Implicit Bias, Office Management and Supervision, Agency, Fair Housing, Trust Funds, Ethics and Risk Management

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Implicit Bias: Video™

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Introduction to Implicit Bias — Probing Below the Surface

A California for all

As the bellwether state of the United States, California draws its strength from a **diversity of people** and **ideas**. Its characters are as colorful as its historic Painted Ladies, resilient as its ancient sequoias, and optimistic as its sunny climate.

The California Dream sells itself — and *real estate professionals* sell the home.

But what happens when this signature strength is hobbled? California's legislature has long neglected housing health, especially in terms of discrimination in real estate. The result is one of the nation's lowest homeownership rates and steepest income disparities.

Worse, disparities frequently track neatly along racial lines. As part of 2008's *Great Recession*, Latinx households were disproportionately targeted for subprime mortgages. During the COVID-19 pandemic, de facto housing segregation left Black residents more vulnerable to contracting the virus.

These snapshots are a far cry from the "A California for all" Governor Gavin Newsom outlined in his 2019 inaugural address. As the fifth-largest economy in the world, California has the resources to ensure a decent standard of living for all its people. So how is it that California's racial minorities and other vulnerable groups come to bear the brunt of the state's housing crises? And what is the real estate

professional's responsibility in this issue?

Breaking the cycle

The answer lies in acknowledging our own biases – both implicit and explicit.

The term **implicit bias** refers to discriminatory thoughts or attitudes of which a person is not *fully aware*. These thought patterns are subtle, subliminal, and below the level of direct consciousness. Think of the portion of an iceberg that rests beneath the surface of frigid water.

Alternatively, **explicit bias** describes the same type of discriminatory thoughts

implicit bias
Actions which are not openly discriminatory but yield discriminatory results.

or attitudes, but paired with an *awareness* of their existence and influence on behavior. Explicit bias is the craggy piece of the iceberg which juts out above the surface of the water, fully visible to all. For example, a real estate agent or landlord who consciously and deliberately refuses to show homes to or accept applications from members of a protected group is guilty of *explicit discrimination*.

This marks the difference between being aware of a stereotype and allowing it to

explicit bias
Blatant discrimination which causes real estate licensees to unlawfully refuse to show properties or take applications from members of a protected class.

color behavior, versus letting it motivate unconsciously — *implicitly*.

Implicit bias training is now taking place across industries — in healthcare, policing, and now real estate, thanks to California **Senate Bill 263**.

This training prepares California real estate professionals to *identify and counteract* elements of systemic racism, conscious and unconscious, in real estate transactions.

More critically, this training is pragmatic in nature and designed to inform behavior. After completing this training, students will be able to:

- take steps to avoid unconscious implicit bias in sales, leasing and lending activities;
- implement fair hiring practices;

- properly report discriminatory practices observed in the industry;
- adhere to advertising guidelines in order to avoid discrimination in marketing; and
- standardize tenant screening practices and the handling of applications.

The point of this training is not to shame any specific group. Even when licensees don't consciously embrace racist stereotypes, those stereotypes may still subtly influence their behavior outside of their direct awareness. Understanding this

The Implicit Association Test (IAT) – Check your perceptions

Methods are available to check your own innate level of implicit bias. In 1998, three scientists launched Project Implicit to educate the national public about bias and disparities. To this end, the **Implicit Association Test (IAT)** was created to measure subconscious attitudes and beliefs held by individuals.

Implicit Association Test (IAT)
A publically available online test designed to measure subconscious attitudes and beliefs held by individuals.

The IAT is a publically available test that is taken online. Primarily, the IAT measures associations between concepts and the strength of those associations.

The IAT tasks individuals with quickly categorizing two selected concepts with an attribute (for example, "Black"/"Caucasian" and "Good"/"Bad"). Later in the test, individuals are then to deliberately invert their responses. The length of time it takes the individual to make each association is measured.

Associations that are made more quickly indicate a more deeply held underlying belief, whereas associations made more slowly (such as associating "Black" with "Good") may signal a subconscious attitude – implicit bias.

However, the IAT is not without its detractors and remains controversial in the scientific community. While it may reveal some degree of implicit bias, it may also simply reflect an individual's familiarity or may result

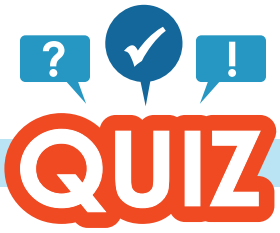
from mental conditioning – telling the brain and fingers to do the opposite of what was done just moments earlier.

