date of purchase: the purchaser may obtain from the developer an amount equal to 10% of the purchase price not to exceed $3,000; and (2) the North Carolina Real Estate Commission can fine the developer $500 for each violation. NOTE: Only the developer can be fined and not the salesperson.
- Time-share projects must have a time-share registrar and no sales may be made until such registrar has been designated.
- The developer also must designate a project broker.
- The project broker must supervise both brokers and provisional brokers licensees at the project location.
- Upon cancellation of the time-share contract, all refunds shall be made no later than 30 days from the date of purchase (not cancellation).

**Trusts**

A trust is an arrangement whereby a person's assets are being held by a third party (trustee) for the benefit of that person (trustor). This trustee is quite often a bank, attorney, or another person. This arrangement is considered to be a fiduciary relationship and often will involve real property. One of the distinct advantages of such a trust is that it allows property to pass outside of probate as well as provides privacy. In probate, the courts will want to verify the validity of the will, obtain an inventory and value of any property, pay relevant debts, and then distribute any
remaining assets to the appropriate parties, such as the heirs. Another advantage of creating such a trust is that it allows much of this to be taken care of in advance, thereby relieving the executor, or administrator, of estate of tasks with which they may have little experience.

Living trusts often are referred to as “revocable trusts” and are created during the lifetime of the person setting up the trust. These documents place assets into a trust for a person’s benefit during their lifetime and then transfer the assets to a designated beneficiary at death.

Testamentary trusts often involve the leaving of assets to children or others in cases in which the distribution may be set to occur at a particular time, such as a 30th birthday, or when a specific event, such as graduation from college or marriage, occurs. This type of trust often involves potentially large sums of money that may not be acquired by the person setting up the trust until their death, such as life insurance proceeds.

Land trusts are agreements in which the trustee agrees to hold ownership of real property for the benefit of the trustor. One of the benefits of this type arrangement is that it potentially provides privacy for the person who owns the property.

It is entirely possible that the recipient of a trust may be able to act only through the actions of the trustee. It is not unheard of for a future recipient (beneficiary) to represent to another person their desire to dispose of assets that are not yet within the control of that recipient. For example a person wants to sell a parcel of real property she “inherited” and is willing to sign the listing agreement. In this situation, the broker will need to determine whether the beneficiary actually has the right to sell independently or if the trustee must be willing to allow the conveyance.

**ENCUMBRANCES TO REAL PROPERTY**

An encumbrance is anything that diminishes the bundle of rights of real property. As such, it is usually considered a burden on the property. Charges, claims, restrictions, or infringements on a property reduce its overall value in some manner. In some instances, however, an encumbrance has a positive effect on the value of the property; one example might be a restrictive covenant, discussed later in this chapter. Therefore, an encumbrance can affect value either positively or negatively.

This section discusses liens, easements, and encroachments. Chapter 5 discusses other land use controls, such as zoning ordinances and deed restrictions.

**Liens**

A lien is a claim or a charge against the property that can result from a contractual agreement or from the operation of law. For example, a lien can result from an owner’s contracting to have work done on property and not fulfilling part of
the contract, from the owner’s failure to pay taxes, or as a result of a lawsuit. A lien creates a cloud on the title. If this claim is not satisfied in the required time, the lien holder may execute the lien by process of foreclosure, which forces the property to be sold at public auction. Proceeds of the foreclosure sale are applied to outstanding liens in the order of priority of the liens, which is discussed later in this chapter.

Liens fall into two groups, which are shown in Figure 2.5:

1. **Specific liens** are claims against a specific property, such as mortgages, property taxes, and mechanic’s liens.
2. **General liens** are claims against a person or that person’s property, such as judgment liens, personal property tax liens, income tax liens, and estate and inheritance tax liens.

**Specific Liens**

**Mortgage liens.** A mortgage or deed of trust pledges a specific property, such as a home, as security for a debt. If the borrower does not pay the debt as promised (defaults), the lender can foreclose the mortgage by having the property sold at public auction and applying the proceeds of the sale to the debt.

**Real property (ad valorem) tax and special assessment liens.** The taxes levied by a local government constitute a specific lien against the real estate. State laws provide that real property tax liens have priority over all other liens. An assessment is a levy, or tax, against a property for payment of a share of the cost of improvements made to areas adjoining the property. Examples of these improvements are paving streets, installing sewer or water lines, and constructing sidewalks. Special assessments constitute a specific lien against the property until paid. Ad valorem and special tax liens are valid for 10 years.

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FIGURE 2.5 Classification of liens.
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“Liens are categorized as specific and general. Specific liens are ‘specific’ because they are tied to a particular individual property.”
—Len Elder, DREI
Mechanic’s liens. In North Carolina, the term mechanic’s (materialman or laborer) lien includes a lien filed by anyone (such as carpenters, lumber companies, appraisers, and surveyors) who provides labor or material to a property or property improvement. If these people are not paid according to the terms of their contract, they can file a lien against the property to which they provided work or materials any time up to 120 days after the last day that any labor or material was furnished to the property. The mechanic’s lien is unique in that when it is filed, it becomes effective as of the first day any labor or material was furnished rather than on the day the lien is recorded. The mechanic’s lien holder has up to 180 days after the last labor or materials were furnished to take court action to enforce her lien, provided she filed the lien within the 120-day filing period. The Statute of Limitations sets the time limit for the filing of lawsuits in various situations. If a lawsuit is not filed within the statutory time period, the injured party loses the right of legal remedy by operation of law. Therefore, the mechanic’s lien must be filed within the statutory period. The special treatment the mechanic’s lien receives as to effective date makes it necessary to verify that all work done on a property within 120 days before closing has been paid for. The mechanic’s lien is the one type of lien that may not show up in a title search but, once subsequently recorded, would constitute a valid lien on the property. To avoid the risks of mechanic’s liens being filed at a later date, most lenders will require the seller to produce a lien waiver in which the parties, who have produced labor or materials within the statutory period of time, have signed a document stating that they will waive their rights to file a lien against the property.

