

**A Primer on Real-Estate
(With Wisdom from Downton Abbey and Detroit)**

By John Sase, Ph.D.

"A lot of Americans think they got a tax cut and they didn't because their local Property tax went up, their excise tax went up, their sales tax went up, and their prices went up, and everything else because we failed to invest in some of these other things we ought to be doing."

--John Kerry, United States Secretary of State

Isobel Crawley [about the village hospital]: "Who funds it?"

Violet Crawley, Dowager Countess of Grantham: "Oh, good, let's talk about money."

--Downton Abbey (BBC-TV)

In the companion article "The Grand Bargain," we summarized and clarified the oral opinion presented by Federal Judge Steven Rhodes on the Grand Bargain for bankruptcy settlement in the case of the City of Detroit. In the wake of this decision, we turn to the recovery of the city in this article.

Viewers of the BBC series Downton Abbey that is shown on PBS will recognize the jewel of a house on an agricultural estate that continues to struggle in order to pay its own way. We can draw a parallel between this fictional estate and Detroit, "the Paris of the Midwest."

Like Detroit, one of the main productive resources of Downton Abbey is its real estate. Where Lord Grantham depends upon agricultural production and rent from tenants to keep afloat, the City of Detroit relies upon tax revenue from properties within its jurisdiction in order to achieve this goal.

Therefore, knowledge of the basics of Real-Estate Law and Economics is essential due to their integral role in the process of generating the property-tax income that is needed to support and regrow the infrastructure of Detroit.

Every attorney and economist in this region should understand these matters because the currently resolving Detroit bankruptcy may affect the work of attorneys and others for whom Real Estate is not their specialty.

We will discuss Real-Estate Economics and the concept of Real Estate, including

Titles and their attributes;

Types of Tenancy and Properties;

Definition by Measurement, using the Survey Township as the standard;

Possession of a property;

Deeds and their conveyance from giver to receiver;

Use of restrictions imposed both privately and publicly; and

Mortgages, both how they are transferred and how they affect the larger financial markets.

Traditional Definition

Let us start with the field of Real Estate. How can we define it? The elemental concept of real estate--the American tradition of property rights--is derived largely from the Anglo-Saxon tradition.

Most directly, this concept of real estate traces back to Nordic cosmology, early informal English tradition, Saxon common law, and the English Magna Carta.

Real estate involves the bundle of rights that we may have in respect to property. This bundle of rights extends beyond the land and the structures built upon it.

It extends upward in the air, downward through the core, and outward to the seas. Let us begin with a simple visualization of real estate by starting along a shoreline. By doing this, we can experience four of the elements of nature—sea, earth, air, and core.

We can visualize property by looking down a beach at a point on the horizon. To one side, we view the sea and to the other side the earth. Above, we observe the space taken by the air.

Focusing our attention downward beneath the surface, we recognize the core. Where we stand is the intersection of these four elements of nature.

Next, let us face inland and imagine a horizon line. Above this line, we view the sky, which aids us in determining air rights (the height of buildings, airplane flight-paths, etc.).

Below the horizon line, we view the ground as the surface of all of the earth, upon which we define land rights and use. Likewise, the core below the ground helps us to define water, mineral, and other rights such as those involving fracking.

Turning 180 degrees in the opposite direction, we face away from land and out to sea. Again, we can mark a horizon line with the sky above and the sea below.

Standing on the shore on a clear day, we can recognize larger objects that appear as far out to sea as twelve miles, due to the curvature of the earth. The application of the principle commonly known as Line of Sight helps us to define the delineation between sovereign states and international waters.

Titles

Now that we have a general picture of real estate and its major elements in nature, we turn to the bundle of legal rights and documents that we have developed in most parts of the world. Let us begin with the concept of Titles and the various documents related to it.

The Title equals the Estate minus the Tenancy. Therefore, we can define Real-Estate Title as a bundle of rights that includes the rights of Disposition, Use, Possession, and Exclusion.

Let us begin our discussion of titles with the most common one known as a "Fee Simple." Generally, ownership of residential property is by Fee Simple.

The Fee-Simple Title reflects a bundle of rights, including the right to 1) "dispose" of the property by selling or giving it away; 2) "use" of the property; 3) "possession" of that property, which is what the Title is about; and 4) the ability and right to "exclude" others from using said property. We can abbreviate these rights with the acronym DUPE.