The IAT may be taken here:

implicit.harvard.edu/implicit/takeatest.html

subtlety – the ice beneath the surface – is the crux of any effective implicit bias training.

To err is human, but to counter those mistakes with compassion is uniquely Californian.



1. Actions which are not openly discriminatory but yield discriminatory results refers to:

   a. explicit bias.
   b. direct bias.
   c. implicit bias.

2. The _____ is a publically available test designed to measure subconscious attitudes and beliefs held by individuals.

   a. Implicit Aptitude Exam (IAE)
   b. Explicit Association Metric (EAM)
   c. Implicit Association Test (IAT)

State and Federal Fair Housing Laws: Identifying the Explicit and the Implicit, Pt I

Systemic racism can exist in real estate too

Although not unheard of, real estate professionals rarely practice overt discrimination. **Overt discrimination** occurs when, based on race or other protected classification, real estate professionals refuse to:

- show properties;
- provide property information;
- give consultations; or
- accept rental/purchase applications.

Alternatively, **implicit discrimination** occurs when a real estate professional performs actions that are not openly discriminatory but produce discriminatory results. For example, an agent may show minority buyers *fewer* listings than non-minority buyers.

Implicit discrimination also happens when agents steer minority buyers to neighborhoods consisting of the same protected class. Implicit discrimination may be unconscious, but it is still unlawful.

Even though it's not always detectable, explicit and implicit discrimination keep protected classes out of their desired homes.

General protection under the federal Civil Rights Act

Regardless of race, all citizens of the United States have the right to purchase or rent real estate under the federal **Civil Rights Act**. [42 United States Code §1982]

Civil Rights Act
A federal law which provides broad protections to numerous classes of individuals in the United States against discriminatory activity.

Further, all individuals within the United States are given the same rights to make and enforce contracts, sue, be sued, enjoy the full benefits of the law and be subject to the same punishments, penalties, taxes and licenses, regardless of race or legal status. [42 USC §1981]

The federal Civil Rights Act applies to race discrimination on the sale or rental of all types of real estate, both residential and commercial. Racially motivated activities in any real estate sales or leasing transaction are prohibited.

Federal protection against racial discrimination given under the Civil Rights Act is the broadest of protections which apply to types of discrimination prohibited in all activities between individuals present in the country.

Greater protection under the Federal Fair Housing Act (FFHA)

While the federal Civil Rights Act provides general protection against all prohibited discriminatory activity, the **Federal Fair Housing Act (FFHA)** protections are specifically limited to dwellings, including rental housing. [42 USC §§3601 et seq.]

Federal Fair Housing Act (FFHA)
A collection of policies designed to prevent discrimination in the access to housing based on an occupant's inclusion in a protected class.

A **dwelling** includes any building or structure that is occupied, or designed to be occupied, as a residence by one or more families. A *dwelling* also includes vacant land offered for lease for residential dwelling purposes, such as a lot or space made available to hold a mobilehome unit. [42 USC §3602(b)]

The FFHA prohibits discrimination in the following situations:

- the sale, rental or advertisement of a residence;
- offering and performing broker services;
- making loans to buy, build, repair or improve a residence;

- the purchase of real estate loans; or
- appraising real estate. [42 USC §3602]

The FFHA bars the use of any discriminatory actions a seller, landlord or property manager might take against a prospective buyer or tenant based on an individual's:

- race or color;
- national origin;
- religion;
- sex;
- familial status; or
- handicap. [42 USC §3602]

Familial status refers to whether a household includes individuals under the age of 18 in the legal custody of a parent or legally designated guardian. [42 USC §3602(k)]

familial status
A status which indicates a household includes individuals under the age of 18.

Handicapped persons are individuals who have:

- a physical or mental impairment which substantially limits the individual's life activities; or
- a record of, or are regarded as having, a physical or mental impairment. [42 USC §3602(h)]

Any individual who claims they have been injured by a prohibited discriminatory housing practice under the FFHA or believes they will be injured by such a practice is considered an **aggrieved individual**. [42 USC §3602(i)]

An *aggrieved individual* may file a complaint with the Secretary of Housing and Urban Development (HUD), within one year of the alleged discriminatory housing practice. HUD then attempts to resolve the dispute by having the parties enter into informal negotiations, called **mediation**. [42 USC §3610(a)]

When a real estate broker subjected to a judicial action is found guilty of discriminatory housing practices, HUD is to notify the California Department of Real Estate (DRE) and recommend disciplinary action. [42 USC §3612(g)(5)]

When a court determines discriminatory housing practices have taken place, actual and punitive amounts of money awards may be granted. Also, an order

may be issued preventing the landlord or broker from engaging in any future discriminatory housing practice. [42 USC §3613(c)(1)]

Federal fair lending laws

In the context of lending and mortgage practices, the federal **Equal Credit Opportunity Act** prohibits discrimination in lending based on race, color, religion, national origin, sex, marital status or age (provided an individual is of legal age).

