

CHAPTER 01

AGENCY – FIDUCIARY DUTIES AND ETHICAL BEHAVIOR OF LICENSE HOLDERS

Learning Objectives

After this chapter, you will be able to

- Identify and define each of the three canons listed in The Canons of Professional Ethics and Conduct.
- Provide one example of an act of omission in a real estate transaction.
- List three ways a license holder can develop geographical competency.
- Discuss license holder best practices for assisting clients with the Seller's Disclosure Notice.
- Role play multiple offer scenarios and license holder best practices.
- Understand proper use of copyrighted surveys.



The Canons of Professional Ethics and Conduct

Since January 1, 1976, real estate license holders in Texas have been required to adhere to fundamental guidelines in professional ethics and conduct set out in Chapter 531 of TREC rules, The Canons of Professional Ethics and Conduct. The three basic canons are:

- ✓ Fidelity,
- ✓ Integrity, and
- ✓ Competency.

§531.2 - Fidelity

Fidelity is the first article of the Canons of Professional Ethics and Conduct found in TREC rule §531.2 and states:

"A real estate broker or salesperson, while acting as an agent for another, is a fiduciary. Special obligations are imposed when such fiduciary relationships are created. They demand:

1. that the primary duty of the real estate agent is to represent the interests of the agent's client, and the agent's position, in this respect, should be clear to all parties concerned in a real estate transaction; that, however, the agent, in performing duties to the client, shall treat other parties to a transaction fairly;
2. that the real estate agent be faithful and observant to trust placed in the agent, and be **scrupulous and meticulous** in performing the agent's functions; and
3. that the real estate agent place no personal interest above that of the agent's client."

The Fiduciary Relationship

A fiduciary relationship is based on trust and confidence. The beneficiary, or in our case, the principal or client, trusts their agent will act in a manner that will prioritize their interests.

The principal should be able to trust their agent to act with care, and loyalty coupled with reasonable and impartial judgment. The fiduciary duty requires the agent to put aside any selfish or personal interest when working on behalf of the client. Please note however, that the agent must also treat all other parties in a transaction fairly.

“Scrupulously” is defined as acting in strict regard for what is considered right or proper. A scrupulous agent tells the truth and follows the law. A scrupulous agent, even while not representing a party to a transaction, will still provide material information to that person, disclose representation and disclose commission agreements.

“Meticulously” is defined as marked by extreme caution or excessive care in the consideration or treatment of details; careful. An agent, in order to be meticulous will chart a timeline of the transaction, noting contingency dates and other contract details. A meticulous agent will keep careful notes regarding the transaction and keep all transaction documents orderly, creating a work file that includes all communications.

DISCUSSION

1. What does fairly mean?
2. Give examples of fair versus unfair treatment.

Putting fidelity into practice requires the agent to understand the goals and interests of the principal and work diligently towards meeting those goals.

Case Study 1

Agent Andrew represents a buyer. Agent Andrew presents an offer on behalf of his buyer to Agent Mabel, who represents the seller. The offer is considerably lower than the list price and lower than the price range Agent Mabel presented to her client based on her comparative market analysis. Additionally, the offer requests Agent Mabel's seller pay the majority of the closing costs associated with the transaction.

DISCUSSION

What options and information should Mabel provide to meet the duty of working in the best interest of her client?

Case Study 2

Agent Yuan shows a home to his buyer client, Wendy. Wendy falls in love with the home and instructs Yuan to present an offer to the seller. Yuan knows of another similar home nearby that likely meets Wendy's criteria, as well. As requested by Wendy, Agent Yuan presents the offer to the seller's agent without informing Wendy of the other home.

DISCUSSION

Is there any concern that Agent Yuan violated his fiduciary responsibility? Should Agent Yuan have done something differently?

§531.3 - Integrity

What is Integrity? Integrity, according to Black's Law Dictionary is defined as:

...prescribing the qualifications of public officers, trustees, etc.: this term means soundness of moral principle and character, as shown by one person dealing with others in the making and performance of contracts, and fidelity and honesty in the discharge of trusts; it is synonymous with “probity,” “honesty,” and “uprightness.” (<https://thelawdictionary.org/integrity/>)

Notice the word “trustees” in this definition. License holders, due to fiduciary responsibilities, are similar to trustees for their clients' interests. A real estate license holder in Texas must demonstrate and practice soundness of moral principle and character.

The Canons of Professional Ethics and Conduct require fidelity and fairness in the discharge of the duty of trust to clients. Section 531.3 of TREC rules (Canons) explains integrity as it relates to real estate as follows:

“A real estate broker or salesperson has a special obligation to exercise integrity in the discharge of the license holder's responsibilities, including employment of prudence and caution so as to avoid misrepresentation, in any wise, by acts of commission or omission.”

The obligation of real estate license holders to exercise integrity is above and beyond what an ordinary person would be required to do in a similar situation. Prudence requires acting wisely and with caution when providing advice to clients, and when representing the characteristics of a property for sale or lease. Misrepresentation destroys the trust and confidence license holders owe to clients and the public.

Instructor's Notes

Discussion

1. **What does fairly mean?** Solicit examples from the group.
2. **Give examples of fair versus unfair treatment.** Solicit examples from the group.

Case Study 1

Most often, listing agents and selling agents are special or limited agents for Buyer and Seller clients. As such, the agent may advise his or her client but may not make decisions for the client.

A listing agent who has received an offer must present the offer to the seller. The seller's agent should review the comparative market analysis originally presented to the seller. The agent should also present an estimate of net sales proceeds, showing the seller an estimate of the proceeds of a sale from this particular offer. The listing agent should review the seller's options for responding to the offer, accept the offer, reject the offer, or counter-offer the offer.

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Case Study 2

Knowing the existence of a similar property could be considered pertinent information for a buyer. Though Agent Yuan must follow their client's instructions, they should make Wendy aware of the similar property and ask if they would like to see it before submitting an offer on the previously viewed property.

This image shows a single page of white paper with horizontal blue or grey ruling lines. The lines are evenly spaced and run across the width of the page, leaving small margins at the top and bottom. There are no vertical margin lines, and the page is completely blank except for the lines themselves.

Acts of Commission and Omission

Integrity also requires prudence and caution in both the acts of commission and omission. Committing an accidental error while engaging in brokerage services may be less egregious than omitting a step or action that is required. However, it may be equally impactful to the transaction. An agent's training and experience should help to ensure against accidental errors in the commission of acts such as forgetting to advise a client to obtain a copy of a survey or an owner's title insurance policy. Omissions may be those acts that are not obvious without a clear understanding of the unique features of a property and the client's intended uses.

An agent who represents a client in the purchase of a farm and ranch property, who fails to advise (omission) the client to seek help in determining if fresh water is available on the property could have violated the Canons, or be considered negligent.

Note: Promulgated contract forms in Texas have the same phrase in common.

"Consult an Attorney"

Case Study 3

An agent represents a buyer and the buyer selects a property advertised as being located on a "greenbelt." The property is priced higher than neighboring properties because it backs to a greenbelt. What are some omissions that could be made by the buyer's agent and consequently impact the client and the transaction?

Possible Omissions:

1. Not advising the client to hire an attorney, civil engineer or other competent professional to be sure the "greenbelt" is actually recorded as a part of the subdivision plat.
2. Not asking the listing agent to provide the greenbelt documentation prior to drafting a contract offer.
3. Not advising the client to exercise caution as properties advertised as being located on a "greenbelt" might only appear to be.
4. Not asking the local government entity that processes the development plans for permits if any permits are pending for development of the "greenbelt".
5. Not advising the client to consult with the local government entity the processes the development plans for permits if any permits are ending for development of the "greenbelt."

If the buyer's agent omits any or all of these actions, the agent may have not exercised prudence and caution.

§531.4 - Competency

Geographic Competency

While competency has been included as a requirement of the Canons of Professional Ethics and Conduct [TREC rule §531.4] since its inception in 1976, in recent years TREC and the Texas Legislature have made it more clear in the law that license holders must be competent in the market area in which they are providing brokerage services. Each local real estate market can have its own unique characteristics. Markets vary widely across such broad and diverse states as Texas.

In December of 2018, TREC amended the broker responsibility rule to require brokers ensure sponsored agents are geographically competent in the market being served. The rule was also amended to require coaching when a license holder performs brokerage services in a particular market for the first time. [§535.2(i)]

In September of 2019, both TREC and the Texas Legislature added clarification in regard to competency. TREC amended rule §531.4 to more clearly define geographic and subject matter competency. The rule now reads:

It is the obligation of a license holder to be knowledgeable and competent as a real estate brokerage practitioner. The license holder must:

1. be informed on local market issues and conditions affecting real estate in the geographic area where a license holder provides services to a client;
2. be informed on national, state, and local issues and developments in the real estate industry;
3. exercise judgment and skill in the performance of brokerage activities; and,
4. be educated in the characteristics involved in the specific type of real estate being brokered for others.

In Senate Bill 624, the 86th Legislature amended Chapter 1101 of the Texas Occupations Code to eliminate the Texas residency requirement for real estate license holders. However, they also added a requirement for all license holders to be geographically competent. It reads as follows:

- The commission may suspend or revoke a license issued under this chapter or Chapter 1102 or take other disciplinary action authorized by this chapter or Chapter 1102 if the license holder: ...
- (6) fails to consider market conditions for the specific geographic area in which the license holder is providing a service;...

How does a license holder become geographically competent?

A license holder must keep in mind at all times that real estate is by its very nature a ***three-dimensional*** service. This means an agent must not only walk the property itself from one end to the other and from corner to corner, but also realize that aerial photographs and internet maps will not provide the “boots-on-the-ground” observations needed to competently advise a client and gain a geographically competent understanding of the market area.

An agent must also clearly identify the specific type of real estate being brokered. While there may seem an obvious distinction between the two most basic types of real estate brokerage, residential and commercial, there are many variations and nuances. For example, an agent who has only performed brokerage services for single-family residential properties, needs training and education before representing a tenant in leased office space. Characteristics of office leasing will be totally foreign to a residential-only agent and may include net rentable square footage vs. useable square footage, common area maintenance fees, build-out allowances, parking fees and allowances, negotiation of waiver of landlord’s liens, the right of the tenant to audit common area maintenance fees annually, and even the language of future estoppel letters. The way in which square footage is defined can vary significantly from space to space and property to property. Retail leasing is equally as complicated. Another complex and challenging area of real estate service is farm and ranch brokerage.