Legislation, effective April 1, 2013, applies to projects for which the anticipated cost exceeds $30,000 at the time of permitting. This law requires the owner to designate a “lien agent” to whom the lien claimants will be required to give notice. Anyone with a potential claim will be afforded a 15-day period from beginning work or risk loss of the mechanic lien priority. This new law does not apply to situations involving an existing single-family residence that is owner occupied.

Commercial Real Estate Broker Lien

North Carolina enacted the Commercial Real Estate Broker Lien Act effective October 1, 2011. This act enabled the commercial broker/firm to be able to file a lien to protect their claim to a sales or leasing commission. This became necessary because commercial brokers often have invested long periods of time and large sums of money in a transaction that can result in large amounts of monies due for the commission. As a result, commission disputes can arise that cannot be resolved before the closing date. Further compounding the problem is the fact that the broker generally had no right to place a lien on the property and had virtually no “leverage” to force the owner to pay after the title was transferred. The
primary avenue available to the broker was to file a suit, which often resulted in long periods of costly litigation.

As a result, this legislation was passed allowing the broker/firm to file a lien for the earned commission in sales or lease transactions. This ability to file a lien is limited to only the listing broker/firm who had the written agreement to sell or lease the property as opposed to the cooperating broker/firm. The lien must be filed before the title is transferred in a sale and can be filed up to 30 days before the closing or by the date of possession in a lease. Once the lien has been filed, the broker/firm has up to 18 months to file a suit to enforce the lien.

**General Liens**

**Judgment liens.** A judgment is a court decree establishing that one person is indebted to another and specifying the amount of that indebtedness. A judgment lien constitutes a general lien against all real and personal property the judgment debtor owns in the county in which the judgment is recorded. The lien takes effect from the time the judgment is recorded. A judgment creditor may record a judgment in any county in the state, and it will constitute a general lien against all of the judgment debtor's property in that county. The creditor also may file notice of the lien in other counties where the debtor may own property and be protected for the debt in those counties as well. The judgment also creates a lien against any property the judgment debtor acquires subsequent to the judgment during the existence of the judgment.

A general lien does not apply to real property owned by husband and wife by the entirety or as joint tenants if the judgment is against only one of them. For the lien to attach to property in such cases, the judgment must be obtained against husband and wife on a debt they both incurred. A judgment lien remains in effect for 10 years in North Carolina unless the judgment is paid. Judgments may be renewed and kept in force for an additional period if the creditor brings another action on the original judgment before the original period has elapsed. Judgment liens have a priority relationship based on the time of recording. The creditor who records a lien before another creditor records a lien against the same judgment debtor has a higher priority claim. The judgment debtor's obligation to the creditor who has priority must be satisfied before creditors with a lower priority. Judgment liens are enforced by an order called an execution. This is an order signed by the clerk of court that instructs the sheriff to sell the property of the judgment debtor and apply the proceeds of the sale to the satisfaction of the judgment.

**Personal property tax liens.** Personal property taxes are assessed on certain personal property owned as of January 1 of the tax year. If these taxes are not paid, they become a general lien against all of the property the individual owns. Like the real property tax lien, this lien takes priority over other liens. The tax on licensed motor vehicles no longer constitutes a lien on real property.
**Federal tax liens.** The U.S. IRS can create a general lien against all of a taxpayer’s property for overdue federal taxes. This lien is created by obtaining a judgment in a federal court against the taxpayer and by filing a certificate of lien against the landowner in the office of the clerk of the superior court in the county in which the taxpayer’s land is located. A federal tax lien does not have a special priority. Its priority is established by time of recording, and its validity extends for 10 years. The federal government imposes a tax on the estate of deceased persons, which is called the federal estate tax. This tax creates a lien that attaches to all real and personal property in the estate and continues until the tax is paid.

**State tax liens.** The NC Commissioner of Revenue can create a general lien against all of a taxpayer’s property for overdue state taxes. This lien becomes effective from the time of docketing in the superior court clerk’s office in the county where the delinquent taxpayer’s property is located and remains effective for 10 years. All states impose a state inheritance tax upon the inheritance of real and personal property. This tax is paid by the heirs to the estate and remains a lien on the property until it is paid. The estate can sell property to satisfy the tax bill.

**Priority of Liens**

The priority of most liens in relation to other liens is based on the time (day and hour) they were recorded. North Carolina practices this “pure race system.” This system provides that liens are established in priority by the time they are recorded—that is, the person who wins the race to the courthouse is at the head of the list. When the proceeds from the foreclosure sale are distributed, the lien holder with the highest priority gets paid first. With the exception of lien holders with special priority, the first to record is the first to be paid. However, certain liens have special priority by North Carolina statute, as is the case with mechanic’s liens, where lien priority relates to the first day of work on the job rather than to the date of recording. The highest priority of all liens is given to liens for real property taxes.

**Homestead Exemption**

North Carolina has a law that prevents the homeowner from total loss in the event of bankruptcy. Homeowners may exempt up to $35,000 ($70,000 for married couples filing jointly) of their home or any other real or personal property protected by the NC homestead exemption. If the homeowner is 65 or older and the spouse is deceased, the exemption protects up to $60,000 if the property was owned as tenancy by entirety or as joint tenancy with rights of survivorship.