Equal Credit Opportunity Act
A 1974 federal enactment prohibiting lenders from discriminating against borrowers from a protected class.

The anti-discrimination rules apply to institutional lenders, mortgage brokers, and others *who make or arrange mortgages*. [15 United States Code §1691a(e)]

Discriminatory practices take many forms, including:

- treating minority mortgage applicants less favorably than non-minority applicants;
- placing additional burdens on minority applicants;
- requiring a spouse's signature on a mortgage application when an applicant qualifies for a mortgage individually; [Anderson v. United Finance Company (1982) 666 F2d 1274]
- discouraging mortgage applicants based on their race, color, sex, etc.; [12

Exemptions from FFHA discrimination prohibitions

There are exemptions to the FFHA prohibitions. A landlord who rents out a single family residence is exempt from FFHA discrimination prohibitions if they:

- own three or fewer single family residences (SFRs);
- do not use a real estate licensee to negotiate or handle the tenancy; and
- do not use a publication, posting or mailing for any discriminatory advertisement. [42 USC §3603(b)(1)]

Thus, the FFHA prohibitions apply to all notices, statements and

advertisements promoting rentals by anyone in the *business of renting dwellings*. [42 USC §3603]

A person is in the business of renting (or selling) dwellings if the person:

- has participated within the past 12 months as a *principal* in three or more transactions involving the sale or rental of any dwelling or interest in a dwelling;
- has participated within the past 12 months as an *agent*, negotiating two or more transactions involving the sale or rental of any dwelling or interest in a dwelling, excluding the agent's personal residence; or
- is the *owner* of a dwelling structure intended to be occupied by five or more families. [42 USC §3603(c)]

If a broker is the agent for any of the participants in a sale or rental transaction, the FFHA anti- discrimination rules apply.

However, attorneys, escrow agents, title companies and professionals other than brokers who are employed by a landlord to complete a transaction do not bring the transaction under the FFHA, unless they participate in negotiations with the buyer or tenant. [42 USC §3603(b)(1)(B)]

Also exempt from FFHA discrimination rules is the sale or rental of a residence in a one-to-four unit residential rental property which is occupied in part by the owner. [42 USC §3603(b)(2)]

Religious organizations who limit the sale, rental or occupancy of dwellings to individuals of the same religion are also exempt, provided the dwelling is owned for noncommercial reasons. No religious exemption exists if the religion is restricted to individuals of a particular race, color or national origin. [42 USC §3607(a)]

Private clubs which provide their members with residential dwelling space for noncommercial purposes may limit rental or occupancy of the dwellings to members.

Further, housing qualified for older citizens which excludes children is not considered prohibited discrimination against buyers or tenants with children based on familial status. However, for housing to exclude children it needs to first qualify as housing for the elderly. [42 USC §3607(b)]

Code of Federal Regulations §1002.5(b)] and

- making inquiries into the marital status of mortgage applicants. [12 CFR §1002.5(d)]

The lender may not make any inquiries into whether an applicant's income is derived from *alimony or child support*. The lender may not inquire whether the applicant intends to bear children. [12 CFR §1002.5(d)]

Further, to deny a mortgage based on an applicant's receipt of income from a public assistance program, such as *welfare* or *social security*, is unlawful discrimination. [15 USC §1691(a)(2)]