Enforcement Spotlight – Geographic Competency

Facts – License holder, Alejandra listed a property located on a state highway. After closing, the Buyers learned that the Texas Department of Transportation (TxDOT) was planning to expand the state highway, doubling it in size, and requiring land from private property owners through eminent domain. Public hearings for the TxDOT expansion began three years before the home was sold. Alejandra said she didn’t know about the project.

Result - Alejandra was found in violation of Section 1101.652(a)(6) of TRELA, failing to consider market conditions for the specific geographic area. Alejandra was ordered to take education and pay an administrative penalty. (Agreed Order)

Consider this...

License holder Alejandra was found geographically incompetent. What are some actions Alejandra could have taken to increase her knowledge about the property she sold?

Answer:

She could have consulted with her broker and/or other agents regarding any pending property changes in the area of the property. A change as substantial as expanding a highway is newsworthy and the broker and other agents may have been aware of it. She also could have performed a city search of the Texas Comptroller’s Online Eminent Domain Database (COEDD).

Building Geographic Competency

An agent can gain competency by obtaining coaching or mentoring from a sponsoring broker or seasoned agent in their office. There is no substitute for personal, professional experience to gain an understanding of unique characteristics in any particular market.

Below are some other practical suggestions to increase geographic competency:

1. **Search the MLS data available for the property.** Some license holders may have access to the MLS, which is a valuable resource for residential property. The MLS allows a license holder to run comparative market analysis in specific areas, comparing home size, age, improvements, etc... However, generally speaking, most commercial spaces, retail

spaces, new homes, and farm and ranch properties are not listed in MLS systems.

2. **Visit the county appraisal district website.**

Texas is home to 254 counties of which there are 253 county appraisal districts. Almost all have public websites offering information such as:

- * current valuation and valuation changes over time;
- * size of land and improvements with details on shape and structure of the improvements;
- * up to the last three deed transactions, maps with shapes of the tract, dimensions, and sometimes subdivision plats;
- * tax rates of the various taxing jurisdictions;
- * exempt statuses; and
- * information on neighboring properties.

A competent agent will always review information publicly available from the appraisal districts. Interviewing appraisers that work in a district can be very informative. The business culture of local areas of Texas are highly variable and these differences are reflected in the official publications of local governmental entities.

3. **Become familiar with real property records in the county.**

Not only are land deeds filed and available to the public, but mineral leases, mineral and water deeds, and subdivision plats are also recorded. Research into real property records at the county level has been and always will be a significant resource for license holders. Hurricane Harvey and the impact on the Cinco Ranch subdivision is one example of where information about the original plat filed and the section of the subdivision subject to inundation by the US Army Corps of Engineers would have been important to know.

4. **Talk to the title companies in the area for suggestions of professional consultants such as surveyors, attorneys, architects, civil and structural engineers, geotechnical engineers, and others.**

Consult with appropriate professionals to discover impactful market information, geographical information, soil conditions, floodplain and flood issues, planning and zoning requirements, and a myriad of other information that may be unique to the local market. If you are able to gain access from neighbors or selling clients, review old title commitments and title policies for relevant information that not only applies to the tract in question but the local marketplace as well.

5. **Talk to other brokers and agents who work in a specific area.**

Ask about the current conditions in the local market. Find out if there are continuing education courses offered in the area that include information about current local conditions in the real estate industry.

6. **If the property is located in farm and ranch country, talk to the Agri-Life Extension Agent and the Farm Services Agency representatives (FSA).**

The Agri-Life Extension Agent, commonly known as the County Agent, knows the area well and as part of the Texas A & M University System, has local expertise that is invaluable. The local FSA office has old aerial photographs of area properties sometimes as far back as the 1940s. The FSA office staff will also be able to tell you if the property qualifies for any government subsidies. Stop in and visit with the local farm implement dealers such as John Deere or Kubota, the feed and seed supply stores, the local lumber yards and hardware stores, and certainly in today's volatile energy exploration markets, talk to the area's oil and gas landmen.

7. **If any property is in a groundwater conservation district (GCD), which includes municipal areas as well as rural areas in some parts of the state, talk to the GCD general manager and staff to discuss the groundwater regulations and exemptions on the property and the area as a whole.**

A visit to the Texas Water Development Board website and the Texas Commission on Environmental Quality (TCEQ) website provides maps of the state in which a local GCD has jurisdiction over area groundwater. Almost all GCDs now have websites that include contact information, rules and by-laws accessible to the public. If the property is located on a watercourse – creek, river, or stream – check at the TCEQ site to determine if the property has any water rights for irrigation or industrial use. Talk to the local water well drillers about water quantity and quality. Talk to the local electrical power company about easements, issues in metering, and future plans for expansion.

8. **Conduct an old fashioned “market study” by creating a map of neighboring tracts individually numbered with corresponding notes for each tract.**

In this way, a competent agent builds a visual database of the market. While this practice is more difficult without MLS support, modern tools such as smart phones with cameras and internet map tools have

allowed for an abundance of data regarding different real estate markets unavailable even a few decades ago.

A few days on the ground in a particular market may allow a competent agent to build a profile of valuable information for a client. In today's modern world of text messages and emails, in person interviews have regained popularity for agents who want to gain competency in the characteristics of a specific type of real estate.

Article 11 of the National Association of REALTORS® Code of Ethics directly relates to the competency necessary for the specific type of real estate a member engages in. See Appendix A for an article that addresses this topic in more detail.

DISCUSSION

Sales Agent Sandra is sponsored by Broker Miguel and lives and works in a small town outside of Houston. Sandra has heard about the large commissions other sales agents are receiving for representing commercial leasing clients in downtown Houston. Sandra has been a successful sales agent for 10 years, practicing in single-family residential resales. Sandra has never executed an office lease, represented a tenant in their search for office space, and never taken a course in commercial real estate.

1. How does Broker Miguel assess Sandra's competency (subject matter and geographic) in commercial leasing?
2. How can Sales Agent Sandra gain competency in commercial leasing?

5. Saying what you will do, doing it, and following up with your client when you say you will.
6. Manage the real estate transaction for your client by maintaining a checklist of the details of transaction including due dates and communications records.

Intermediary

Intermediary status was created in 1996. A broker who represents the seller and the buyer in the same transaction must act as an intermediary. Properly establishing an intermediary relationship can be accomplished in a few steps. See Appendix C for detailed information outlining the steps that must be taken to correctly establish an intermediary relationship.

Multiple Offers

TRELA 1101.557 requires all offers received be presented to the seller. In hot markets, multiple offers are more common. Handling multiple offers and the communication between license holders representing the sellers and buyers can be very delicate and challenging. At all times, the seller's agent must remember their fiduciary duty to their client as well as their obligation to treat the other side(s) fairly and honestly [TREC rules §531 and §535.156]. Timelines for communication are also established by rule [TREC rule §535.2]. Brokers should have policies and training available for agents in multiple offer situations.

Kahoot! Quiz

Earlier in the Chapter, we discussed the 3 Canons of Professional Ethics and Conduct – Fidelity, Integrity, and Competency. Let's test your skills at identifying which action (or lack of action) falls under the appropriate canon:

1. Failing to advise the client to seek the counsel of an attorney regarding operating in-home surveillance during an open house.
2. Having and sharing knowledge about the school districts in which an agent is showing homes.
3. Treating all parties fairly in a real estate transaction.
4. Taking a course from Texas Real Estate Research Center at Texas A&M University about current real estate industry trends.

Instructor's Notes

Discussion

1. **How does Broker Miguel assess Sales Agent Sandra's competency (subject matter and geographic) in commercial leasing?** Miguel can assess any formal or professional education Sandra may have had on the topic of commercial leasing. Miguel should determine if Sandra has had any previous experience in this subject and geographic area. Education and experience should be recent. If Sandra has no previous education or experience, she should not be allowed to practice commercial leasing until she gains competency.
2. **How can Sales Agent Sandra gain competency in commercial leasing?** Sandra could join professional trade associations for license holders who specialize in commercial real estate. The Institute of Real Estate Management (IREM) and the Certified Commercial Investment Member (CCIM) Institute are examples. Sandra could seek out formal or informal courses in commercial leasing. She would be wise to seek the assistance of other sales agents or brokers in the Houston area who are experienced and actively practicing in commercial leasing.

Kahoot! Quiz

See the Kahoot! access instructions already mentioned previously for students and instructor in Legal Update I, Chapter 4.

For this quiz, students are expected to identify each statement as an example of integrity, fidelity or competency. The instructor may provide additional feedback regarding each answer. Note that questions 1 and 6 fall under multiple answers.

Earlier in the Chapter, we discussed the 3 Canons of Professional Ethics and Conduct– Fidelity, Integrity, and Competency. Let's test your skills at identifying which action (or lack of action) falls under the appropriate canon:

1. Failing to advise the client to seek the counsel of an attorney regarding operating in-home surveillance during an open house. **INTEGRITY/COMPETENCY**
2. Having and sharing knowledge about the school districts in which an agent is showing homes. **COMPETENCY**
3. Treating all parties fairly in a real estate transaction. **FIDELITY**
4. Taking a course from Texas Real Estate Research Center at Texas A&M University about current real estate industry trends. **COMPETENCY**
5. Saying what you will do, doing it, and following up with your client when you say you will. **INTEGRITY**
6. Manage the real estate transaction for your client by maintaining a checklist of the details of transaction including due dates and communications records. **FIDELITY/COMPETENCY**

Multiple Offers Scenario

Viola is a very experienced sales agent. She has a new listing that will hit the market soon. The market is very hot and Viola expects the seller to receive multiple offers. She is preparing a training for two new sales agents (Sunil and Jenny) that have recently joined her office.

Viola: Good morning, Sunil and Jenny! I am so happy you are joining me for this round table discussion on multiple offers! I'll use my newest listing as an example.