**Writ of Attachment**

North Carolina allows a type of pre-judgment right to creditors called a writ of attachment. This right exists for creditors of debts, other than mortgages, and is obtained as the result of a judgment being passed down in a court of law against the debtor. By obtaining the writ of attachment, the creditor makes certain the debtor’s property will be available to satisfy the debt once the judgment is
finalized. Upon obtaining the judgment, the sheriff will be instructed to sell the property to satisfy the debt.

**Restrictive (Protective) Covenants**

Restrictive (protective) covenants are private restrictions that limit the way land may be used. They attach to the land, and they pass with title to successive purchasers. Often a developer defines such covenants to establish characteristics of a new residential subdivision. They may limit construction to single-family homes on a specific lot size, or they may require a given size or type of architecture. Agents, and consumers alike, should be cautious that restrictive covenants in a given subdivision can change within different areas of the development. The covenants can address anything that is legal. Careful consideration should go into establishing restrictive covenants because property becomes more difficult to sell as the number of restrictions increases. The restrictions may be written in the individual deed or recorded as a master instrument, a declaration of restrictions.

**Lis Pendens**

This notice of pending litigation indicates the existence of an unresolved lawsuit that affects title to all or part of the property of the defendant. Recording of the lis pendens (lawsuit pending) provides constructive, or effective, notice of the forthcoming legal action and its possible outcome. As a result, if the property is transferred to a new owner after the notice of lis pendens is placed on the public record in the county where the property is located, any court order or lien resulting from the lawsuit will affect the new owner’s title to the property. Notices of lis pendens are routinely filed in boundary dispute cases.

**Easements**

An easement is a nonpossessory right or interest in land owned by another. It provides a right of use in land and not a right of possession.

**General Classification of Easements**

Easements can exist for a variety of legal uses, such as right-of-way for ingress and egress; a party wall; the right to take water from the land of another; the right to receive air, light, or heat from above the land of another; the right to obtain water from a well or spring on the land of another; and a right-of-way for the purpose of putting utility lines under and above the surface of the land.

**Appurtenant Easement**

An appurtenance is something that has been added to something else and, as a result, becomes an inherent part of that to which it has been added. In real property law, an appurtenance is the right that one property owner has in the property of another as a result of the first property owner’s ownership in a particular
CHAPTER 2 Property Ownership and Interests

For example, if a purchaser receives a title to a tract of land and included in this title is an easement in the form of a right-of-way across the adjoining land of another, this easement is an appurtenance to that title. Whenever the titleholder conveys that title to another, the conveyance includes the easement because the easement is appurtenant to the title. Because an appurtenant easement moves with a title, it is said to run with the land. The land that is benefited by the easement is described as the dominant tenement, dominant land, or dominant estate, and the land encumbered by the easement (the land on which the easement exists) is described as the servient tenement, servient land, or servient estate (see Figure 2.6).

Easements in Gross

Unlike appurtenant easements, easements in gross are not dependent upon ownership of an adjoining property. Easements in gross have no dominant tenement, only a servient one. Typically, the owner of an easement in gross does not necessarily own property in the area of the property in which the easement exists. The owner of an easement in gross usually receives an easement by contract.

The most prevalent use of easements in gross is in the form of commercial easements. Commercial easements are common throughout the United States and typically are held by utility companies for the purpose of installing power lines, telephone lines, and gas lines above the surface of the earth, on the earth itself, or underground. Railroad rights-of-way are another prominent example of a commercial easement. These commercial easements are typically for long periods of time, perhaps indefinitely, and are binding on future owners of the servient estate. Commercial easements in gross are assignable and can be conveyed.

FIGURE 2.6 An example of an appurtenant easement.
Personal easements in gross are a form of personal, nonassignable, and uninheritable rights to use a property for a particular purpose or for the duration of the recipient’s life unless stated otherwise. Many personal easements are not recorded and therefore are not enforceable against the grantor. If recorded, however, the easement would be binding upon any future owner of the servient property for as long as the easement exists. Personal easements are not to be confused with a license agreement. A license agreement is the right to occupy a property only for a relatively brief period of time and is not considered to be a conveyance of binding property rights. Examples of a license agreement would be tickets to a movie or sporting event where the holder’s right is for only the duration of the named event.

Creation of Easements

Easements may be created by the use of an express written agreement, may be implied by the actions of a person, or may be created by the operation of law (see Figure 2.7). The Statute of Frauds requires that all transfers of interest in real property be in writing; therefore, an express easement cannot be created orally.

Express Easements

Express easements must be in writing according to the Statute of Frauds and should be recorded. An owner selling his land can expressly grant an easement to a buyer by using the appropriate language in the deed. In Figure 2.6, if A sold the land to B, A could grant the easement to B to cross A’s land. If the situation were reversed, and B sold the land to A, B would reserve the easement. The party walls illustrated in Figure 2.8 are another example of express written easements. A party wall is used by two adjoining neighbors to support the sidewall of each unit. If the property line ran down the middle of the wall, each party would have a cross easement in the other or would have a tenancy in common.

<table>
<thead>
<tr>
<th>1. Express (must be in writing according to statute of frauds)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Grant or reserve</td>
</tr>
<tr>
<td>b. Party walls</td>
</tr>
<tr>
<td>c. Dedication</td>
</tr>
<tr>
<td>2. Implied (actions of the parties)</td>
</tr>
<tr>
<td>a. Necessity</td>
</tr>
<tr>
<td>b. Reference to a recorded plat</td>
</tr>
<tr>
<td>3. Operation of law (court order)</td>
</tr>
<tr>
<td>a. Prescription</td>
</tr>
<tr>
<td>b. Condemnation</td>
</tr>
</tbody>
</table>

FIGURE 2.7 The way easements arise.
Source: © 2019 OnCourse Learning
entirely within the property of one party, however, the other party would have an easement in the use of the wall. Easements may be created by express dedication, in which a portion of a property is set aside for use by the public. For example, a developer who is building a residential subdivision may dedicate a portion of the land for use by the public, such as roadways or recreational parks. 