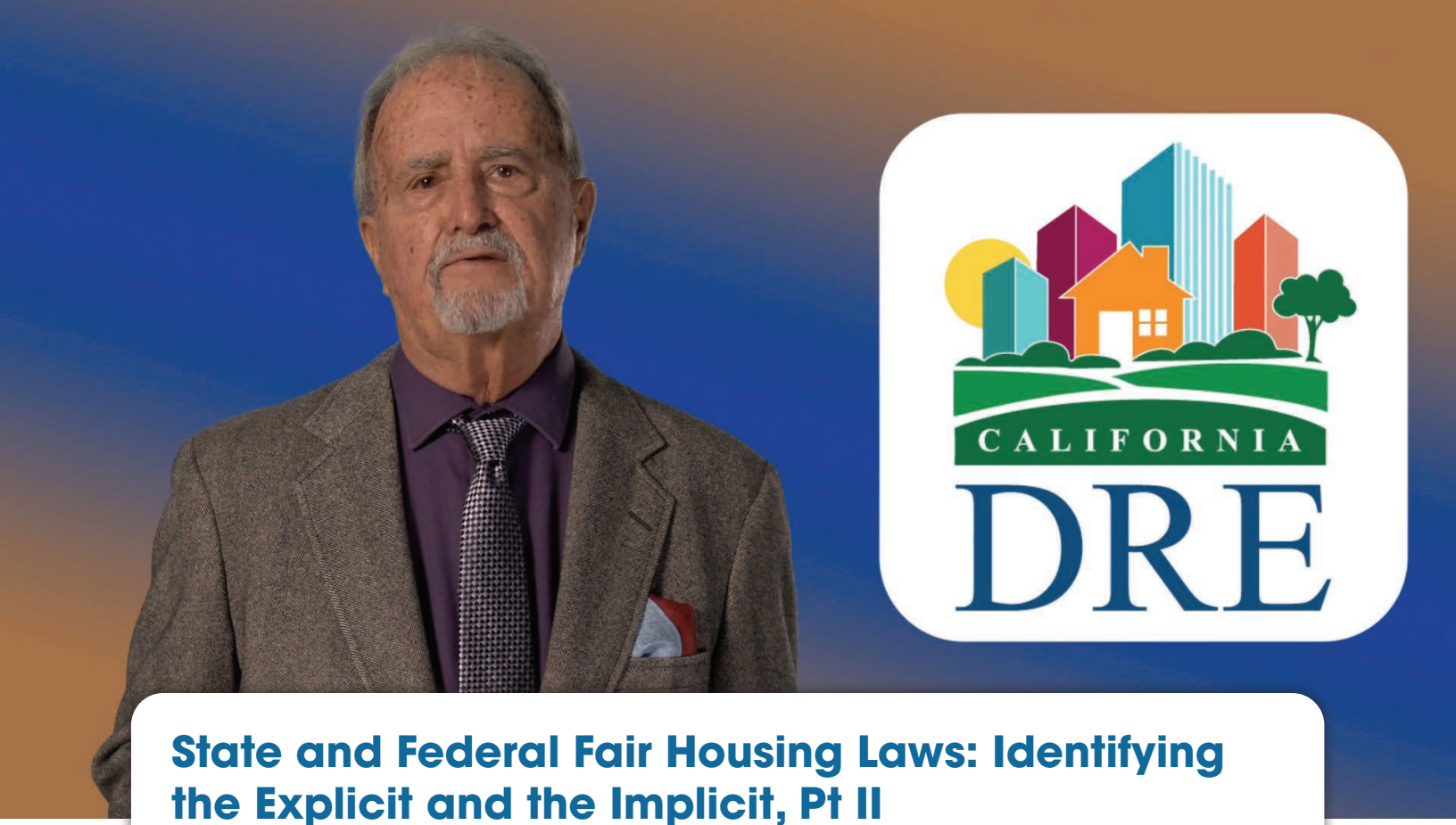
However, discrimination is rarely practiced overtly – it is practiced **implicitly**. Most lenders are not transparent enough for the consumer to see the discrimination. Most often, discrimination takes the form of a lender denying a mortgage to a minority borrower without a valid reason, or applying different standards to minority and non-minority borrowers.

Lenders need to be careful not to provide more assistance to non-minority borrowers than to minority borrowers when preparing applications and working out problems which arise.

The **different treatment** of minority and non-minority applicants is a form of unlawful *implicit discrimination*.

1. While the federal Civil Rights Act provides general protection against all prohibited discriminatory activity, the _____ protections are specifically limited to dwellings, including rental housing.

   a. Federal Fair Housing Act (FFHA)
   b. Equal Credit Opportunity Act
   c. Unruh Civil Rights Act



State and Federal Fair Housing Laws: Identifying the Explicit and the Implicit, Pt II

California prohibitions against discrimination

California prohibits discrimination in the sale or rental of housing accommodations based on an individual's race, color, religion, sex, gender, gender identity, gender expression, sexual orientation, familial status, marital status, disability, genetic information, national origin, source of income, veteran or military status, ancestry, citizenship, primary language, or immigration status. [CC §§51 et. seq.; Calif. Government Code §12955; DRE Reg. §2780 and §2781]

This list of protected individuals under state law is more extensive than all others.