When I was on the listing appointment last night, I reviewed the marketing plan and the comparable data to assist the seller in establishing a list price. I also discussed the possibility of multiple offers. If that occurs, I explained to the seller that it is their choice whether we tell all the buyer's agents who bring an offer OR none of the agents who bring an offer, that we have multiple offers.

The seller asked, "What if one of the buyer's agents asks for the price of the highest offer?". I told them we really would be better off if we just informed all buyers' agents that we have multiple offers and ask them to please bring your highest and best offer. If we tell one agent what the highest offer is, we have to tell all agents, not only the highest offer price, but all the details of all the offers excluding the names of the buyers. This can be very unmanageable. So, I asked the seller what they would you like me to do if this situation occurs? I can tell all of the agents there are multiple offers OR I can tell none of the agents there are multiple offers?

Sunil: What did she say? I bet she said, "Tell them all."

Jenny: Wow, Sunil I would have guessed she would say, "Don't tell anyone."

Viola: The client asked, which was the better way to go. I told her that sometimes when a seller's agent tells the buyer's agents there are

multiple offers, a bidding war is created. Buyers' agents and their buyers are curious about the details of other competing offers but disclosing those details can be problematic.

Jenny: What's the problem with sharing details?

Viola: Because if you tell one buyer's agent you must tell them all. It can be a nightmare to keep up with, so our broker recommends to inform all buyer's agents of the multiple offer situation, without sharing details.

Sunil: I cannot stand it...what did she decide?

Viola: She decided to tell every agent who has an interested buyer that we have multiple offers, without disclosing the details.

Jenny: This is very interesting, Viola, Is there anything else we need to know about multiple offers?

Viola: Well, the next thing I talked about with the seller is "love letters." You know, those letters that buyers write about how their children will love the playground down the street and this backyard is perfect for "Yippie" the dog?

Sunil: What's wrong with those? When we bought our house, we wrote one and the seller picked our offer!

Viola: Some sellers have based decisions on information contained in these letters that may have fair housing implications. Agents and sellers need to avoid EVEN the slightest hint of acting in violation of fair housing laws. In another class we can watch some videos and have some dialogue about that. The seller understood and decided not to be a part of that at all!! She instructed me to return the letters to the buyer's agent unopened.

Jenny: There is so much to learn and remember!

Viola: Yes there is and we have yet to cover it all!!

DISCUSSION

1. What is a best practice on the presentation of multiple offers?
2. Does a license holder really have to present ALL offers?
3. Is it true that a license holder can stop presenting offers after the seller has accepted an offer and a contract has been executed?
4. What do I do if an offer proposes some terms or conditions that I believe to be unethical or violate TREC rules?
5. How can license holders let other agents know that the seller will not accept any "love letters?"

Best Practices For Selection and Use of a Seller's Disclosure Notice

License holder should follow their broker's policy on seller disclosure(s) notices. Absent guidance from the broker, the license holder should provide the seller disclosure forms available in the market. The seller can choose which form they will use. If a form is used that requires additional forms or documents to be attached, be sure to attach them in an effort to fully and honestly inform potential buyers of the property condition.

Aflalo v. Harris – A Civil Case in Dallas County Update

You may remember learning about Aflalo v. Harris, a case involving issues with the seller's disclosure notice and subsequent documentation in the last edition of Legal Update. See Appendix E for an update of the proceedings between the two parties.

Broker's Price Opinion (BPO)

It is common practice for a license holder to prepare a broker price opinion (BPO), or a comparative market analysis (CMA) for their clients. In fact, under TREC rule 535.16(c), a license holder is obligated to provide a BPO or CMA when negotiating a listing or offering to purchase the property for the license holder's own account. This practice should be consistent for every client.

Prior to foreclosure, banks may request a BPO on a property before hiring an appraiser. Attorneys may request a BPO in situations where litigation is involved, and the price of property may be a factor. Property owners considering protesting taxes may ask a license holder to prepare a BPO or CMA. Additionally, those in the early stages of a potential condemnation or eminent domain proceeding may seek this information. For Q&As on Broker Price Opinions, see Appendix F.

Copyrighted Surveys

Have you looked closely at surveys lately? If you have, you have likely seen a copyright symbol. This is the symbol declaring this document the original work of the surveyor, whose stamp is also on the document. There has been some legal debate as to whether a survey is copyrightable.

What does this mean for license holders? Encourage clients to review the fine print on the survey for restrictions on reuse or a copyright symbol. If either

is present, instruct the client to contact the surveyor regarding use in a subsequent transaction. If allowed, be sure the client gets that permission in writing.

Can a copyrighted survey be shared without the written permission of the surveyor?

Probably not under copyright law. If the copyright is upheld, whoever published the survey could be subject to copyright infringement action and damages. This could come into play if a license holder uploads the survey to the MLS. However, it could be argued that sellers are basically sharing the survey they purchased with the buyer and not publishing it in violation of copyright law. This is not unlike someone buying a copyrighted book and giving it to a friend to read. Without any court cases, it is still a gray area.

Does this mean the seller who purchased the survey can share it with their buyer?

The client needs to look at their agreement with the surveyor or on the survey itself to see what rights the client was given when the survey was originally purchased. Did it include the right to show it to a future buyer or a title company upon the sale of the property?

How does the seller obtain permission to share a copyrighted survey?

Contact the surveyor and ask! Always get permission in writing!

Does this mean that a previous buyer can share the survey with a subsequent buyer in a few years?

Probably not, because the buyer did not purchase the original survey and would have no contractual rights of use. From a practical standpoint, after a number of years, the next buyer or lender will probably want a new survey.

What liability is created for the broker by the license holder who recommends sharing a copyrighted survey?

The broker could be included in the copyright lawsuit or sued independently by the seller after they lose a copyright infringement suit. Either way this means attorney costs and possible damages to be paid by the broker.

What liability is created for the seller by the license holder who recommends sharing a copyrighted survey?

They could be sued for copyright infringement and incur attorney fees, court costs and possibly be liable for damages.

CHAPTER 02

WATER AND MINERAL RIGHTS

Learning Objectives

After this chapter, you will be able to

- Identify the three types of water sources in Texas and which government entities regulate each.
- Understand the obligations and duties license holders owe clients and customers regarding water rights.
- Be aware of water right situations that require reporting on the seller's disclosure notice.
- Understand how real estate transactions involving mineral rights should be handled, including the use of the correct TREC promulgated form.
- Describe the role of title insurance where mineral rights are a factor.



Introduction

Most Texans' understanding of water rights goes only as far as their monthly water bill. Most believe that as long as the faucet turns and water flows, their water "right" is limited only by their ability to pay.

However, Texas has often been plagued with long droughts. The Texas Water Development Board's (TWDB) State Water Plan for 2012 asked: Do we have enough water for the future?" Their startling and unequivocal answer was:

"We do not have enough existing water supplies today to meet the demand for water during times of drought. In the event of severe drought conditions,

the state would face an immediate need for additional water supplies of 3.6 million acre-feet per year with 86 percent of that need in irrigation and about 9 percent associated directly with municipal water users. Total needs are projected to increase by 130 percent between 2010 and 2060 to 8.3 million acre-feet per year. In 2060, irrigation represents 45 percent of the total and municipal users account for 41 percent of needs."

The shortages of water Texans are predicted to face in our future, coupled with the obvious impact water has on our everyday lives, including water's impact on real property values, means real estate license holders and consumers must be better educated about water rights in Texas.

Assessing the water characteristics of any particular property presents unique challenges to buyers, sellers, lessors, lessees, and real estate agents. The water scarcity predicted in our future requires potential buyers to consider a variety of less often considered assessment criteria. The potential of future water scarcity requires sellers and their real estate agents to exercise extreme caution and prudence in their duties of disclosure regarding the water situation of any property being offered for sale.

Real estate license holders in Texas must keep one very important thought in mind when considering water rights – advise your clients to **consult an attorney** while making their decision to purchase a property or making representations about water rights when selling a property.

Three Types of Water Sources and Their Owners

Water in Texas varies between the water flowing on the surface and the water flowing underground. The regulation of water is actually conducted by multiple government agencies.

There are three basic types of water sources this chapter discusses: **surface water, diffused surface water, and groundwater.**

Surface Water is water that flows on the surface of the ground in a watercourse. According to Title 30, Texas Administrative Code (30 TAC) §291.7(61) a “watercourse” is defined as “a definite channel of a stream in which water flows within a defined bed and banks, originating from a definite source or sources. (The water may flow continuously or intermittently, and if the latter, with some degree of regularity, depending on the characteristics of the sources.)”

[http://txrules.elaws.us/rule/title30_chapter297_sec.297.1#:~:text=\(61\)%20Watercourse%2D%2DA%20definite,a%20definite%20source%20or%20sources.](http://txrules.elaws.us/rule/title30_chapter297_sec.297.1#:~:text=(61)%20Watercourse%2D%2DA%20definite,a%20definite%20source%20or%20sources.)

The courts have described watercourses as having:

- (1) a defined bed and banks;
- (2) a current of water; and
- (3) a permanent supply source of water.

Who owns the rights to surface water like lakes, streams, or creeks? The State of Texas owns the water in a watercourse, held in trust for the citizens of the state. The Texas Commission on Environmental Quality (TCEQ) regulates the use of surface water in Texas by a system of water rights. Texas follows the legal concept of and allocates surface water rights and permits based on “first in time is first in right.” The TCEQ, through its

authority in allocating water rights, oversees 17 state-wide river authorities and 4 watermasters.

Diffused surface water can be described as rainwater that runs off your roof or over the surface of your land without flowing in a stream or channel. This type of water is owned by the landowner and is subject to very limited or no regulation.

Groundwater is water held underground in aquifers and pools. Ownership of groundwater in Texas was debated for many decades, but in the fall of 2011 the debate about ownership of groundwater ended. The Texas Legislature passed a bill, SB 332, which states “The legislature recognizes that a landowner owns the groundwater below the surface of the landowner’s land as real property.”

However, groundwater is regulated by 101 groundwater conservation districts (GCDs) with 101 different sets of rules and regulations within the parameters of Chapter 36 of the Texas Water Code. Note that not all of Texas groundwater is covered under the jurisdiction of a GCD, either. Many citizens in these jurisdictions are unaware of these regulatory agencies.