The Differences between Real Estate and Real Property

Often, we bandy about the formal terms Real Estate and Real Property and use them interchangeably. In actuality, what we call Real Property exists as the combination of the Real Estate and the Title (Real Property = Real Estate + Title) and serves as the basis of Freehold Tenancy, the type of tenancy that has an indefinite duration of time.

Freehold-Estate Tenancy may extend perpetually and can be passed from one party (one generation) to another. Most commonly, the Freehold tends to possess a Fee-Simple Title.

Alternately, the tenancy may be a Life Estate for which someone has the right to remain on a property (in a house) until s/he passes away. After this event, property is turned over to another party by prearranged agreement. This second party is referred to as the Remainder Man (Person).

A Non-Freehold extends for a limited duration, the length of time that a person may hold it. Therefore, it is Non-Freehold. Generally, we refer to this type of hold as a Leasehold, which requires a lease-contract that specifies a set duration of time.

This Leasehold resembles the Fee-Simple Title, except that one of the four property rights in the bundle of rights is excluded. This excluded right is the one to dispose of the property--to sell or give it away. However, the rights to use, to possess, and to exclude others from using it still apply under this Leasehold.

The Non-Freeholder enjoys the property for a limited duration of time because the Leasehold excludes the right of disposition. In summary, Leasehold rights differ from a Freehold bundle of rights, which include disposition, use, possession, and exclusion. Therefore, the Freehold Estate equals the Title, which in turn equals this bundle of rights to the property.

Tenancy

Next, let us consider types of Tenancy along with types of properties. Tenancy in Severalty involves a number of people. Commonly, it includes a legal partnership or a married couple and specified heirs for that tenancy.

Typically, this tenancy constitutes Joint Estate for which there is the Right of Survivors. Anyone included in this tenancy who survives has the right to

continue the tenancy and to enjoy its Fee-Simple Title with its four-fold rights of property. Similarly, in the related Tenancy by Entireties, the Right of Survivors is the same.

Properties

Types of property include Business, Residential, and Agricultural Property. Business Property may be service sector, industrial (generally manufacturing), or commercial (both wholesale and retail). Residential Properties are defined as properties of four or less units or vacant land that is zoned for residential use.

Also, this type of property includes ten or less acres of agricultural land. Commonly, acreage that is this small lacks the natural conditions to provide a sustainable working farm. Agricultural Property is defined as land that may be an operating farm or undeveloped land not zoned for any economically higher use.

Survey-Township Measurement

To define Real Estate by measurement in the United States, we use the Survey Township as our basic standard. With exceptions that are based upon surveys under alternate systems, we have used this definition since the early nineteenth century.

The standard Survey Township measures six miles by six miles square (thirty-six square miles encompassing 23,040 acres).

To measure large tracts of land by township, we start by establishing a baseline and a meridian line, striving to center the intersection of the two lines. For example, the Michigan Meridian, which extends southward from Sault Sainte Marie through Ohio, was established in 1815.

For the Michigan survey, the baseline that extends across the state to Lake Michigan (Baseline Road or Eight-Mile Road) was established eight miles north of Detroit, which was then the state capital.

However, if we inspect a map of Detroit, we can see two major anomalies. The first occurs on the east side of the city and along much of the riverfront.

This land was originally surveyed by the "French-lot" system (strip farms) when the region was a colony of France. The original deeds for these surveyed properties were established at that time of development.

The second anomaly appears as a rectangle of streets offset on an angle that follows Woodward Avenue from the city center. Known as the Ten-Thousand Acre Tract, it was granted to the city by Congress (before statehood) after the fire of 1805.

Michigan attained statehood in 1837. Not long after, the survey and platting (mapping and coding) of the regions to the north and west of these anomalies were completed under the Public-Lands Survey in the 1840s.

The Survey Township (six miles by six miles, thirty-six square miles containing 23,040 acres of Property) serves as our standard unit of measurement.

In order to understand how the Real-Estate Market works, we need to discuss the process of Subdivision. Therefore, let us consider how we further subdivide a Township.

The first level of Subdivision produces thirty-six square-mile sections. As a result, each section is one square mile and includes 640 acres.