Discriminatory activities and conduct include:

- making a written or oral inquiry into the race, sex, disability, etc. of any individual seeking to rent housing;
- ads or notices for rental of housing which state or infer preferences or limitations based on any of the prohibited discrimination factors;
- a broker refusing to represent an individual in a real estate transaction based on any prohibited factor; and
- any other practice that denies housing to a member of a protected class. [Gov C §12955]

The denial of housing based on the landlord or broker's perception that a prospective buyer or tenant has any of the protected characteristics is absolutely prohibited, whether it was done *explicitly* or *implicitly*. An individual who has been the victim of discriminatory housing practices may recover their money losses. [Gov C §12955(m)]

Fair Employment and Housing Act (FEHA)

The **Civil Rights of Department** is the California government agency which enforces anti-discrimination law. [Gov C §§12901, 12903, 12930, 12935]

Civil Rights Department
A state agency designated with protecting Californians from housing, employment, and public accommodation discrimination.

Any individual who feels they have been discriminated against may file a complaint with the *Department*. The Department investigates the complaint to determine any wrongful conduct. If grounds exist, the Department then seeks to resolve the situation through discussions with the individual against whom the complaint is made. [Gov C §12980]

California's Unruh Civil Rights Act

California's **Unruh Civil Rights Act**, another anti-discrimination law, prohibits discrimination by a **business establishment** based on numerous status classifications, including: an individual's sex, race, color, religion, ancestry, national origin, disability or medical condition. [Calif. Civil Code §§51; 51.2; 51.3]

Unruh Civil Rights Act
A California law which prohibits discrimination by a business establishment based on sex, race, color, religion, ancestry, national origin, disability or medical condition. A real estate practice is a business establishment.

However, age restriction is a legitimate discrimination as long as the restriction is in a project that qualifies as a senior citizen housing development.

The *Unruh Civil Rights Act* applies to anyone in the *business of providing housing*. Brokers, developers, apartment owners, condominium owners and single family residential owners renting or selling are considered to be in the business of providing housing.

As business establishments, landlords may not boycott, blacklist, refuse to lease or rent because of the race, creed, religion, color, national origin, sex, disability or medical condition of an individual's, or that individual's business partners, members, stockholders, directors, officers, managers, agents, employees, business associates or customers. [CC §51.5]

DRE regulation of discrimination

The DRE also enforces numerous regulations prohibiting discriminatory practices by real estate brokers and agents. A broker or agent found guilty of engaging in **discriminatory business practices** may be disciplined by the DRE. [California Department of Real Estate Regulation §2780]

DRE prohibited *discriminatory practices* include situations in which a broker or agent discriminates against anyone based on race, color, sex, religion, ancestry, disability, marital status or national origin.

Prohibited practices include any situation in which a broker, while acting as an agent, discriminates against anyone based on race, color, sex, religion, ancestry, disability, marital status or national origin. Examples of discriminatory practices include:

- refusing to negotiate for the sale or rental of real estate;
- refusing to show property or provide information, or steering clients away from specific properties;
- refusing to accept a listing;
- publishing or distributing advertisements that indicate a discriminatory preference;
- any discrimination in the course of providing property management services;
- agreeing with a client to discriminate when selling or leasing the client's property, such as agreeing not to show the property to members of particular minority groups;
- attempting to discourage the sale or rental of real estate based on representations of the race, sex, disability, etc. of other inhabitants in an area; and
- encouraging or permitting employees to engage in discriminatory practices.

A broker has a duty to advise their agents and employees of all anti-discrimination rules, including DRE regulations, the Unruh Civil Rights Act, the California Fair Employment and Housing Act, and the FFHA. [DRE Reg. §2725(f)]

The broker, in addition to being responsible for their own conduct, owes the public a duty to ensure their employees follow anti-discrimination regulations when acting as agents on the broker's behalf.

1. A broker owes the public a duty to ensure:
   a. their own compliance with anti-discrimination law.
   b. their employees' compliance with anti-discrimination law.
   c. Both a. and b.