Now that you are familiar with the three types of water sources in Texas, let’s dive deeper into how surface water and groundwater is regulated in our state (and yes, that pun was intended).

Surface Water Regulators and Regulations

The “buck-stops-here” surface water regulator in Texas is the TCEQ. Generally, a permit is required from TCEQ in order to use surface water for any purpose outside of domestic and livestock use, emergency use by fire departments, and other similar public services.

The TCEQ website offers a very large Excel spreadsheet of all the surface water rights holders in the state and can be found at https://www.tceq.texas.gov/permitting/water_rights/wr-permitting/wrwud.

License holders should advise clients to seek the help of attorneys familiar with surface water rights and permitting in Texas and/or to seek the assistance of licensed engineers or hydrologists. Unfortunately, some older, and even more recent, surface water deeds are not filed or recorded in the county’s real property records. Title insurers have been very reluctant to offer any insurance coverage on the water rights associated with a property.

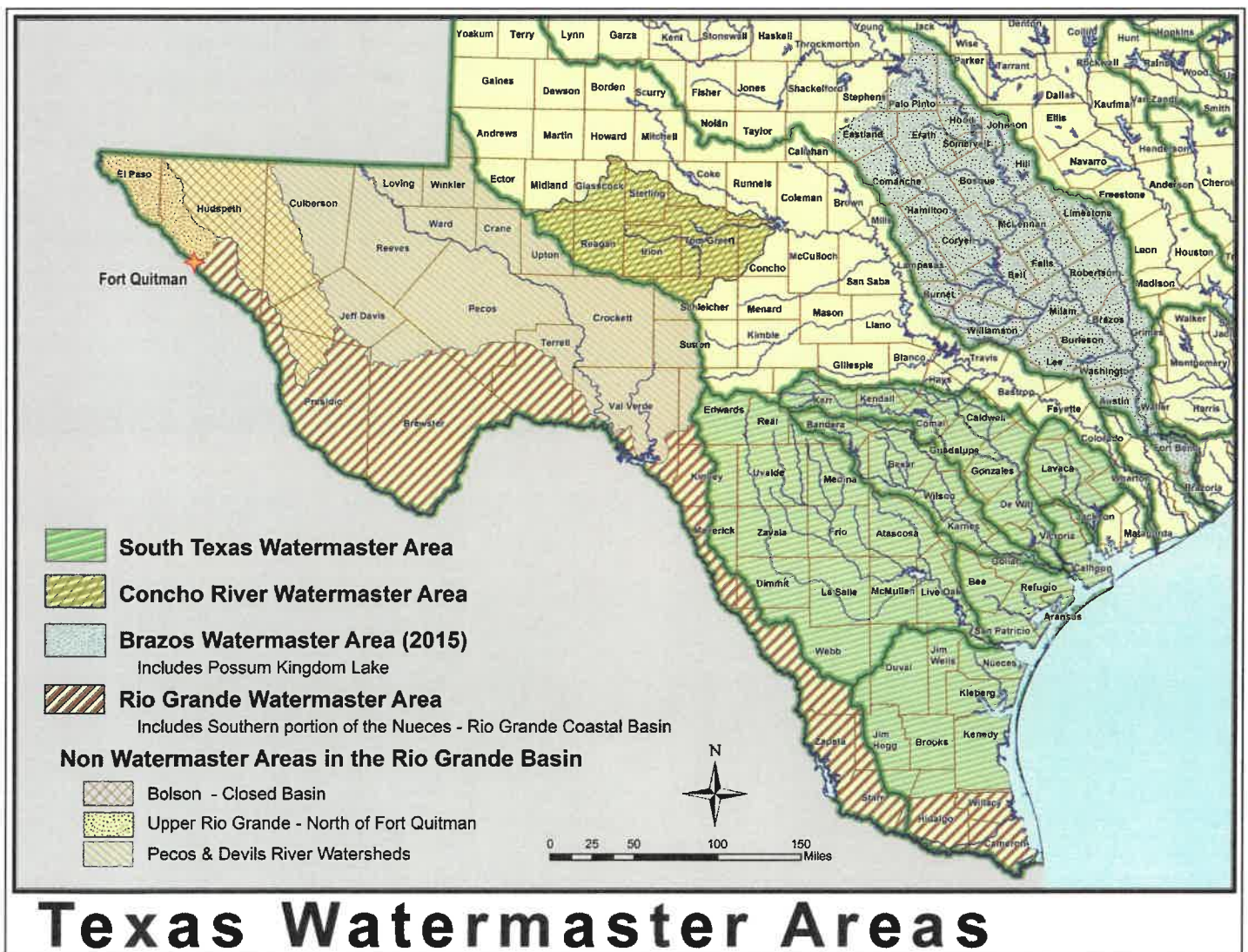
An example of the public’s lack of knowledge about surface water regulations is evidenced in a common question about lake water use. Often this question comes from Lake Travis property owners or potential purchasers of land there: “May I pump water from the

lake to my home since I am adjacent to the water?" The answer is "No. You must obtain a permit from the Lower Colorado River Authority (LCRA) to do so." Without a permit, the homeowner may incur fines for the violation of unpermitted water use on a state-owned lake. Note that none of the seller's disclosure notices or promulgated contract or forms mention the TCEQ's authority over the use of surface water or the river authorities' jurisdiction within their boundaries.

Watermasters

There is another level of surface water regulation that even fewer Texans understand - the jurisdiction and duties of our four state **watermasters**. The role of the watermaster is one of the oldest regulatory activities concerning surface water in Texas.

Similar to getting a permit from the TCEQ for using surface water, before diverting a water source regulated by a watermaster, the water right holder must notify the watermaster of the intent to divert at a specific time and the specific amount of water to be diverted. If the water is available and the water right holder will not exceed its annual authorized appropriation of water, the watermaster then authorizes the diversion and records this against the right. The watermaster program includes staff "deputies" who perform regular field inspections of authorized diversions to insure compliance with the water right.



https://www.tceq.texas.gov/permitting/water_rights/wmaster

Groundwater Regulators and Regulations

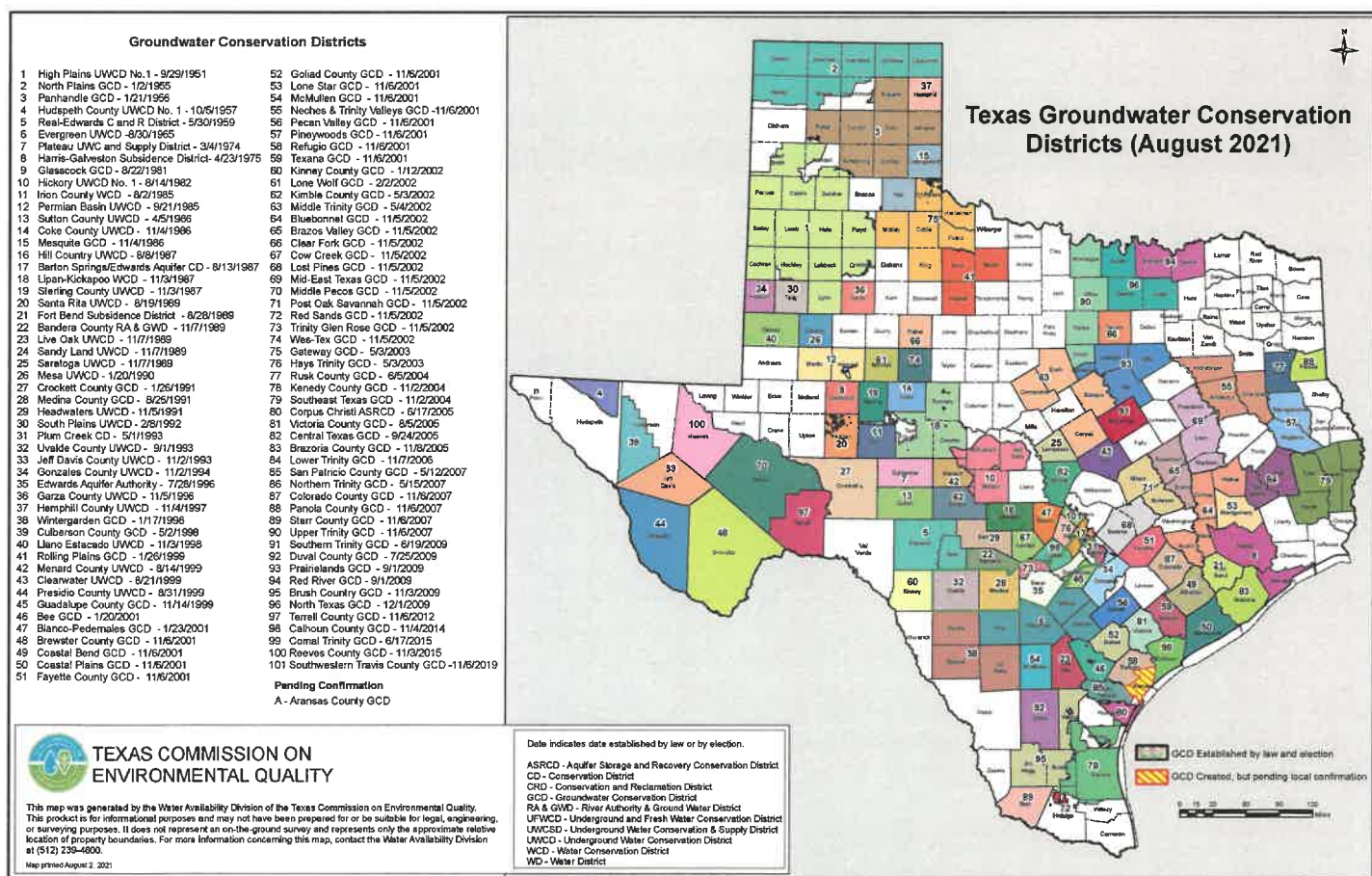
How is water from aquifers and underground pools that feed springs and wells regulated? Groundwater is regulated through groundwater conservation districts (GCDs). Today there are 101 GCDs in Texas covering a large portion of the state, but not all of the state. Each GCD has its own set of rules and regulations, its own definition of terms such as "domestic and livestock uses," and its own permitting requirements in accordance with the Texas Water Code. Most of the districts have boundaries set by county lines, even though the water doesn't stop flowing at county lines.