**Implied Easements**

In contrast to express easements, implied easements have no documentation. In certain cases, the actions of a party create an easement when these actions demonstrate an intent to create an easement. An *easement by necessity* is implied if a seller conveys title to a buyer who would be landlocked without access to a road. In Figure 2.6, if A sold the property to B and did not grant B the easement shown, B would have the right to claim such an easement by reason of the necessity to get to the public road. An *easement by dedication* may be implied as well as express. If the developer described in the preceding section had not expressly granted the roadways in the new subdivision but had described the property by referring to a map showing the existence of such streets, the easement would be implied.

**Easements by Operation of Law**

An easement may be obtained by *prescription*, that is, by *using another’s land for a prescribed period of time*. The use must be open and well known to others (notorious) and must be continued and uninterrupted for the period of time required by laws of the state. Users must prove in court that they have satisfied all the requirements for the intended use. An easement also can be created by *condemnation* under the power of *eminence domain* of the government. This power enables the government to take private land for the benefit of the general public. In all cases, the property owner must be compensated for differences in value before and after the action by the government. Usually, condemnations for rights-of-way
for various public uses are for the purpose of obtaining an easement rather than for acquiring title.

A statutory cartway proceeding is another easement that can arise by operation of law. The owner of a landlocked parcel of property can petition to have a cartway sectioned off over someone else's property. A three-person jury decides where the cartway is to be and what damages the owner of the landlocked property must pay the owners of the land where the cartway is located. Specific statutes govern this proceeding. A cartway of at least 18 feet in width may be obtained to connect the landlocked property to a public highway if the cartway is for the purpose of cultivation or for using the land for one of the purposes listed in the statute.

**Termination of Easements**

Easements may be terminated as follows: by the release of the easement by the dominant owner to the servient owner, by combining the dominant and servient lands into one tract of land, by abandonment of the easement by the dominant owner, by the cessation of the purpose for which an easement was created, and by the expiration of a specified period of time for which the easement was created.

**Encroachments**

An encroachment is a trespass on the land of another as a result of an intrusion or invasion by some structure or other object, such as a wall, fence, overhanging balcony, or driveway. The encroaching owner may obtain title to the area of the land upon which the encroachment exists by adverse possession (discussed in Chapter 4) or may obtain an easement by prescription in the case of the encroaching driveway if the owner of the land subject to the encroachment does not take appropriate legal action. Because encroachments are illegal, the owner who is being encroached upon can sue for damages (a judgment by the court requiring the encroacher to compensate the owner for the encroachment) or can petition the court for a decree ordering the encroachment to be removed.

Encroachments caused by building improvements straddling property boundaries are a major reason why lending institutions require surveys that specify the location of all improvements on the property. Typically, the existence of an encroachment is established by an accurate survey.

**Summary of Important Points**

1. Real property consists of land and everything attached to the land, including things that grow naturally without requiring planting and cultivation. Real property ownership is often described as a bundle of rights because it involves many attributes.
2. Annual crops that require planting and cultivation are personal property and are called emblements or *fructus industriales*.

3. Ownership in land includes the surface of the earth and the areas above and below the surface.

4. A fixture begins as personal property and becomes real property when attached to land improvements or the land. Since fixtures create many practical problems in real estate transactions, practitioners need to pay careful attention to this concept.

5. Private ownership of property is subject to four powers of government: eminent domain, police power, taxation, and escheat.

6. Estates involve the definition of the scope of one's interest in real property. Estates in land are divided into two groups: freehold and estates of less than freehold (leasehold). In freehold estates, one has an ownership interest in realty that lasts at least a lifetime. The nonfreehold, or rental, interests last less than a lifetime.

7. The freehold estates are the fee simple estates, which are inheritable, and life estates, which are not inheritable unless the life estate is for the life of another (*pur autre vie*).

8. The most comprehensive form of ownership in real property is fee simple absolute.

9. Life estates revert to the grantor or pass on to a remainderman.

10. The duration of a life estate is measured by the life of the life tenant.

11. Conventional life estates are created by someone's intentional act. Legal life estates, such as marital life estates, are created by operation of law.

12. A life tenant has the right of alienation, the right of encumbrance, the right of estovers, and the rights of possession and enjoyment of the property and of deriving certain income from it.

13. A life tenant is obligated to preserve and maintain the property for the benefit of the future interest.

14. Title held in the name of one person only is called ownership in severalty.

15. When title is held concurrently by two or more persons or organizations, it is called co-ownership (also, concurrent, or joint ownership). The forms of co-ownership are tenancy in common, joint tenancy, tenancy by the entirety, and certain aspects of condominiums and cooperatives.

16. Joint tenancy and tenancy by the entirety require the four unities of time, title, interest, and possession. Tenancy by the entirety is limited to husband and wife and requires a fifth unity, marriage (or unity of person), and includes the right of survivorship.

17. The owner of a condominium unit holds title to the unit either in severalty or as a co-owner with another, and she and any co-owners of the individual unit hold title to the common areas as a tenant in common with the owners of the other units.
18. The creation of a condominium requires the recording of a declaration, articles of association, bylaws, and construction plans.

19. The North Carolina Condominium Act applies to the sale or resale of condominiums created on or after October 1, 1986. This act provides consumer protection by requiring a developer to disclose certain information on new condominiums before a contract is signed, allowing the purchaser of a new condominium a seven-day right to cancel the purchase, requiring owners of resale units to disclose monthly assessments and other fees, and providing an implied warranty that the unit is constructed in an acceptable manner.

20. Ownership in a cooperative results from stock ownership in a corporation that owns a building containing cooperative apartments. Stockholders occupy apartments under a lease.