The State of Michigan established a system of roads based on these sections. The system of east-west mile roads and north-south roads set a mile apart from one another serves as the primary surface-road system within the city and beyond.

If we subdivide each square mile into quarter-sections, each of these quarter-sections measures one quarter of a square mile and contain 160 acres.

Another system of narrower and less commercial roads has been set at the half-mile points within the mile-road system that bounds the Sections. The boundaries of these quarter-sections are one-half mile by one-half mile.

The process of further subdivision of the quarter sections has occurred under the authority of local governments. The next standard subsection is a sixteenth of a section, a sixteenth of a square mile and 40 acres in size.

Traditionally, this has been considered as the size of a workable family farm. In urbanized areas, developers have subdivided the quarter sections into

forty-acre sixteenth sections for residential- and business-Property development.

The placement of streets and the size of individual residential and business lots within the subsections have varied in size at the discretion of developers.

Possession of Property

Matthew Crawley: "Downton is being mismanaged and something must be done. The thing is, how do I do it without putting people's noses out of joint?"

--Downton Abbey (BBC-TV)

Possession of property is one of the four basic rights in the Bundle of Rights. In discussing this right, we need to address the transfer issue of Voluntary Alienation, the giving up of the right to possess land voluntarily.

This action is accomplished through an instrument of conveyance (transfer) of these rights through a deed or will.

Conversely, Involuntary Alienation occurs when a person dies without a will. In such cases, the property goes to probate and the court determines ownership.

In some cases, a person dies without a will and without heirs. In this kind of case, which is referred to as Escheat, the property is deeded over to the State Government.

Involuntary Alienation also can include situations involving Eminent Domain and Condemnation by Eminent Domain in which a government may take over a property if it pays a fair value for the property.

The government may do this regardless of whether or not the present owner wants to keep the property. Usually, an Eminent-Domain action is taken for some larger public purpose, such as the construction of an expressway.

Our next transfer issue is Adverse Possession, which may be Open or Hostile Possession without permission. This may include matters of taxation. If taxes on the property are in arrears, the county or municipality of jurisdiction can take over the property and sell it.

In Wayne County and the City of Detroit, this type of Adverse Possession has left both governmental bodies with an excessive quantity of unproductive properties in respect to tax revenue.

This remains the major post-bankruptcy issue for Detroit, an issue that affects the county as well.

Currently, both governments hold a large number of seized properties as well as properties that are in active tax foreclosure or are in arrears. Due to this fact, these governments are unable to collect their major traditional source of operational revenue.

Clear Adverse Possession may occur if there is a legitimate claim on the title. Flagrant Possession can occur by a party moving in and occupying the land. However, it may be that a property exists where there is no apparent claim.

In such cases, if a person resides at that property for seven years (squatter's rights by common law), then that person may claim ownership to what otherwise would be considered an abandoned property.

"OR" and "EE"

Let us return to Voluntary Alienation. In order for the transfer to occur, this alienation requires an instrument of conveyance in the form of a deed or sometimes in the conveyance of a title. Before we move more deeply into this matter of transfer, let us clarify the names and roles of the two principal parties.

The giver represents "the origin;" therefore, his/her name ends with "OR." The receiver is "the end-recipient;" therefore, his/her name ends with "EE." The instrument of the title or deed is given by a Grantor to a receiver, who is known as the Grantee.

Lien vs. Title Theory

Two different theories of Title Rights exist throughout the United States. Depending on the individual State, we see the application of one of these theories--Lien Theory or Title Theory.

Generally, the specific theory indicates which of the two parties has the predominant right over the property.

In a Lien-Theory State, the Grantee (the Mortgagor or buyer of the Property) maintains legal control. In a Title-Theory State, the Mortgagee (the lender) maintains that control. Half of the States (including Michigan) adheres to Title Theory.

Deeds and Their Conveyance

The Deed is an instrument of conveyance for the transfer between two parties. One party is the giver, the other the receiver.

The giver who is the Grantor (most likely the seller) gives the Deed to the Grantee (who is the buyer).

For example, the transaction may involve a Sale-by-Owner property. In such a case, that For-Sale-by-Owner gives the Deed or Title (or both) to the borrower, who is the receiver.

The Deed is a recorded Constructive Notice. Therefore, a Constructive Notice is a written document that is filed as a public record.