White households

Latinx households

Black households

Access to Homeownership and the Wealth Gap

A source of wealth

Homeownership is the main source of wealth for American families. To increase household wealth, the U.S. government subsidizes and encourages homeownership through various tax incentives and mortgage programs, like:

- the mortgage interest deduction (MID);
- Federal Housing Administration (FHA)-insured, low down payment mortgages;
- low ceilings on capital gains tax; and
- Proposition 13 (Prop 13) in California.

Yet despite these incentives, some groups have greater difficulty becoming homeowners than others, which leads to an enormous wealth disparity between racial and ethnic groups.

The median household wealth as of 2019 is:

- $184,000 for white households;
- $38,000 for Latinx/Hispanic households; and
- $23,000 for Black households. [Kent, Ana Hernández & Ricketts, Lowell. (2021) *Wealth Gaps between White, Black and Hispanic Families in 2019*]

Put another way, for every dollar held by white households, Black households hold

only 12 cents, and Latinx households hold only 21 cents.

While all types of asset ownership are greater for white households, the majority of this **racial wealth gap** can be explained by lower **homeownership rates** among Black and other minority households.

racial wealth gap
The disparity of wealth held amongst different racial and ethnic groups.

Why minority households steer clear of homeownership

If homeownership is the key to wealth, why don't more minority households buy homes?

If past experience has taught minority communities anything, it's that for Black and Latinx households, homeownership is not the "safe investment" many vociferously proclaim it to be.

The **National Bureau of Economic Research (NBER)** published a study on the impact of the 2008 Millennium Boom and subsequent Great Recession on the homeownership rates of Black and Latinx households compared to white households (Asian households were excluded from the study). [Bayer, Patrick; Ferreira, Fernando & Ross, Stephen L. (2013) *The Vulnerability of Minority Homeowners in the Housing Boom and Bust*]

It found the 2009 **foreclosure crisis** had a greater effect on Black and Latinx homebuyer communities compared to white communities. The share of homeowners who lost their homes to foreclosure during this time was:

- over 1-in-10 Black and Latinx households; and
- just 1-in-25 white households.

Why were Black and Latinx homeowners more than twice as likely than White homeowners to lose their homes? Three factors converged to increase the likelihood of foreclosure:

- **aggressive subprime** or **predatory lending**;

predatory lending
The practice of targeting individuals unprepared or underqualified for homeownership with relaxed mortgage standards, luring borrowers into taking out a mortgage with higher fees and subprime terms.

- high **debt-to-income ratios (DTIs)** allowed by lenders; and
- high cases of **employment instability**.

Millennium Boom: the perfect storm for minority homebuyers

The most dangerous factor that increases the likelihood of foreclosure for Black and Latinx homebuyers is **predatory lending**.

The largest recognized case of predatory lending was settled by **Bank of America (BofA)** in 2012 for their subsidiary company, Countrywide's, discriminatory lending practices. BofA paid $335 million to roughly 200,000 victims of Countrywide's actions.

Countrywide discriminated against minority homebuyers in two ways, by:

- charging **higher fees** to minorities than white homebuyers with equivalent qualifications; and
- **steering** minority homebuyers into subprime mortgage products, even though the targeted homebuyers had equal or better credit histories than other white homebuyers who were not shown bad mortgages.

Steering
An unlawful housing practice that includes words or actions by a real estate sales licensee intended to influence the choice of a prospective buyer or tenant. A violation of federal fair housing provision that seek to eliminate discrimination in the sale or rental of housing.

Higher upfront fees and **subprime mortgages** induced the minorities targeted by Countrywide to ultimately pay much more than similarly qualified white homebuyers. Therefore, when the housing market and the economy went bust following the Millennium Boom, it was more difficult for minority homebuyers to make mortgage payments than the white homeowners who took our mortgages with Countrywide — the mortgages themselves were already less favorable and posed more risk.

subprime mortgage
A mortgage made to a borrower based on loose underwriting standards and resulting in a high risk of default.

Lenders also deliberately encouraged minority homebuyers to take on more debt than they would reasonably be able to carry — in effect, *steering* them to a mortgage product with a higher DTI that would provide the greatest benefit to the lender. The higher a homebuyer's DTI, the greater the risk and the less likely

the buyer will be able to make future mortgage payments.

Lenders of the **Millennium Boom** era did not seem to care about this axiom, and knowingly pushed minority homebuyers into mortgages they were unable to pay. This resulted in higher immediate fees for lenders, who jettisoned the risk to other investors by selling the bad mortgages on the secondary mortgage market — out of sight, out of mind.