21. Business organizations may receive, hold, and convey title to real property.

22. Less-than-freehold estates also are called leasehold estates and are estates of limited duration, providing possession and control but not title (as in the case of freehold estates).

23. The leasehold estates are estate for years, estate from year to year, estate at will, and estate at sufferance.

24. Encumbrances are things that diminish the bundle of rights. They may take the form of a claim, lien, charge, or liability attached to and binding upon real property. Examples are encroachments, liens, restrictive (protective) covenants, easements, marital life estates, and deed restrictions. A lien is a claim or charge against property that may result in the loss of title through foreclosure. Restrictive covenants, lis pendens, easements, and encroachments also encumber, or diminish, the full interest in title.

25. An appurtenance is a right or privilege that results from ownership of a particular property and transfers with the title. An appurtenance depends on a principal item or the real estate. It belongs to that to which it is attached. It cannot stand alone.

26. A fee simple absolute title is freely transferable by the owner because he has the highest rights in the property, but the title may not always be free of encumbrances. Fee simple titles often have encumbrances, which pass with the title. To be effective, however, such encumbrances need to be recorded where they are easily discoverable (with certain exceptions, such as the potential for a mechanic's lien).

27. A freehold and a nonfreehold estate can exist at the same time in a rental property. The landlord retains the title (freehold) but has handed over the right of possession (nonfreehold) for a period of time.
28. Riparian rights are the rights of property owners adjoining a watercourse, such as a river. Such owners have the right to draw reasonable amounts of water from and enjoy access to the watercourse.

Boundary lines of property bordering water include the following:

a. Navigable waterway: Adjacent landowners own to banks.

b. Nonnavigable waterway:
   1. One owner owning all the land surrounding water also owns the land under water.
   2. If more than one owner owns surrounding land, each owns land to center of water.

c. Oceans or lakes where water levels fluctuate: Adjacent owners own to mean high watermark.

d. State-owned land under navigable waterway and the foreshore (land between high and low watermarks) of oceans and lakes.

29. A manufactured home can be considered either personal or real property depending on whether the appropriate paperwork has been filed.

30. To be considered real property, the manufactured homeowner must remove the wheels, axles, and towing hitch and also file an affidavit attesting to such.

31. Manufactured housing is built according to HUD standards.

32. Modular construction is built according to “stick-built” state building codes.

33. Modular construction is considered to be real property as soon as erected on the foundation.

34. The most important elements of time-share rules are given in the Key Time-Share Facts for North Carolina list on page 40 (the list is not repeated in its entirety because of length and number of points).

Review Questions

Answers to the review questions are in the Answer Key at the back of the book.

1. Personal property attached to real property is prevented from becoming real property by which of the following?
   A. value
   B. an appurtenance
   C. security agreement and financing statement
   D. mineral rights

2. Which of the following is a right in the property of another that results from ownership in a particular parcel of real estate?
   A. easement in gross
   B. appurtenant easement
   C. license
   D. condemnation
3. Which of the following is (are) correct?
   A. An easement provides a nonpossessory interest in land.
   B. The land on which an easement exists is the dominant tenement.
   C. The land that benefits from an easement is the servient tenement.
   D. All of the above

4. Easements may be created in all of the following ways EXCEPT:
   A. condemnation.
   B. dedication.
   C. prescription.
   D. assessment.

5. An easement is terminated:
   A. when the purpose for which the easement was created ceases to exist.
   B. when the adjoining dominant and servient tenements are combined into one tract of land.
   C. by abandonment of the easement by the dominant owner.
   D. all of the above.

6. If a property owner gives a specific person permission to cross his property, this is a(n):
   A. easement in gross.
   B. easement appurtenant.
   C. lease.
   D. encroachment.

7. The creation of an easement by condemnation results from the exercise of which of the following?
   A. prescription
   B. eminent domain
   C. dedication
   D. implication

8. A fee simple determinable:
   A. is an example of a nonfreehold estate.
   B. typically stipulates the conveyance is “as long as” it is used for a particular purpose.
   C. is an example of pur autre vie (for the life of another).
   D. is an example of freehold rights until the original owner’s rights are determined to be invalid.

9. If a widow inherits an estate by will granting her the right of use and possession of a parcel of land for the rest of her life, with the provision that the estate will go to her children in fee simple upon her death, she has received:
   A. an inheritable freehold estate.
   B. a life estate with remainder.
   C. a life estate pur autre vie.
   D. none of the above.

10. The highest and best form of estate in real property is which of the following?
    A. appurtenant easement
    B. defeasible fee
    C. life estate in reversion
    D. fee simple absolute

11. Estate for years, estates from year to year, estates at will, and estates by sufferance:
    A. are leasehold estates
    B. create a legal relationship between the parties of landlord and tenant
    C. are nonfreehold estates
    D. all of the above

12. Title held in the name of a corporation with many stockholders is considered to be held as:
    A. severalty.
    B. joint tenancy.
    C. tenancy in common.
    D. tenancy by entireties.
13. Which of the following types of ownership requires unity of interest, title, time, and possession?
   A. cooperative
   B. tenancy in common
   C. joint tenancy
   D. condominium

14. None of the following includes the right of survivorship in North Carolina EXCEPT:
   A. tenancy in common.
   B. tenancy by the entirety.
   C. life estate.
   D. joint tenancy.

15. The purchaser of a condominium unit receives title to the land on which the condominium is situated as a:
   A. tenant by the entirety.
   B. tenant in common.
   C. joint tenant.
   D. tenant at sufferance.

16. The purchaser of a condominium time-share:
   A. takes title for a specified time period (or periods) each calendar year.
   B. may not convey title to anyone else.
   C. has a 30-day right to rescind the purchase contract.
   D. all of the above.

