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Attorney Representation in a Real Estate Transaction

When a law firm represents a party in a real estate transaction, it performs many separate functions. These are usually either administrative or legal in nature.

Some examples of administrative tasks are: making arrangements for the closing, preparing financial summaries of the transactions, gathering information on taxes, ordering releases and similar tasks. These duties are often delegated to our law firm's professional staff of paralegals and secretaries who carry out these responsibilities capably.

However, in a real estate transaction there are a series of functions which require an attorney's professional expertise. An attorney can have a significant role in advising you in the following areas:

The Brokerage Contract or Listing Agreement. If you are selling your home, an attorney can provide advice on the terms, meaning and items included in these contracts. It is also important for buyers to be aware of the description and contents of the structure being purchased.

The Preliminary Negotiations. While price is often paramount in the minds of the parties, there are a number of other issues to consider such as terms of payment, mortgage contingency clauses, the status of fixtures or personal property, the risk of loss by casualty pending the closing.

The Purchase Contract. Once the parties enter into a written contract, their rights and obligations become fixed. It is the most important document in the entire transaction and will be scrutinized by the attorney.

The Mortgage and Financing Commitment. Interest rate and term (or length of the mortgage), while important, are not the only issues involved in mortgage financing. Points, commitment, service charges, prepayment penalties and a host of other influences are worthy of consideration and advice.

Determining the Status of Title. This is generally the most crucial legal work in the transaction. Even if a title insurance policy is to be issued, it is critical that any limitations in the title be determined and explained.

Eliminating Title Problems. In some instances, if a problem exists in the title, some type of action may be available to cure the problem. Your attorney can initiate or review any such action.

Survey. If a survey of the property is required, we can advise you on the legal implications of the surveyor's findings and the scope and extent of the surveyor's certification.

Inspections. In some instances, one or more inspections, e.g., for termites, radon, water quality, smoke detectors, may be required or desirable. An attorney's advice can be useful in determining the scope of such inspections and the methods of dealing with any problems that might be discovered.

Drafting of Instruments. It is the attorney's responsibility to draft or review the necessary instruments of conveyance. In some cases, a lender will retain its own counsel to prepare the mortgage and note but your attorney, of course, will be responsible for reviewing these when you are the borrower.

- **The Closing.** This is the stage at which the parties execute and exchange documents, make required payments and conclude the formal transaction. The law firm will attend to virtually all of the details surrounding this aspect of the transaction, including alerting you in advance of the items you will need to provide, many of which are discussed elsewhere in this booklet.
- Since some of the customs surrounding real property transactions vary in different areas, an attorney may not be performing a particular function in your case. For example, if you have already executed a contract for the sale or purchase of a home before retaining our firm, an attorney may be unable to subsequently change the terms of the contract.

The Listing Agreement

A listing agreement is a contract between the sellers and their broker wherein the sellers agree to compensate the broker for services performed in offering the property for sale and procuring a buyer. In addition, the listing agreement contains a general description of the real property to be sold and a specific description of the contents of the home, e.g. range, washer and dryer, etc., which are or are not included in the sale. It is therefore important that both prospective sellers and purchasers be clear about what is or is not included in the sale.

The Purchase Contract

In many states, in order to be a valid and enforceable contract, an agreement to purchase real property need only describe the property generally, contain the terms of sale, e.g., price and payment, provide for a specific closing date and be signed by both buyer and seller. This agreement is the most important document in the entire transaction. In some areas buyers and sellers execute these agreements without the aid of attorneys, using forms provided by real estate brokers. In other areas, it is the custom to execute a "binder" designed to hold the property from

sale to another pending the preparation by attorneys of a formal contract. Where a party executes a contract before consulting with an attorney, it is generally beyond the attorney's power to change or modify the terms of the contract except by mutual consent of the parties. Therefore, whenever possible, it is desirable to consult with an attorney prior to entering into any contract.