Lastly, homeowners were more likely to lose their home following the Great Recession due to the statistical fact that the heads of Black and Latinx households are more likely to be employed in professions more susceptible to economic downturns, like manufacturing and other hourly jobs. In other words, the heads of these households are more likely to lose their jobs than their white counterparts.

Job loss and the inability to pay are the biggest reasons homeowners default on their mortgages. Other **financial shocks** also contribute to the decision to strategically default, which is typically a struggling household's last resort. [Gerardi, Kristopher; Herkenhoff, Kyle F.; Ohanian, Lee E. & Willen, Paul. (2015) *Can't Pay or Won't Pay? Unemployment, Negative Equity, and Strategic Default*]

The problem for California real estate

California is a large, diverse state. Nearly 40% of the population identifies as Latinx (Hispanic or Latino/Latina), according to the U.S. Census. Roughly 16% identify as Asian and 7% identify as Black or African American. Therefore, discrimination in the mortgage and housing markets has a far-reaching influence on our state.

Another issue for minority homebuyers, not mentioned in the NBER report, is the discriminatory behavior practiced by *some real estate agents*.

Compared to similarly qualified white clients, the U.S. Department of Housing and Urban Development (HUD) finds real estate agents show fewer rental and for-sale listings to Black, Asian and Latinx clients. [Aranda, Claudia L.; Levy, Diane K; Pitingolo, Rob; Santos, Rob; Turner, Margery Austin; Wissoker, Doug; The Urban Institute. (2013) *Housing Discrimination Against Racial and Ethnic Minorities 2012]*

Why do some real estate agents tend to show minority homebuyers fewer listings than their white counterparts?

It's usually *implicit bias* on behalf of the real estate agent. For instance, some real estate agents may think they're doing their Black clients a favor by only showing them homes in neighborhoods predominately full of other Black residents (an unlawful practice). Or agents may not realize they're slower to respond to requests by minority homebuyers, exercising a lesser degree of urgency than they would normally provide.

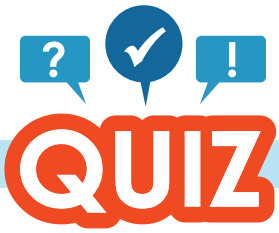
This perpetuates neighborhood **segregation**, which limits minority household access to higher quality jobs, better schools and other resources that disproportionately benefit white households.

segregation
The systemic act of separating households by race, which, in real estate, limits minority household access to higher quality jobs, better schools and other resources that disproportionately benefit white households.