17. In the cooperative form of ownership:
   A. the owner owns his unit in severalty.
   B. each owner owns an interest in the common areas.
   C. the owners own the building as tenants in common.
   D. none of the above.

18. A tenant in common:
   A. may sell her interest in the property.
   B. may pledge the entire property as security for a mortgaged loan.
   C. may not bring legal action to partition the property.
   D. has the right of survivorship in the property.

19. Ownership as tenants by the entirety includes which of the following?
   A. the right of one owner to convey title to his share of ownership without the participation of the other owner
   B. the right of survivorship
   C. ownership of an unequal interest in the property with another
   D. conversion to ownership as joint tenants if the owners are divorced

20. An encumbrance always:
   A. has a positive effect on property value.
   B. has a negative effect on property value.
   C. is a lien.
   D. none of the above.

21. All of the following are examples of specific liens EXCEPT:
   A. income tax liens.
   B. mortgage liens.
   C. mechanic’s liens.
   D. real property tax liens.

22. Which of the following statements regarding judgment liens is correct?
   A. Judgment liens will not attach to property to which title is held by a husband and wife as tenants by the entirety unless both participated in the creation of the debt and are both named as defendants in the judgment.
   B. Judgment liens have a priority over the real property tax assessment.
   C. Judgment liens have a priority over all liens other than property tax liens.
   D. None of the above.
23. Liens, easements, encroachments, and restrictive covenants are examples of which of the following?
   A. emblements
   B. estovers
   C. estates
   D. encumbrances

24. Which of the following is an estate that automatically renews itself for consecutive periods?
   A. estate at will
   B. life estate
   C. estate from year to year
   D. estate for years

25. New construction time-share properties in North Carolina require:
   A. the developer to have a real estate license before sales are made.
   B. project registration with the Commission before marketing the units for sale.
   C. all time-share salespersons must have a time-share license in NC.
   D. the purchaser to be given a right of rescission for 3 days from purchase.

26. Time-share property in North Carolina:
   A. must be for a residential use.
   B. is considered personal property.
   C. is the right to occupy a property during five or more separated time periods over five or more years.
   D. allows a bona-fide employee of the developer to sell the units without a real estate license.

27. An example of an appurtenant easement would be:
   A. city water and sewer easement.
   B. easement for a neighbor friend to cross a nearby property to access the beach.
   C. an easement for the adjoining property to have a driveway over the subject property.
   D. a railroad right-of-way easement.

28. All of the following involve ownership of real property EXCEPT:
   A. cooperatives.
   B. condominiums.
   C. townhouses.
   D. time-shares.

29. All of the following are real property EXCEPT:
   A. standing timber.
   B. underground minerals.
   C. readily movable items.
   D. naturally growing vegetation.

30. The item(s) included as real estate is (are):
   A. trees.
   B. fences.
   C. a built-in microwave.
   D. all of the above.

31. A manufactured home that is towed to the land and placed upon a permanent foundation but still has the wheels, axles, and towing hitch attached will be considered:
   A. personal property.
   B. real property.
   C. an improvement.
   D. a fixture.
CHAPTER

3

PROPERTY TAXATION AND ASSESSMENT

KEY TERMS

- ad valorem
- appraisal
- assessed value
- assessment
- market value
- mill rate
- mills

LEARNING OBJECTIVES

At the conclusion of this chapter, you should be able to:

1. Describe real property taxation and special assessment systems in North Carolina.
2. Describe the mill rate system used in the majority of other states.

IN THIS CHAPTER

The taxation on real property is the major source of revenue for the local units of government, including both the county and the city or township. Taxes are imposed on real property ad valorem, that is, according to value. North Carolina’s statute, known as the Machinery Act, sets forth the details of property taxation. A key point of the act is that it requires the assessed value, or the value placed upon property for purposes of taxation, to be set at true market value, or market value, a 100% assessment, at least once every eight years. This reappraisal of property every eight years is called an octennial reappraisal. A horizontal adjustment upward or downward may be made at the four-year interval between the eight-year adjustments.

An official called a tax assessor is responsible for the valuation of property for tax purposes. Property values must be reasonably uniform to provide equal taxation of property owners. Many property owners take advantage of an appeal process when they believe their property has been overvalued. As a practical matter, a real estate agent can expect numerous phone calls from past clients asking...
for information to support a value of their property that is less than the new assessment if they believe that assessment is higher than the actual market value. Often all they need is information on the selling prices of similar homes in their neighborhood. If they need an appraisal, the agent should refer them to a licensed appraiser.

Students will need to be prepared for questions regarding the mill rate method of tax computation and for other rules regarding assessment rates that commonly are used in other states. Such information is included in the sections Tax Rate and Calculations and Appraisal and Assessment.

**TAX RATE AND CALCULATIONS**

Each local government sets a tax rate annually to meet the needs of its budget. It does this by dividing the total assessed value of all the property subject to taxation by the amount of money needed for the budget. The rate is then applied to the assessed value of the individual properties subject to taxation. The rate must be sufficient to provide the revenue for the local government’s budget and may be changed every year. North Carolina uses the formula of a tax rate per $100 of assessed valuation. Given the assessed value of the property and the current tax rate, you can easily calculate the annual property taxes. For example, if the assessed value is $185,500 and the tax rate is $1.50 per $100 of assessed valuation, the annual tax is calculated as $(\frac{185,500}{100}) \times 1.50 = 1,855$ units of $100 \times 1.50 = 2,782.50$.

Nationally, a more common form of tax calculation involves the mill rate. A **mill rate** is a tax rate based upon one-tenth of one cent, or one mill. This equates to one-thousandth of a dollar (i.e., $0.1 \times 0.01 = 0.001$ one mill). The tax rate is typically stated in terms of “$x$” number of **mills** (i.e., 15 **mills**).