Finally, certain types of contracts, such as those involving the purchase of a unit in a condominium or other common interest community, are governed by laws requiring the disclosure of specific information and the rights of such purchasers.

Among the items to be negotiated in a purchase contract, in addition to the price, are the type of mortgage (e.g. conventional VA, FHA, etc.) the buyers will need as a condition of purchasing (i.e., the "contingency clause") and how long they will have to obtain a commitment from a lender to provide such a mortgage. Other items include date of occupancy, the type and effect of inspections to be done, and the responsibility for loss in the event of catastrophic damage to the property.

Financing Commitment

The commitment or approval letter is the most important document a borrower receives from the lender prior to closing. It informs the borrower that the loan application has been approved and that the bank has committed itself to lending the requested funds. However, this obligation is often conditioned upon certain requirements that must be met before or at the time of closing. Some of the typical requirements are: (a) explanation of any unfavorable item in a credit report; (b) verification of the borrower's employment; (c) provision of a survey; (d) homeowner's insurance; (e) termite or other inspections; and (f) proof of necessary cash funds to close the transaction.

The commitment also sets forth the basic terms of the loan (fixed or variable rate, etc.), and the loan-associated fees (e.g., points) to be charged by the lender. The lender may require that the borrower sign and return a copy of the commitment or approval letter within a specified period in order for the loan commitment to be binding.

Since most purchase contracts are contingent upon the buyers' obtaining financing by a specific date, it is essential that the attorney be informed as soon as the commitment is received. At that point, the contract becomes unconditional, and all parties and their attorneys can begin the necessary preparations for the closing. Of course, the attorney should be notified immediately if the lender declines or rejects the loan, since this can affect the buyers' liability under the sales contract.

Determining the Status of Title

A purchaser of a parcel of real property acquires the legal right to own and use that property. These legal rights, known as "title", may be subject to certain rights that were established by previous owners of the property. Only a thorough title search will reveal these rights, restrictions or other interests and permit the attorney to show how they might affect the use and ownership of the property. The title search is accomplished by reviewing prior deeds and other documents

recorded in the land records where the property is located for a specific period back in time. A title search discloses the previous owners of record and those burdens, benefits or other interests each has subjected the property to during their respective periods of ownership.

The attorney will report the outcome of this search to the client and explain any outstanding interests or encumbrances. In some instances, encumbrances of record act to benefit rather than burden the property. Such items might include easements for public utilities, restrictive covenants which protect the character of the area and zoning regulations. Outstanding financial interests of record such as mortgages or liens will have to be released at the time the new buyer acquires title, unless some other arrangement has been agreed to by all parties concerned.

In the event that any title problems are discovered, the attorney will attempt to cure the problem or to work with you to help reach an equitable solution with the other party prior to the transfer of title at the closing.

Survey

Lenders often have specific rules regarding whether or not a survey of the property will be required as a condition of the loan and, if so, the type of survey that is acceptable. These requirements may or may not be sufficient to protect the new owner's interests. Buyers or current owners may want to obtain a survey in order to clarify their interests. Therefore, it is important that property owners be made aware of the various types of surveys and their costs. Attorneys can assist clients in making such decisions by comparing the price of each type of survey to the protection afforded.

A current survey is usually required in order to include "survey coverage" in an owner's title insurance policy. Information on title insurance and its function in the transaction is provided elsewhere in this booklet.

Inspections

Prior to closing, it is common for lenders to require inspections of the premises for various types of conditions in order to ensure that the structure is sound and that its systems are in good working order. Buyers may also request inspections to make certain that the structure and its operating systems and appliances do not have any critical defects that were not known at the time they decided to purchase the property.

Some of the many inspections that can be performed are as follows: *Septic Inspections* - The waste system is inspected by an engineer to verify the good working order of waste disposal; *Well Water* - Tests can be performed by engineers to ascertain the quality of the water servicing the premises; *Engineering* - An engineer examines structural soundness and describes electrical, plumbing and similar systems; *Pest Inspections* - Private contractors inspect the premises for infestation and possible damage caused by termites and other pests.