Many consumers in Texas may not realize that GCDs even exist until a property owner wants to drill a well on their property or apply for an irrigation permit that would require drilling into the ground to access the groundwater.

Below is a map showing the existing Texas Groundwater Conservation Districts. It can be found at <https://www.tceq.texas.gov/assets/public/permitting/watersupply/groundwater/maps/gcdmap.pdf>

License holders can assist their clients by referring them to the TCEQ map site above to determine if a property lies in the jurisdiction of a GCD. **Remember that a license holder, unless they hold a license to practice law in Texas or hold an engineering license, may not attempt to interpret the by-laws and rules of any individual GCD on behalf of a client.**

What can happen if a seller fails to disclose to a potential buyer that the property lies within the jurisdiction of a GCD? The Buyer could find themselves the victim of misrepresentation by the Seller and/or the Seller's agent. For example, property in the Barton Springs Edwards Aquifer Groundwater Conservation District (BSEAGCD), domestic and livestock wells are exempt from needing a permit to drill for groundwater. However, if a water provider delivers water to the property line and the owner of the property ties in and uses the water for domestic and livestock use, then their original permit exemption for a water well now needs a permit. If the Seller and the Seller's agent advertise that the property has two water sources (the well and the public water line), they may be guilty of misrepresenting the water sources. Few (if any) Sellers or Seller's agents are aware of this rule in the BSEAGCD, yet they should be if they want to avoid misrepresentation and a possible lawsuit.



1. The Property has the items checked below [Write Yes (Y), No (N), or Unknown (U)]:

Water Supply: _____ City _____ Well _____ MUD _____ Co-op

Are you (Seller) aware of any of the above items that are not in working condition, that have known defects, or that are in need of repair? ☐ Yes ☐ No ☐ Unknown. If yes, then describe. (Attach additional sheets if necessary): _____

9. Are you (Seller) aware of any of the following? Write Yes (Y) if you are aware, write No (N) if you are not aware.

_____ Any notices of violations of deed restrictions or governmental ordinances affecting the condition or use of the Property.

_____ Any rainwater harvesting system located on the property that is larger than 500 gallons and that uses a public water supply as an auxiliary water source.

_____ Any portion of the property that is located in a groundwater conservation district or a subsidence district.

If the answer to any of the above is yes, explain. (Attach additional sheets if necessary): _____

Water and the Seller's Disclosure Notice

For over two decades, any defect actually known to the seller of a single-family home must be disclosed on a seller's disclosure notice, including defects not covered on the form. The prudent Seller, Buyer and Agent should keep in mind the source and availability of water to any property. Any known defects about the property's water rights must be fully and truthfully disclosed.

TREC's Seller's Disclosure Notice is the minimum required by law and mirrors the provision in the Texas Property Code. It contains the opportunity to disclose information about the property's water and water rights in the two areas above.

Water Right Issues That Require Reporting

Below are examples of water right issues that would require disclosure on a seller's disclosure notice:

1. A notice of violation of deed restrictions or governmental ordinances affecting the condition or use of the property, such as a non-permitted groundwater well;
2. A condition on the property which materially affects the physical health or safety of an individual, such as a water well that is located inside the minimum distance from a septic tank or field; and
3. Location of the subject property within a GCD or district.

The Seller's Disclosure Notice does not have a place to disclose specific information about surface water rights at this time. **A license holder should advise their client to consult an attorney and/or an engineer about the surface water rights to a property containing a watercourse.**

There is also no promulgated form that a license holder may use if the seller wants to reserve all or a portion of a property's water rights at this time. **A license holder should advise their client to consult an attorney.**

The next drought will inevitably bring with it a greater awareness of the water rights or defects in the water rights of properties in Texas. Best practices for license holders concerning water rights include:

- * Advise clients to consult an attorney to determine the water rights on a property.
- * Assist clients by providing resources to help determine if the groundwater rights to the property are in the jurisdiction of a GCD.
- * Assist clients by providing them links to the TCEQ's website for information about a property's surface water rights.
- * Avoid interpretation of any laws, regulations, geological data, or other information outside their duties as a license holder.

A dutiful and diligent license holder will become

familiar with property water rights to gain geographic competency and avoid misrepresentation or acts of omission.

Mineral Rights

Mineral rights are complicated and often confusing. Just determining the ownership and rights of any mineral holdings for any property in Texas can be highly controversial and strongly debated in courts of law. **Sellers may not know what mineral rights they own!** Additionally, developments in mineral extraction or discovery of new mineral resources in different parts of the state can cause a significant shift in the value of the mineral rights themselves seemingly overnight. It is also important for you and your client to understand that title insurance often does not cover mineral rights and may require your client to obtain additional coverage.

Because of this, license holders who are not attorneys or oil and gas experts such as petroleum landmen should never give advice to their clients on mineral

rights. Minerals and mineral rights are a significant part of real property values in many parts of Texas.

Advise your client to hire an attorney to assist when drafting contracts involving oil and gas mineral rights related to a real estate transaction.

Mineral rights can be severed from the real property and sold. Once severed and sold, the mineral right owners can have rights to the use of the surface of the property in order to lease, extract, and use the minerals they own. In many parts of the state, it is common to discover that all or part of the mineral rights have been severed, and in some cases, for over a hundred years! Severed mineral rights are often split between multiple individuals who have never had contact with each other. Whether the license holder represents the buyer or seller of a property with minerals, the license holder should advise their client to **CONSULT AN ATTORNEY** in all matters involving mineral rights.

See Appendix G for additional resources regarding water and mineral rights.

**ADDENDUM FOR RESERVATION OF OIL, GAS, AND OTHER MINERALS****ADDENDUM TO CONTRACT CONCERNING THE PROPERTY AT**

(Street Address and City)

NOTICE: For use ONLY if Seller reserves all or a portion of the Mineral Estate.

- A. "Mineral Estate" means all oil, gas, and other minerals in and under and that may be produced from the Property, any royalty under any existing or future mineral lease covering any part of the Property, executive rights (including the right to sign a mineral lease covering any part of the Property), implied rights of ingress and egress, exploration and development rights, production and drilling rights, mineral lease payments, and all related rights and benefits. The Mineral Estate does NOT include water, sand, gravel, limestone, building stone, caliche, surface shale, near-surface lignite, and iron, but DOES include the reasonable use of these surface materials for mining, drilling, exploring, operating, developing, or removing the oil, gas, and other minerals from the Property.
- B. *Subject to Section C below*, the Mineral Estate owned by Seller, if any, will be conveyed unless reserved as follows (check one box only):
- ☐ (1) Seller reserves all of the Mineral Estate owned by Seller.
- ☐ (2) Seller reserves an undivided _____ interest in the Mineral Estate owned by Seller. *NOTE: If Seller does not own all of the Mineral Estate, Seller reserves only this percentage or fraction of Seller's interest.*
- C. Seller ☐ does ☐ does not reserve and retain implied rights of ingress and egress and of reasonable use of the Property (including surface materials) for mining, drilling, exploring, operating, developing, or removing the oil, gas, and other minerals. *NOTE: Surface rights that may be held by other owners of the Mineral Estate who are not parties to this transaction (including existing mineral lessees) will NOT be affected by Seller's election. Seller's failure to complete Section C will be deemed an election to convey all surface rights described herein.*
- D. If Seller does not reserve all of Seller's interest in the Mineral Estate, Seller shall, within 7 days after the Effective Date, provide Buyer with the contact information of any existing mineral lessee known to Seller.

IMPORTANT NOTICE: The Mineral Estate affects important rights, the full extent of which may be unknown to Seller. A full examination of the title to the Property completed by an attorney with expertise in this area is the only proper means for determining title to the Mineral Estate with certainty. In addition, attempts to convey or reserve certain interest out of the Mineral Estate separately from other rights and benefits owned by Seller may have unintended consequences. Precise contract language is essential to preventing disagreements between present and future owners of the Mineral Estate. If Seller or Buyer has any questions about their respective rights and interests in the Mineral Estate and how such rights and interests may be affected by this contract, they are strongly encouraged to consult an attorney with expertise in this area.

CONSULT AN ATTORNEY BEFORE SIGNING: TREC rules prohibit real estate licensees from giving legal advice. READ THIS FORM CAREFULLY.

Buyer_____
Seller_____
Buyer_____
Seller

The form of this addendum has been approved by the Texas Real Estate Commission for use with similarly approved or promulgated contract forms. Such approval relates to this contract form only. TREC forms are intended for use only by trained real estate license holders. No representation is made as to the legal validity or adequacy of any provision in any specific transactions. It is not intended for complex transactions. Texas Real Estate Commission, P.O. Box 12188, Austin, TX 78711-2188, 512-936-3000 (<http://www.trec.texas.gov>) TREC No. 44-2. This form replaces TREC No. 44-1.

TREC NO. 44-2

CHAPTER 03

AD VALOREM TAXES AND VALUATION

Learning Objectives

After this chapter, you will be able to

- Understand ad valorem tax best practices and guidelines.
- Understand the license holder's role in assisting property owners protesting property taxes.
- Explain Paragraph 13 – Prorations and how rollback taxes function.
- Recall the tax exemptions allowed in Texas, and describe license holder best practices in advising a client seeking a tax exemption.



Property Taxes On the Rise

License holders may be asked to assist clients in preparation for their client's property tax protest hearings at appraisal district offices.

Geographically competent agents must understand the process of ad valorem taxation in Texas. Still, unless they have become knowledgeable in the tax protest process, they should be careful not to venture into providing advice to their clients on how to protest the valuations and thus minimize taxes. License holders can assist their clients in preparing competitive market analyses, broker price opinions, and other credible evidence of comparable property closed sales.

Ad valorem tax valuation lies in the jurisdiction of attorneys, appraisers and ad valorem property tax consultants.

The Central Appraisal District System

Prior to the establishment of county-based central appraisal districts, each of the over 3,500 real property taxing entities in Texas valued real estate in their jurisdiction in their own manner.