Historically, an actual notice is oral. By tradition, a person would stand in the middle of a village while all of his/her neighbors would gather about. Then, s/he would proclaim, "I now own [a specified piece of] property" and describe it to the townsfolk.

This kind of notice is neither written nor filed. Therefore, an actual notice is an informal notice.

A number of different types of deeds exist. The following are some of those that we encounter most often:

Bargain-and-Sale Deed for conveying real property without covenants. This is a deed for which the Grantor implies to have or have had an interest in the property but offers no warranties of Title to the Grantee.

Quit-Claim Deed, in which the owner/grantor terminates ("quits") any right and claim to the property but does so without Title Covenant or warranty.

Special-Warranty Deed, in which the seller warrants or guarantees the Title only against defects arising during the period of his/her tenure or ownership of the property.

General-Warranty Deed conveys the property with certain (standard) covenants and warranties. The Grantor is bound legally by these warranties, whether written expressly into the deed or implied by statutory language.

Free-and-Clear Deed, which warranties that the property is free of liens, encumbrances, and legal questions as to ownership.

Essentially, these instruments are what the names suggest. Deed requirements state that there must be a premise. In other words, there must be a grantor and a grantee and some interchange between them.

In addition, there is what has come to be known as the Habendum Clause or the Seisin Clause (a term that traces back to the Middle Ages). This clause means to have and to hold the property with some consideration of value given.

In summary, a valid deed must be signed by the grantor along with two witnesses, offered voluntarily by the grantor and accepted voluntarily by the grantee.

Encumbrances (or the Lack Thereof)

As this term emerges repeatedly, let us consider the matter of Encumbrances. If no encumbrances exist, then the property (i.e. the deed) is free and clear.

This means that there are no liens upon it, such that no financial obligation remains when the property is sold. Therefore, no party can claim a portion of the sale price in order to pay off a lien.

As an example, a home has an accumulated past-due water bill. When the seller receives payment for the house at sale, the water department may step in and make its claim for reimbursement.

Deed Conveyance

As we have seen, a deed is an instrument of conveyance between two parties, the giver and the receiver. Let us look at the transaction that occurs between giver and receiver.

The giver is a grantor and also the seller. In contrast, the receiver is the grantee and the buyer of the property. Therefore, the giver tenders a note to the receiver, the borrower.

By doing this, there exists recognition of entitlement for the basic rights of disposition, use, possession, and exclusion.

For example, if a buyer makes the winning bid on a city-owned property at a city auction, the city is the grantor and the buyer is the grantee. The grantee would now own the piece of real estate and have the obligation to pay the semi-annual taxes on it.

Furthermore, there are conditions of a title that need to be considered.

We refer to the first condition as the Chain of the Title, a path that sometimes traces back to an original land grant. An uninterrupted chain must be established for the title passed from one party to the next.

This assurance is made through a Title Search, summarized in a document known as the Abstract of Title. The abstract is accompanied by an Opinion document as to the quality of the search in respect to the cleanliness of the deed and the passage of the title.

Title Insurance

Title Insurance plays an important role in all of this business because it protects the buyer and the lender. For buyers, the insurance protects them for the amount of the purchase price.

For lenders, it protects them in terms of the loan amount. Title Insurance protects both parties in cases of forgeries that may have occurred in the present day or the distant past in respect to both the deed and the title.

Restrictions

Restrictions of Use for a property may be either public or private. The private restriction may exist in the form of a Deed Restriction that is written into the deed or some restrictive covenant that is added to it.

For example, there may be a restriction placed in terms of the type and number of structures that may be built upon the property.

Government restrictions may involve zoning laws that determine how a property may be used. For example, a local restriction may prevent a person from giving piano lessons in his/her home.

In addition, government actions include the right to tax property as well as the right of Eminent Domain. Such actions place restrictions on a piece of real property. If a deed-holder does not pay the property taxes, s/he may forfeit this property to the government.

Encroachment and Easement

Encroachment and Easement involve adjacent properties and the rights of the adjacent-property owners. Encroachment occurs when one person uses a property belonging to someone else, such as moving a fence onto that property without the expressed permission of the owner.

An Easement is just the opposite. Here is an example: You open your car door in a driveway and gets out onto a strip of lawn that belongs to a next-door neighbor. The neighbor, screaming "Get off my property," turns a hose on you. Who is right in this case? Generally, you would be, because a one-foot Easement is allowed.