Lenders often require additional inspection when making particular types of loans. *Construction Mortgage* - When lending funds for new construction, the lender will require an inspection upon

the completion of each phase of construction before disbursing funds for the next phase. *New Construction/Permanent Financing* - If recently constructed, the lender may require verification that the construction is complete and that the premises are suitable for occupancy.

It is advisable for the buyer to reinspect the premises immediately prior to the closing to be certain that it is essentially in the same condition as it was at the time the contract was executed, that no significant damage has been done to the premises in the intervening time and that the fixtures and items to be included in the sale have not been removed from the premises.

Pre-Closing Arrangements

There are various types of insurance which are frequently purchased in connection with the acquisition of real estate, some of which are often required by lenders as a condition of the loan. You may also wish to purchase insurance to protect your interests. Below is a list of some of the most common types of insurance and a discussion of their purposes.

Homeowner's Insurance: This can protect both the lender's interest and your interest. The coverage afforded by the homeowner's policy includes personal liability, theft, and hazard protection other than flood. The lender will usually require coverage equal to the amount of the loan. To protect your interest, coverage should at least be equal to the replacement value of the house. In most instances, the lender will require proof of payment of the first year's premium, along with a copy of the policy at the time of closing.

Title Insurance: Separate policies are available to protect the lender's interest and your interest. Coverage afforded by title insurance is different to each of the insureds based upon their interests in the title. The lender will receive coverage based upon its mortgagee interest in the property. The amount of coverage is based upon the amount of the loan.

You, as the owner, can also receive coverage based upon your interest in the property. A complete discussion of an owner title insurance policy is covered elsewhere in this booklet.

The one-time premium for title insurance is paid at the time of closing. The lender will require a policy to cover the amount of the loan and, if the loan involves negative amortization, may also ask to be insured for a specific amount over the initial amount of the loan.

Virtually every lender requires title insurance in connection with first mortgage loans. The expense is borne by the borrower.

Private Mortgage Insurance (PMI): This type of insurance protects the lender against loss due to default by the borrower. It is generally required whenever the loan amount exceeds 80% of the fair market value of the property being purchased and may also be required in other instances. The requirement for this insurance is usually waived after the loan has been reduced to a specific level. The first year's premium may be required to be paid on the day of closing. In some instances, the lender may require that you purchase additional insurance to protect against specific hazards.

Flood Insurance: If the property being purchased has a building or other structure located in an area subject to flooding, federal law prohibits the lender from making any loan secured by a mortgage on the property unless the borrower purchases flood insurance. This insurance must be renewed annually (but can be paid up to three years in advance) and is usually purchased in an amount equal to the loan. The program for flood insurance is sponsored by the federal government.

Adjustments

There are many miscellaneous, ongoing expenses associated with home ownership. Such expenses may include one or more of the following: real property taxes, sewer assessments, fire district taxes, water, heating oil and common expense assessment (for condominiums). It is likely that a seller will have paid some of these items in advance, covering a period of time that extends past the date of closing, i.e, the date of transfer of title. Therefore, adjustments will be made to reimburse the seller for expenses paid in advance that will relate to a period of the buyers' ownership of the property. Many of these items have different payment periods.

There will also be instances when items are not payable until after the period of use or service has passed. In that event, the seller will reimburse the buyers for expenses the buyers will incur after the closing which relate back to the period of the seller's ownership. There may also be adjustments for miscellaneous expenses that may have been negotiated between the parties during the pre-closing period. For instance, the seller may agree to do some repair on the house or substitute an additional item (such as a fixture) in lieu of having to do repairs, or there may be an agreement to reimburse the buyers for the cost of having the repairs completed after the buyers take ownership. All of these arrangements or agreements should be reported to us prior to the closing in order that they can be included in the financial calculations and adjustments that we prepare prior to the closing.

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