There are 253 central appraisal districts in Texas based on county lines. While there are 254 counties in Texas, two counties share one district. The appraisal districts are charged with assessing the fair market value of each and every real property in their district, literally millions of tracts of land in Texas. Additionally, the districts assess the value of business personal property. The Texas Comptroller of Public Accounts oversees the entire ad valorem tax appraisal system. Ad valorem is a Latin term that means "according to value."

Rate Proposals

Overlooked by many people in Texas who tend to only focus on the assessed values of their properties, is the proposed tax rates established by each of the government entities that have ad valorem taxation authority. Generally, in Texas, public school districts (those up to the 12th grade) ad valorem taxes make up over 50% of the total annual property tax invoice. Property owners and geographically competent real estate license holders should be aware of or consider becoming active in the public hearings held by the taxing authorities presenting their annual ad valorem tax rates.

Protesting Property Taxes

According to the Texas Comptroller of Public Accounts publication titled “Property Taxpayer Remedies,” the central appraisal districts:

“must send required notices by May 1, or by April 1 if your property is a residential homestead, **or as soon as practically possible** [emphasis added]. The notice must separate the appraised value of real and personal property. If the appraised value is increased, the notice must show an estimate of how much tax you would have to pay based on the same tax rate your city, county, school district, and any special purpose district set the previous year.”

If a property owner disagrees with the appraised value they may file a Notice of Protest with the county’s Appraisal Review Board (ARB). The ARB is an independent, impartial group of citizens authorized to resolve disputes between taxpayers and the appraisal district. The Comptroller offers a form for use at <http://comptroller.texas.gov/forms/50-132.pdf>.

Many people in Texas have expressed frustration with the process of protesting ad valorem tax valuations. The appraisal districts are allowed local discretion in their interpretation and implementation of the Property Tax Code. Because ad valorem tax issues are so complex and varied, license holders who are not attorneys or ad valorem tax experts should steer clear of giving ad valorem tax advice to their clients.

The tax appraisal process is another example of why license holders’ geographic and subject matter competency is essential. The appraisal districts have discretion in the valuation process that can be unique to their jurisdiction. A geographically competent license holder could assist their client in finding out the local appraisal district’s process, but unless competently trained, should not interpret or offer advice about how to navigate the process. License holders should advise their clients to seek assistance of an appraiser, attorney, or ad valorem property tax expert.

According to the Comptroller, a property owner may protest the value of a property when:

- * The value the appraisal district placed on the property is too high (market value argument);
- * The property is unequally appraised (equity argument);
- * The condition of the property has substantially changed (ie: flood, fire, etc.);
- * There is a substantial error regarding the property (ie: size, or removal of an improvement);
- * The appraisal district denied a special appraisal, such as open-space land, or incorrectly denied an exemption application;
- * The appraisal failed to provide the required notices; and,
- * Other matters prescribed by Tax Code 41.41(a).

Listed below are ways a property owner can protest proposed valuation.

- * In some appraisal districts, a property owner can request an informal review with an appraisal district representative to understand the reason behind the proposed valuation. Informal meetings are not part of the Tax Code, but districts offer them to expedite the protest process.
- * A property owner may also file the Notice of Protest, even if the owner feels the dispute will be resolved informally. This preserves the owner’s right to protest.
- * Upon finding no remedy in the informal review, the property owner has an opportunity to appear in a hearing with the representatives of the ARB. Representatives in counties with a population under 120,000 are appointed by local appraisal districts. Representatives in larger counties are appointed by the local administrative law judge.
- * If the property owner is dissatisfied with the ARB’s decision, the owner has the right to appeal the decision.
- * Dependent upon the facts and type of property, the property owner may file the appeal with the local district court, appeal to binding arbitration, or may appeal to the State Office of Administrative Hearings (SOAH.) License holders should advise their clients who have chosen to appeal to consult an attorney. The attorney may ask the license holder to assist in research.

More information is available on the Comptroller’s Property Tax Assistance website <https://comptroller.texas.gov/taxes/property-tax/> under these titles:

- * Appraisal Protests and Appeals;
- * Appraisal Review Board Manual;
- * Paying Your Taxes;

- * Property Tax Basics;
- * Taxpayer Bill of Rights;
- * Texas Property Tax Code; and,
- * Valuing Property.

How may a license holder assist a client in the valuation process?

- * A geographically competent agent may provide accurate comparable sales data to the client; and,
- * A geographically competent agent may recommend attorneys, licensed appraisers, property tax consultants, and other professionals to assist the client in preparation for their valuation arguments.

Special Considerations

It is not uncommon for civil engineers, architects and other professionals to consult on unique characteristics of commercial property and the impact on value. Similarly, hydrologists, agricultural business professionals, and other professional consultants may be called upon to offer opinions on unique characteristics of farm and/or ranch property and the impact on value.

License holders should guard against providing any advice to their clients that is outside their area of expertise.

Property Tax Exemptions

Exemptions and special valuations available to property owners include:

- a. Homestead exemption;
- b. Over 65 exemption;
- c. Disabled exemption;

- d. Agricultural valuation; and
- e. Wildlife valuations.

The Texas Legislature passed a new law, effective January 1, 2022, that allows residential buyers to file for homestead exemptions in the same year they purchase their home. Previous home buyers had to wait until January 1 to file for the exemption. Additionally, the homestead cap prevents taxation on an increased value of more than 10% after the first year of home ownership.

Unless the license holder is geographically competent to advise the client in how to qualify and obtain approval for one of the exemptions or special valuations, the license holder should advise the client to **consult with an attorney or ad valorem tax expert.**

Paragraph 13 - Prorations

Paragraph 13 of the One to Four Family Residential Contract (Resale) addresses ad valorem tax prorations. Often, the closing will occur before the current year's valuation has been proposed and the tax rates for that year are known. The title company will estimate the taxes based upon the best available information at the time, and then prorate.

Similarly, Paragraph 13 of the Farm and Ranch contract addresses ad valorem tax prorations, but includes additional information in (13) (A) due to the unique characteristics of farm and ranch properties. Paragraph (13) (B) relates to rollback taxes.

If the land is qualified for an agricultural appraisal, but the property owner changes its use to non-agricultural, the property owner will owe a rollback tax for each of the previous three (3) years in which the land

13. PRORATIONS: Taxes for the current year, interest, maintenance fees, assessments, dues and rents will be prorated through the Closing Date. The tax proration may be calculated taking into consideration any change in exemptions that will affect the current year's taxes. If taxes for the current year vary from the amount prorated at closing, the parties shall adjust the prorations when tax statements for the current year are available. If taxes are not paid at or prior to closing, Buyer shall pay taxes for the current year.

13. PRORATIONS AND ROLLBACK TAXES:

- A. PRORATIONS: Taxes for the current year, interest, maintenance fees, assessments, dues and rents will be prorated through the Closing Date. The tax proration may be calculated taking into consideration any change in exemptions that will affect the current year's taxes. If taxes for the current year vary from the amount prorated at closing, the parties shall adjust the prorations when tax statements for the current year are available. If taxes are not paid at or prior to closing, Buyer shall pay taxes for the current year. Rentals which are unknown at time of closing will be prorated between Buyer and Seller when they become known.
- B. ROLLBACK TAXES: If this sale or Buyer's use of the Property after closing results in the assessment of additional taxes, penalties or interest (Assessments) for periods prior to closing, the Assessments will be the obligation of Buyer. If Assessments are imposed because of Seller's use or change in use of the Property prior to closing, the Assessments will be the obligation of Seller. Obligations imposed by this paragraph will survive closing.

received the lower appraisal. The rollback tax is the difference between the taxes paid on the land's agricultural value and the taxes that would have been paid if the land had been taxed at a higher market value.

Effective June 15, 2021, HB 3833 amended Section 23.55 of the Texas Property Tax Code to remove the 5% interest that was previously added to the rollback tax calculation.

The chief appraiser determines if a change to a non-agricultural use has been made and sends a notice of the change. If the property owner disagrees, the owner may file a protest with the Appraisal Review Board (ARB). The owner must file the protest within 30 days of the date the notice was mailed. The ARB then decides the outcome. If the property owner does not protest or if the ARB decides against the owner's position, the owner owes the rollback tax, subject to the due process of appeal by the owner.

The Farm and Ranch contract form clearly places the obligation to pay the rollback taxes on the party (buyer or seller) who changes the use. Note that paragraph (13) (B) "survives the closing."

Rollback Taxes

While a license holder could assist their client in researching the consequences of rollback determinations, the warning is clear – the appraisal district determines the final rollback cost.

As a best practice license holders should advise their clients to contact the appraisal district to fully understand the consequences of a change of use from agricultural valuation to a non-agricultural in a particular district.

In Conclusion

With the news of increasing demand for property in Texas as evidenced by the current market conditions, ad valorem taxes will surely increase for all Texas property owners.

License holders may assist their clients by:

1. Helping them understand the process of ad valorem taxation in Texas;
2. Providing them with research sources available to the public, such as comparable sales information; and
3. Recommending they consult an attorney or ad valorem tax expert.

Unless specifically qualified, license holders should **NOT:**

1. Offer opinions about ad valorem valuation methodology;
2. Offer advice regarding ad valorem tax valuation or exemption processes; or
3. Offer advice about how to protest a tax valuation or denial of a special exemption or valuation.

Case Study 4

Broker Edward is in the process of obtaining a 640-acre farm and ranch listing in West Texas. Edward realizes 600 acres of the property is used for a year-round youth camp. Edward knows the seller has an agricultural valuation for 600 acres of the property. Edward suspects the appraisal district has not audited the agricultural valuation in many years. How does Edward represent the ad valorem taxation of the property to potential buyers? Are there potential problems for the seller? Are there problems that may survive the closing?

Case Study 5

Broker Bill served as a buyer's agent in a residential transaction on Lake Travis in Austin that closed in November. The following year, his client was furious about a huge property valuation increase proposed by the Travis Central Appraisal District. The client asked Bill to represent him at the informal hearing, compile comparable data for the potential ARB hearings, and possibly a district court trial. The client all but demanded Bill's help. What can Bill do? What should Bill do?