More on Mortgages

Let us look at mortgages in a little more depth. A mortgage tells us that the Mortgagor, the buyer, provides the lender with a guarantee for the full repayment of the loan.

For the two parties involved in such transactions, we again have a giver and a receiver. One party gives a Promissory Note and mortgage to the

Mortgagee, the lender that often is a bank. This second party is the note-holder, who gives loan money to the note-giver, the party that is the buyer.

The monthly payment for a piece of property usually is a fixed amount. Of this amount, part of the payment is principle and part of it is interest.

At the beginning of a mortgage, most of this monthly payment is interest. Very little of the payment reduces the principle and pays down the balance of the mortgage loan. As we proceed to the years near the end of the mortgage, most of that fixed payment then becomes principle.

A mortgage is made up of different payments. Together, the principle and the interest are referred to as to as Debt Service.

However, in most mortgages, there are taxes that are paid along with property insurance. Both items are paid by the borrower into an impounded fund called an Escrow Account. Drawn from this account, these items are included as part of the time payment.

They are held in escrow and then dispersed to the Mortgagee.

Therefore, the mortgage payments include Debt Service and Escrow-Impound Payments. Together, these two items comprise the total amount that is paid over time.

Commonly, this total is referred to by the acronym PiTI (pronounced "pity"). It includes Principal, (i)nterest, Taxes, and Insurance.

A promissory note (an obligation to pay) is signed by the Mortgagor, who borrows money with the promise of paying it back. The mortgage is recorded and becomes a security instrument in respect to the property.

The mortgage is a Voluntary Lien that ensures that the lender will get paid. It is signed by the Mortgagor, the borrower. As a document, it can facilitate the act of foreclosure.

When mortgages enter the financial market in clusters, they often get bundled into other financial instruments that can be resold multiple times, creating a nightmare of confusion as to the identity of the legitimate lender. Careful tracking of these documents has become increasingly critical.

Over the past decade, this document-tracking has been widely abused. This has led to many people losing their homes and businesses unjustly.

In the first decade of the 21st Century, lenders turned to the issuance of sub-prime mortgages (high-risk mortgages with very little security) to a large degree. Potentially, these sub-prime mortgages can earn a higher amount of interest because of the risk.

However, most of these Mortgaged-Back Securities collapsed, causing the downfall of Lehman Brothers along with deep problems for other Wall Street firms in September 2008.

Due to the number of sub-primes made in Detroit, this collapse contributed to pushing the city into bankruptcy.

A Farewell to ARMs?

Traditionally, Prime Mortgages have been the conservative instrument of choice for banks. Lenders tend to like this standard mortgage because of the low risk.

However, Prime Mortgages do not carry the highest rate of interest. Therefore, in terms of the gamble involved, these mortgages are not desirable for investors in the realm of Hedge Funds and other less-conservative investments.

With a shift to these higher-risk instruments, Adjustable-Rate Mortgages (ARMs) appeared. With ARMs, the interest rate on a mortgage rises or falls with prevailing baseline-interest rates that are set in accord with the London Inter-Bank Offer Rate (LIBOR).

As a result, ARMs have the potential to put borrowers below water (such that the value of the property is decreased to below what is owed on the Property) as the interest rates on their mortgages increase. Under these circumstances, there has been a greater tendency for buyers to abandon their properties.

In Summary

Tom Branson: "Sometimes a hard sacrifice must be made for a future worth having."

--Downton Abbey (BBC-TV)

In this column, we have discussed the field of Real Estate and its relation to the tax base of Wayne County and the City of Detroit.

We looked at titles and the attributes of these documents and the types of tenancy and properties.

We defined and measured property in terms of the unit of the Survey Township.

We discussed possession of property by different means and looked at deeds and their conveyance from giver to receiver.

We discussed the restrictions of use of property.

Finally, we addressed mortgages and the role that they play in the wider financial market.

The loss of private ownership through abandonment or otherwise translates into a loss of tax revenue, the primary income of a city. Without this income, Detroit cannot support itself and survive.

We hope that our readership of attorneys, economists, and others are better equipped with the methodology of Real Estate for application in their professional practices as well as the knowledge to carry on informed discussions.