**Test Tip!**

Students need to be prepared for property tax problems using the “mill rate” when taking the national portion of the state exam and using the “tax rate per $100” in the state portion.

There are basically two easy ways to calculate taxes involving the mill rate:

1. Multiply the number of mills $\times 0.1$ of 1 cent (i.e., $0.1 \times 0.01 \times$ number of mills = mill rate as a decimal).
2. Divide the assessed value by $1,000$ and then multiply by the mill rate.
Example: What would be the tax bill for a property with an assessed value of $185,500 that has a tax rate of 15 mills?

Answer: Solution is provided by illustrating both methods just addressed.

1. \( 1 \times 0.01 \times 15 = 0.015 \) (15 mills as a decimal)
2. \( \$185,500 \times 0.015 = \$2,782.50 \) Tax Bill

OR

3. \( \$185,500 \div \$1,000 = 185.5 \) (# of $1,000)
4. \( 185.5 \times 15 = \$2,782.50 \)

Students need to understand how to compute NC \textit{ad valorem} property taxes.

Property Subject to Taxation

Generally, at some point, all real and personal property is subject to taxation in North Carolina. Most people know of several exceptions to this generalization, however, such as property owned by churches and nonprofit charities. According to new tax laws, licensed personal property (such as automobiles) is now taxed upon relicensing. The legislature also has exempted household goods from personal property taxation and eliminated the intangibles tax on funds in the bank. Additionally, special cases exist for historic and certain types of agricultural property and for the property of elderly and disabled people.

Listing Property for Taxation

All property subject to taxation must be listed with the local tax office. Real property is listed in the county where the property is located; personal property is listed in the county where the owner has her permanent residence, if this is different. The Machinery Act requires property to be listed during January, even though the localities operate on a July 1 fiscal year. In certain circumstances in which the taxing authority considers it necessary, it has a local option to extend the listing period for another month.

Appraisal and Assessment

The distinction between appraisal and assessment often confuses people. \textbf{Appraisal} is the process of determining a market value; it is discussed in detail in Chapter 13. \textbf{Assessment} is the determination of a value of the property for taxation purposes. As noted previously, real property in North Carolina must be revalued, or reappraised, at least every eight years, at which time the assessed value is set at 100% of the market value. As a practical matter, however, one would not expect the two values to be identical at times other than this revaluation,
as the property usually appreciates in value over the course of the eight years. As a result, the true market value, or simply market value, is historically higher than the assessed value, although the economic conditions of the past few years has certainly shown the assessed value can be much higher than the present market value of a given property.

In many other states, it is quite common to see the implementation of an assessed rate. The assessed rate is a percentage of the market value that is being taxed. For example, if a state is taxing property at 75% of the market value, then you would multiply 75% times whatever the market value is set to determine the value for tax computation purposes (i.e., $160,000 market value × 75% = $120,000 assessed value). Typically, if the assessed value is reduced, the amount required to be charged as the tax rate will be increased to collect the amount needed for taxes.

**Timetable for Listing and Tax Collection**

Real and personal property taxes attach to the property on January 1 when the property is due for listing. The property owner has until January 31 to list the property. Property taxes are due September 1 and are paid in arrears. Penalties are assessed at the beginning of January if taxes are not paid at that time. Many property owners think the taxes are due January 1 of the year after they are billed in September because they do not have to pay a penalty for late payment until then. All real estate agents should be aware that this is not the case; the taxes are due September 1.

**Important Dates for North Carolina Property Taxation**

- January 1 = tax lien attaches to property
- January 31 = taxable property listed
- July 1 = annual tax rate must be set
- September 1 = tax bill is due and payable
- January 5 of next year = last day to pay tax bill without late penalty

**Property Tax Lien**

In North Carolina, unpaid property taxes legally constitute a valid lien against the property as of the first day of the tax year (January 1) even though the tax bills will not be sent out until after July 1 and are not due until September 1.

As noted in the discussion of liens, the real property tax lien takes the first priority. As such, it is an exception to North Carolina’s pure race system because, in essence, the tax collector has already won the race to the courthouse, even before the others start.

"Know the following tax dates. Tax bills become a lien in advance on January 1st. Tax bills generally go out in July. The due date for taxes is September 1st. Taxes become delinquent January 1st of the following year.”

—Len Elder, DREI
CHAPTER 3 Property Taxation and Assessment

Property taxes are lawfully considered a lien as of January 1 of the current tax year even though tax bills are not due and payable until September 1.

Special Priority of the Tax Lien

Even though a lien is recorded against a property in one year, a subsequent default in the payment of property taxes years later will take precedence over the earlier recorded lien. As a practical matter, most creditors understand this situation and see to the payment of taxes so their lien priority is not disturbed. For example, mortgage lenders prefer to collect monthly tax escrow payments from the borrower so the lender has the funds to pay the taxes on time to protect the mortgage lien.

Special Assessments

In addition to the ordinary property taxes that are collected by the local government for normal operating expenses, taxes may be levied for special county, city, or town projects (such as paving streets, building sidewalks, or installing sewer or water lines) that benefit certain properties. The statutes allow a number of ways to determine the amount of these assessments. A common way is to base the assessments on the number of feet a property has that borders on the improvement. This is referred to as a “front foot” and is a linear measurement along the distance of what is being “fronted” (e.g., road, waterway, railroad).

By County

Counties have the authority to establish special assessments for new utilities to the area, such as a new water reservoir or sewage treatment facility, that benefit all properties within the jurisdiction. The statutes specify a detailed process of determining the cost of the project, publishing a notice of the intended assessment, and setting a schedule for the payment of the tax by the individual property owners.