Case Study 6

Sales agent Delia is representing a buyer new to Plano. The Seller's Disclosure Notice her client receives shows absolutely no defects current or prior. However, Delia noticed the Collin Central Appraisal District website shows that the home's property valuation declined for the two prior consecutive years. What should Delia advise her client to do?

Instructor's Notes

For the case studies below, split the class into three groups. Assign each group one of the case studies. Allow each group 5 minutes to review and answer each case study within their group. Bring the class back together and an appointee from each group should brief the class on each group's findings.

Case Study 4

Broker Edward must share his knowledge of the agricultural valuation with his seller. Edward has become aware of the fact the appraisal district has not audited the ag valuation in many years. If Edward is competent to conduct brokerage in the farm and ranch industry, he must know about roll back penalties for changes in use. First, Edward must ask the seller if the seller had an attorney or ad valorem tax consultant confirm that the current use of the property as a youth camp qualifies or disqualifies the property for an agricultural valuation (it does disqualify it). Next, whether or not the seller knows the answer, Edward must disclose the questionable situation to any and all prospective buyers.

The Texas Occupations Code Chapter 1101, section 1101.652 (b) (3 and 4) requires license holders to disclose actually known defects to potential buyers. The TREC Canons of Ethics require the license holder to treat other parties to a transaction fairly. The Canons also place fiduciary duties on Edward in relation to his selling client. Edward must be scrupulous and meticulous in his work, and must employ prudence and caution to avoid misrepresentation, by acts of commission or omission. If Edward did not ask about the circumstances, he would not be acting scrupulously and meticulously. This would be an act of omission. Whether or not the current use disqualifies the property from an ag valuation is a material issue. If the current use disqualifies the property from an ag valuation, it indicates the situation is a known defect. The

seller could be very uncomfortable publicizing the use as a youth camp. It could alert the appraisal district and trigger roll back penalties whether or not the seller closes the transaction. A prudent seller must disclose this issue to potential buyers. The problem will survive the closing, and the issue of any use that eliminates the ag valuation should be negotiated and solved prior to closing.

Case Study 5

Bill's help is limited to his actual professional expertise in ad valorem taxation hearings and testimony at a district court trial. Bill is prohibited from offering advice in any area outside his expertise as a real estate license holder per the TREC Canons of Professional Conduct and Ethics §531.4 "Competency." He may prepare a comparative market analysis or provide other research, although he has no duty to do so for a past client after the closing of the transaction. Bill can provide his past client with the names of professional ad valorem tax consultants that may assist with testimony. The best practice for Bill to take is to provide his past client with support but not advice or testimony.

Case Study 6

Delia has fiduciary duties to her client, one of which is to be scrupulous and meticulous in representation of the client's interests. Delia should advise the client to consult an attorney who may help obtain information to determine why the district lowered the valuation. Additionally, Delia should ask the seller's agent if they know why the valuation was reduced. If the answers to her questions are not forthcoming within the feasibility period of the purchase contract with the seller, then Delia should advise her client to seek an extension until the questions are answered to the client's satisfaction.

APPENDIX

A

NATIONAL ASSOCIATION OF REALTORS® CODE OF ETHICS AND STANDARDS OF PRACTICE ARTICLE 11

Introduction

Brokers who are members of Texas Realtors® may purchase guidebooks that suggest methods and procedures to follow to ensure your sponsored agents are geographically competent in their chosen type of real estate brokerage. Without doubt, brokers who sponsor agents should consult their attorney for guidance in developing competency assessment tools.

The National Association of Realtors® Code of Ethics and Standards of Practice has been in existence since 1913. The “Code” sets standards for some 1.3 million-member agents across the United States. Articles 2, 11, and 12 offer specific guidelines and standards that a prudent agent would follow in order to be competent in the area and specific type of real estate being considered. In Article 2, in order to avoid exaggeration, misrepresentation, or concealment of pertinent facts a REALTOR® would have to be have geographically and specific type of property competence.

Article 11 directly requires a REALTOR® to conform to the standards of practice and competence necessary for a specific type of property. Article 11, Standard of Practice 11-1 provides very specific guidelines for REALTORS® when they provide opinions of value or price (in Texas license holders cannot provide an opinion of “value” but are allowed to provide estimates of price – see TREC rule §535.17).

There are without doubt many other practices that diligent professional agents can use to become competent in any local marketplace. Any and all of the above suggestions can be modified to fit any and all types of real estate. Now it is the law – a license holder must be competent in the in the geographic marketplace and the specific type of real estate being purchased, sold, or leased. Through competence license holders better serve the public.

NAR Code of Ethics and Standards of Practice Article 11

The services which REALTORS® provide to their clients and customers shall conform to the standards of practice and competence which are reasonably

expected in the specific real estate disciplines in which they engage; specifically, residential real estate brokerage, real property management, commercial and industrial real estate brokerage, land brokerage, real estate appraisal, real estate counseling, real estate syndication, real estate auction, and international real estate.

REALTORS® shall not undertake to provide specialized professional services concerning a type of property or service that is outside their field of competence unless they engage the assistance of one who is competent on such types of property or service, or unless the facts are fully disclosed to the client. Any persons engaged to provide such assistance shall be so identified to the client and their contribution to the assignment should be set forth. (Amended 1/10)

Standard of Practice 11-1

When REALTORS® prepare opinions of real property value or price they must:

- 1) be knowledgeable about the type of property being valued,
- 2) have access to the information and resources necessary to formulate an accurate opinion, and
- 3) be familiar with the area where the subject property is located

unless lack of any of these is disclosed to the party requesting the opinion in advance.

When an opinion of value or price is prepared other than in pursuit of a listing or to assist a potential purchaser in formulating a purchase offer, the opinion shall include the following unless the party requesting the opinion requires a specific type of report or different data set:

- 1) identification of the subject property
- 2) date prepared
- 3) defined value or price
- 4) limiting conditions, including statements of purpose(s) and intended user(s)
- 5) any present or contemplated interest, including the possibility of representing the seller/landlord or buyers/tenants
- 6) basis for the opinion, including applicable market data

- 7) if the opinion is not an appraisal, a statement to that effect
- 8) disclosure of whether and when a physical inspection of the property's exterior was conducted
- 9) disclosure of whether and when a physical inspection of the property's interior was conducted
- 10) disclosure of whether the REALTOR® has any conflicts of interest (Amended 1/14)

Standard of Practice 11-2

The obligations of the Code of Ethics in respect of real estate disciplines other than appraisal shall be interpreted and applied in accordance with the standards of competence and practice which clients and the public reasonably require to protect their rights and interests considering the complexity of the transaction, the availability of expert assistance, and, where the REALTOR® is an agent or subagent, the obligations of a fiduciary. (Adopted 1/95)

Standard of Practice 11-3

When REALTORS® provide consultive services to clients which involve advice or counsel for a fee (not a commission), such advice shall be rendered in an objective manner and the fee shall not be contingent on the substance of the advice or counsel given. If brokerage or transaction services are to be provided in addition to consultive services, a separate compensation may be paid with prior agreement between the client and REALTOR®. (Adopted 1/96)

Standard of Practice 11-4

The competency required by Article 11 relates to services contracted for between REALTORS® and their clients or customers; the duties expressly imposed by the Code of Ethics; and the duties imposed by law or regulation. (Adopted 1/02)

APPENDIX

B

ARTICLE "NAVIGATING SELLER'S DISCLOSURE AFTER HARVEY"

BY CHARLES PORTER AND GARY PATE, TEXAS REALTOR, NOVEMBER 2017



Texans with properties that flooded after Harvey must disclose this to prospective buyers.

By Dr. Charles Porter, Gary L. Pate
November 01, 2017

In the aftermath of Harvey, many are wondering about the duties of disclosure real estate agents owe to buyers and sellers.

The Texas Real Estate License Act (Chapter 1101, Texas Occupations Code) lists a number of ways in which real estate agents' behavior could result in suspension or revocation of licensure. Among others, Sections 1101.652 (b)(1-4) are germane to agents' behavior related to the disclosure of flooding. Specifically, agents are required to disclose to a potential buyer "a significant defect, including a latent structural defect, known to the license holder that would be a significant factor to a reasonable and prudent buyer in making a decision to purchase real property."

The seller's disclosure notice is not the real estate agent's disclosure but the seller's disclosure. While you may provide the form and answer questions about it, you should not complete the form for a seller. Stress to sellers the importance of answering the questions honestly and thoroughly. It is hard to imagine a seller harmed by over-disclosure.

As to flooding of real property, there is no doubt this condition is a significant defect that must be disclosed to a potential buyer if actually known to the agent. Although the License Act only requires disclosure of what is actually known, it is possible a court could impose a broader standard of "ought to have known" on license holders.

As a fiduciary, license holders must represent the interest of their clients and perform services with the necessary levels of integrity and competency. After Hurricane Harvey flooding in Houston and the massive publicity worldwide, it seems improbable that any real estate agent in the southeast Texas area did not know about the event. An agent's fiduciary duty may require a license holder to investigate for their clients whether a property in the Houston area actually flooded.

Members of the Texas REALTORS® have exclusive access to the Seller's Disclosure Notice (TAR 1406), which has options to disclose information about a property's flooding history, including whether there has been flooding and if there is present flood insurance coverage.

APPENDIX

E

AFLALO V. HARRIS – A CIVIL CASE IN DALLAS COUNTY UPDATE

Facts: Aflalo used the Texas REALTORS® Seller's Disclosure Notice (TXR 1406) when selling his property. Aflalo indicated on the Notice that he did have flood insurance, but he did not attach TXR 1414, Information About Special Flood Hazard Areas, as the form instructs. Harris (buyer) terminated the contract due to Aflalo not providing a complete Seller's Disclosure Notice under Texas Property Code 5.008.

Previous Court Proceedings: Aflalo lost at the trial court. The court ruled that by using the Texas REALTORS® Seller's Disclosure Notice, the disclosure requirement was increased above and beyond the requirements in the Texas Property Code. The Texas Court of Appeals reversed the trial court and ruled in favor of Aflalo. Harris (buyer) appealed to the Texas Supreme Court.

Outcome: On May 1, 2020, the Texas Supreme Court declined to review the case, which means the Court of Appeals ruling in favor of Aflalo holds. The Texas REALTORS® Seller's Disclosure Notice does not add additional disclosure requirements beyond the Texas Property Code. The case was sent back to the trial court for further proceedings based on that finding. In February 2021, Harris filed a Motion for Summary Judgment, which essentially asks the court to rule in their favor based on the evidence without going to trial. That motion argued that although the Harrises breached the contract, Aflalo did not prove damages, that Paragraph 15 of the contract bars a seller from recovering both the earnest money and actual damages, and that Aflalo had also sued his listing agent, arguing that the listing agent, not the Harrises, caused the damages Aflalo was seeking from the Harrises. The trial court granted the Harrises' Motion for Summary Judgment. The court determined that the Harrises did breach the contract and Aflalo was entitled to the \$10,000 earnest money. However, the court denied any additional damages for the breach of contract, thereby making the Harrises the prevailing party. Under paragraph 17 of the TREC One to Four Family Residential Contract (Resale), the prevailing party is entitled to reasonable attorney's fees. The court awarded the Harrises almost \$261,000 in attorney's fees.

There was also a lawsuit filed by Aflalo (seller) against their listing broker for not providing the additional form TXR 1414, Information About Special Flood Hazard Areas, which had been put on hold.

Aflalo voluntarily withdrew this lawsuit in January 2021 before a judgment was reached.

**Errata
to
2022-2023 Legal Update Instructor Manual, Student Manual, and Power Points
effective July 2022**

Legal Update I Instructor and Student Manual	
Cover Page	<ul style="list-style-type: none"> • Updated Edition to Edition 10.1 • Added "Revised 7/2022" in bottom right corner
Title Page	<ul style="list-style-type: none"> • Updated Edition to 10.1
Contents Page	<ul style="list-style-type: none"> • Updated Edition to 10.1 • Page numbers updated
Chapter 1 - Legislative Changes and TREC Rule Updates Key TREC Rules Updates Page 1 - 3	<p>• Revised §531.18 - Consumer Information (effective 4/1/2022) The amendment and the updated Consumer Information form was necessary to implement statutory changes enacted by the 87th Legislature in HB 1560, which moved the regulation of residential service companies, also known as home warranty companies, from TREC to the Texas Department of Licensing and Regulation (TDLR) effective September 1, 2021. The amendment to the Consumer Protection Notice removes a reference to home warranty companies being regulated by TREC. The new form number is CN 1-4 and is available at www.trec.texas.gov.</p> <p>Note that the previous form version CN 1-3 which was effective 2/1/2021, added a statement to alert consumers that inspectors licensed by TREC are required to maintain errors and omissions insurance to cover losses arising from the negligent or incompetent performance of a real estate inspection.</p> <p>• Added §535.56 - Education and Experience Requirements for a Broker License (effective 3/10/2022) The amendment to §535.56 and the adopted forms incorporate a new point system that is easier to understand. This simplified point system does not increase the requirements to obtain a broker's license and is intended to further streamline the broker license application process. The amendment and forms also include changes to the requirements by mandating that an applicant must have performed at least one transaction per year for at least four of the five years preceding the date the application is filed. They also remove the low point value categories of Exclusive Right to Sell Listings, Buyer and Tenant Representation Agreements, and Listings, but increase the opportunity for agents to count team management and now delegated supervision by eliminating the previous maximum amount of points that could be counted under that category. Form # BL-A and BL-B are available at www.trec.texas.gov.</p>

<p>Chapter 1 - Legislative Changes and TREC Rule Updates Key TREC Rules Updates Page 1-3 Continued</p>	<ul style="list-style-type: none"> Added §535.92 - Continuing Education Requirements (effective 12/2/2021) The amendment eliminates subsection (f), which allowed license holders to obtain continuing education (CE) credit for a course taken to fulfill a requirement of a professional designation and included a list of specific professional designations recognized by the Commission for purpose of obtaining CE credit. License holders may still receive CE credit for such courses if providers have submitted and the Commission has approved the course for credit through the usual course approval process. Added §535.148 - Receiving an Undisclosed Commission or Rebate (effective 12/2/2021) The amendment updates a statutory reference pursuant to changes enacted by the 87th Legislature in HB 1560 that residential service companies are now licensed and regulated by the Texas Department of Licensing and Regulation (TDLR). The amendment also updates the Disclosure of Relationship With Residential Service Company form (#RSC-3).
<p>Chapter 2 - Promulgated Contract Forms & Addenda Learning Objectives Page 5</p>	<ul style="list-style-type: none"> 3rd Learning objective - corrected "backup" to "back-up." 5th learning objective - changed "his or her" to "their."
<p>Chapter 2 - Promulgated Contract Forms & Addenda Proper Use of Paragraph 21 of the One to Four Family Residential Contract (Resale) Page 11</p>	<ul style="list-style-type: none"> 2nd column, 2nd paragraph - corrected capitalized "Seller's agent" and "Seller's contact" to lowercase "seller's agent" and "seller's contact information."
<p>Chapter 2 - Promulgated Contract Forms and Addenda An Important Note on Escalation Clauses Page 17</p>	<ul style="list-style-type: none"> 2nd column, 2nd paragraph - 3rd sentence - corrected grammar error: deleted "and" and capitalized "the" to "The" [Real Estate Licensing Act...]

Chapter 3 - Fair Housing - Diversity and Inclusion in Real Estate Fairhaven: A Fair Housing Simulation Page 21	<ul style="list-style-type: none"> • First sentence - corrected "Realtors®" to "REALTORS®" • "Reprinted with permission... -" corrected "Realtors®" to "REALTORS®"
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Legal Update II Instructor and Student Manual	
Title Page	<ul style="list-style-type: none"> • Updated Edition to 10.1
Contents Page	<ul style="list-style-type: none"> • Updated Edition to 10.1 • Page numbers updated • Changed §531.1 - Fidelity to §531.2 • Changed §531.2 - Integrity to §531.3 • Changed §531.3 - Competency to §531.4
Chapter 1 - Agency - Fiduciary Duties and Ethical Behavior of License Holders §531.2 - Fidelity §531.3 - Integrity §531.4 - Competency Pages 1 - 3	<ul style="list-style-type: none"> • Updated section headings and content throughout the manual in accordance with new TREC rule numbering for Fidelity, Integrity and Competency (§531.2 - §531.4)
Chapter 2 - Water and Mineral Rights Water and the Seller's Disclosure Notice Page 13	<ul style="list-style-type: none"> • Last sentence - corrected "in these areas:" to "in the two areas above."
Chapter 3 - Ad Valorem Taxes and Valuation	<ul style="list-style-type: none"> • Some areas of this chapter were revised was revised to make it more concise. Disabled exemption added to the list of property tax exemptions.

<p>Appendix E - Aflalo V. Harris - A Civil Case In Dallas County Update</p>	<ul style="list-style-type: none"> • Under Previous Court Proceedings section corrected "Realtors® Seller's Disclosure Notice" to "REALTORS® Seller's Disclosure Notice." • Deleted "Update" and subsequent text from v. 10.0 with "Outcome" and the following text: On May 1, 2020, the Texas Supreme Court declined to review the case, which means the Court of Appeals ruling in favor of Aflalo holds. The Texas REALTORS® Seller's Disclosure Notice does not add additional disclosure requirements beyond the Texas Property Code. The case was sent back to the trial court for further proceedings based on that finding. In February 2021, Harris filed a Motion for Summary Judgment, which essentially asks the court to rule in their favor based on the evidence without going to trial. That motion argued that although the Harrises breached the contract, Aflalo did not prove damages, that Paragraph 15 of the contract bars a seller from recovering both the earnest money and actual damages, and that Aflalo had also sued his listing agent, arguing that the listing agent, not the Harrises, caused the damages Aflalo was seeking from the Harrises. The trial court granted the Harrises' Motion for Summary Judgment. The court determined that the Harrises did breach the contract and Aflalo was entitled to the \$10,000 earnest money. However, the court denied any additional damages for the breach of contract, thereby making the Harrises the prevailing party. Under paragraph 17 of the TREC One to Four Family Residential Contract (Resale), the prevailing party is entitled to reasonable attorney's fees. The court awarded the Harrises almost \$261,000 in attorney's fees. <p>There was also a lawsuit filed by Aflalo (seller) against their listing broker for not providing the additional form TXR 1414, Information About Special Flood Hazard Areas, which had been put on hold.</p> <p>Aflalo voluntarily withdrew this lawsuit in January 2021 before a judgment was reached.</p>
<p>Appendix F-Broker Price Opinion Q&A</p>	<ul style="list-style-type: none"> • 4th question (What must be kept in your files?) Delete the first sentence "A CMA for every listing and for every buyer." • Same question - delete the semicolon after the period (typo).

	Legal Update Power Point Updates
General	Manual page references in footers updated
Title page	Slide 1 updated to Edition 10.1

	<ul style="list-style-type: none"> • Updated slide 4 - Consumer Information from eff. 2-1-21 to 4-1-22. • Added slide 5 for additional rules: §535.56 -Education and Experience Requirement, §535.92-CE Requirements, §535.148-Receiving and Undisclosed Commission or Rebate.
Chapter 1 - Legislative Changes and TREC Rule Updates	

Legal Update II Power Point Updates	
Title page	Slide 1 updated to Edition 10.1
Chapter 1 - §531.2 - Fidelity	Slides 6 & 7 - Fidelity changed from §531.1 to §531.2
Chapter 1 - §531.3 - Integrity	Slides 8 & 9 - Integrity changed §531.2 to §531.3
Chapter 1 - §531.4 - Competency	Slides 10 & 11 - Competency changed §531.3 to §531.4
Chapter 3 - Ad Valorem Taxes and Valuation	Slide 42 - Property Taxes Protest Hearings renamed Property Taxes on the Rise to match the manual
Chapter 3 - Rate Proposals	Slide 44 - Reworded to match the manual
Chapter 3, Protesting Property Taxes - When Can Value Be Protested	Slide 46 added bullet #3 "The CAD denied a special appraisal, or incorrectly denied an exemption application;"
Chapter 3, In Conclusion	Slide 58 - deleted "(unless the licensee holds an appraisal license)" - redundant because the manual states "unless specifically qualified."