By City and Town

Procedures also are established for cities and towns to levy and collect special assessments that are similar to those established for the counties.

Special Assessment Liens

As a real property tax lien, the special assessment attaches to the land and enjoys a high, although unique, priority. This lien is behind the real and personal property tax liens, but it takes priority over other liens.
Math Concepts for this Chapter

- Calculation of ad valorem property taxes given the tax rate and assessed value.
- Students should be able to perform calculations by using BOTH the North Carolina rate of “per $100” or the mill rate (National Exam section).

Tax Calculations Using North Carolina Tax Rate

1. Kevin's property has an assessed value of $178,500 and is being taxed at the rate of $1.15 per $100. What would be the amount due for annual taxes for this property?
2. Renee has a house located within the city limits that has an assessed value of $145,000. The tax rate per $100 is $0.85 for the city and $0.50 for the county. What are her annual taxes for this property?

Tax Calculations Using Mill Rate

3. Pam has a property that is assessed at $225,500 and is being taxed at the rate of 15 mills. What are the annual taxes due for this property?

Solutions

1. $178,500 ÷ $100 = 1,785 number of $100 increments
   $1.15 × 1,785 = $2,052.75 annual taxes due
2. $0.85 + $0.50 = $1.35 tax rate per $100 for city and county
   $145,000 ÷ $100 = 1,450 number of $100 increments
   $1.35 × 1,450 = $1,957.50 annual taxes due
3. $225,500 ÷ 1,000 = $225.50
   $225.50 × 15 = $3,382.50 annual taxes due

Summary of Important Points

1. The Machinery Act established the rules for property taxation in North Carolina.
2. The assessed rate for property in North Carolina is 100% of market value.
3. The assessed value is the value placed on property for purposes of taxation. Historically, the assessed value will be less than the active market value.
4. Tax rates for North Carolina are per $100 of assessed value.
5. Students will be required to calculate property taxes by using both the North Carolina system of “per $100” as well as the mill rate method.
6. Tax rates can be changed annually. Do not confuse this with the fact that tax values are to be adjusted at least every eight years.
7. Tax values may be modified every four years by using a horizontal adjustment. A horizontal adjustment is different than the eight-year reappraisal in that a horizontal adjustment simply applies a set percentage increase for all properties in the affected area. For example, if the county wishes to implement a 20% horizontal adjustment, all properties in that area will be increased in value by 20%. The eight-year reappraisal is more of a “door-to-door” analysis of property value.

8. Property that is owned as of January 1 of each year is to be listed for tax purposes no later than January 30.

9. Tax bills must be mailed out by September 1, at which time they are payable.

10. Taxes are to be paid by December 31. There will be interest penalties charged if taxes are not paid by January 5 of the following year.

11. An assessment is the pro rata share of the cost of some improvement, such as sidewalks, water and sewer lines, and street improvements.

12. Assessments typically are charged by the front foot.

13. A front foot is a linear measurement of the width of the property along the side that is being improved.

14. The mill rate system is used for most states in the United States.

15. One mill is the equivalent of 0.1 of 0.01.

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**Review Questions**

Answers to review questions are in the Answer Key at the back of the book.

1. The tax levy against real property to provide the funds to pay all or part of the cost of an improvement to the property is which of the following?
   A. mechanic’s lien
   B. special assessment
   C. general lien
   D. judgment lien

2. Real property taxation in North Carolina:
   A. requires listing the property by December 30.
   B. makes September 1 the due date of the tax.
   C. requires penalties for paying after September 1.
   D. none of the above.

3. How often may the North Carolina property tax rate be changed?
   A. every eight years
   B. every four years
   C. every two years
   D. each year

4. The Jones’s home has an assessed value of $100,000 in a locality where the tax rate is $1.45 per $100. What is their monthly payment for tax escrow?
   A. $83
   B. $100
   C. $121
   D. $1,450
5. The tax rate is calculated on every $100 of the:
   A. sales price.
   B. appraised value.
   C. listing price.
   D. assessed value.

6. According to the Machinery Act in North Carolina, all real property must be reassessed for tax purposes at least:
   A. every year.
   B. every two years.
   C. every four years.
   D. every eight years.

7. Kim's house is located within the city limits and has a market value of $240,000. The local tax office is assessing her property at 75% and there are tax rates per $100 of $0.95 for the city and $0.35 for the county. What are her annual taxes for this property?
   A. $1,710.00
   B. $2,280.00
   C. $2,340.00
   D. $3,120.00

8. Carol's property has an annual tax bill of $1,495.00 and an assessed value $130,000. What is her tax rate per $100? (rounded)
   A. $11.50
   B. $1.15
   C. $0.87
   D. $0.01

9. A municipality has total assessed value of property located within its environs of $18,057,000. They have recently adopted an annual budget of $162,513. At what rate per $100 must they tax the local properties in order to meet this budget?
   A. $0.90
   B. $1.14
   C. $9.00
   D. $11.43

10. George's property recently sold for $235,000 and has an assessed value of $215,000. If the local tax rate is $1.40 per $100 how much would the annual taxes for this property be?
    A. $3,290
    B. $3,150
    C. $3,010
    D. $250.83

11. A parcel of land is being taxed at a rate of 25 mills. Assuming that it has a market value of $175,000 and is being assessed at 70%, what would the annual tax liability be?
    A. $4,900.00
    B. $4,375.00
    C. $3,062.50
    D. $1,225.00

12. A parcel of property (not a corner lot) that measures 95 feet wide by 175 feet deep is being assessed $8.50 per front foot for water and sewer lines that are being installed. How much will the assessment be for this particular property?
    A. $2,295.00
    B. $1,615.00
    C. $1,487.50
    D. $807.50

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