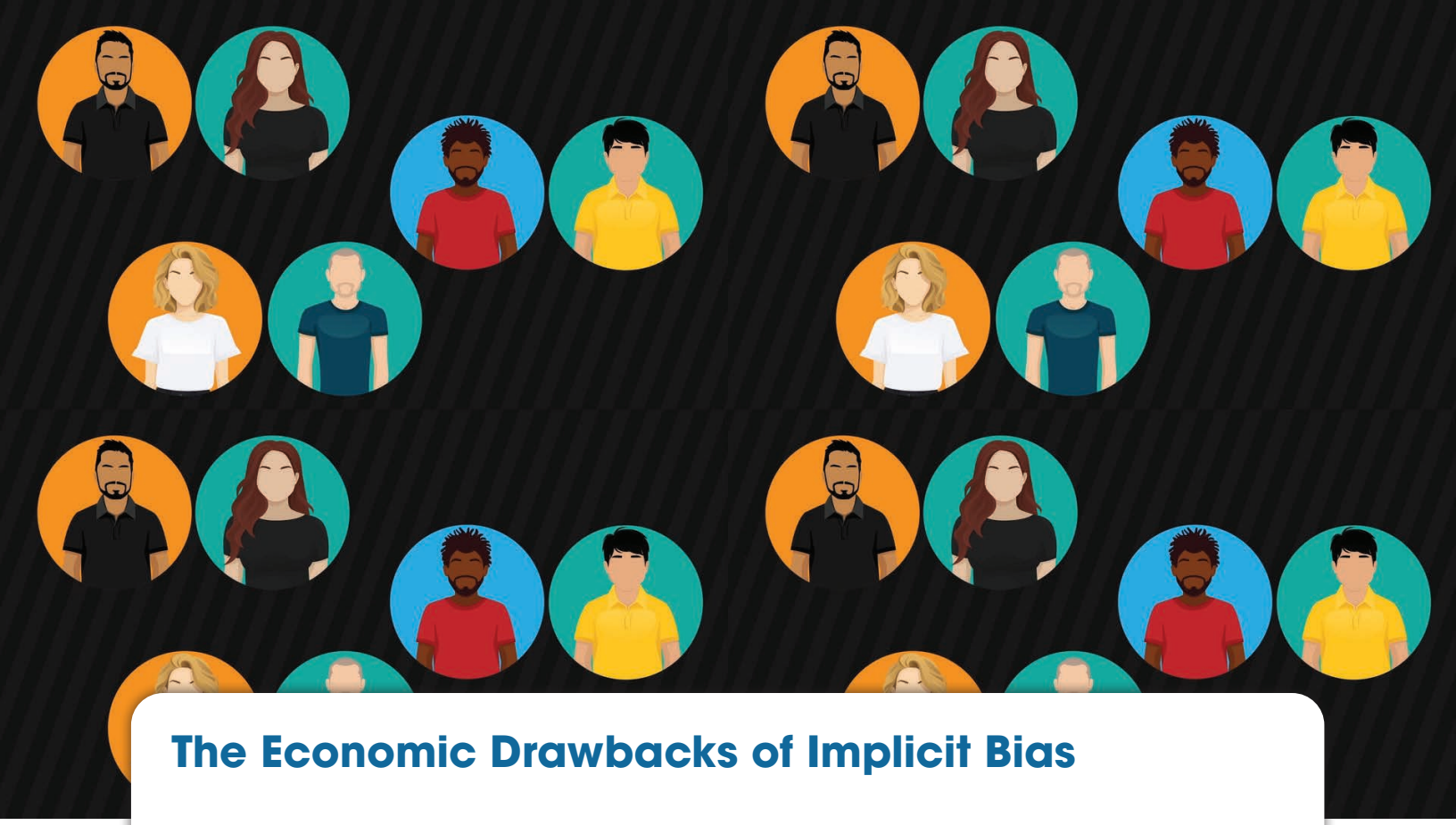
The only way to stop a California real estate agent from discriminating against minority clients?

The **California Department of Real Estate (DRE)** may enforce anti-discrimination laws. However, the DRE will only pursue an agent for ethics violations after first receiving a *formal complaint*.

In cases of discrimination, most homebuyers, sellers and renters do not know how to take appropriate action by contacting the DRE. Therefore, it is up to fellow agents and brokers to report discriminatory practices to the DRE. Aggrieved individuals may report complaints on the DRE's website using their online complaint form.



1. The racial wealth gap refers to:
   a. the allocation of resources in a manner which favors individuals in a protected class.
   b. the use of debt financing to acquire property to maximize the return on cash invested.
   c. the disparity of wealth held amongst different racial and ethnic groups.
2. The most dangerous factor that increases the likelihood of foreclosure for Black and Latinx homebuyers is:
   a. climate change.
   b. predatory lending.
   c. financial literacy.



The Economic Drawbacks of Implicit Bias

Implicit bias from real estate licensees

On top of the economic reasons mentioned above, minority households face **discrimination** in the form of:

- intentional **mortgage discrimination**;
- implicit (and sometimes explicit) discrimination from real estate professionals; and
- a higher likelihood of **default** and **foreclosure**.

Implicit discrimination ensures minority homebuyers and renters are:

- shown fewer properties; and
- given less information by real estate agents. [Aranda, Claudia L.; Levy, Diane K; Pitingolo, Rob; Santos, Rob; Turner, Margery Austin; Wissoker, Doug; The Urban Institute. (2013) *Housing Discrimination Against Racial and Ethnic Minorities 2012]*

A landmark study conducted by the Department of Housing and Urban Development (HUD) measured implicit racial discrimination by comparing the experiences of white testers against testers who were Black, Asian or Latinx, each with identical socioeconomic profiles.

Testers were instructed to contact housing providers and/or real estate licensees about recently advertised rental or sales listings. For consistency, two testers

contacted the same provider about the same listing. Testers had the same gender, age, family composition and financial characteristics, with their race the only contrasting factor.

This test was repeated 8,000 times across 28 major U.S. metros, including five metros in California.

Testers obtained listing information and scheduled viewings in equal measure, demonstrating that blatant racial discrimination has fallen significantly. But this was not true for the quieter, but equally harmful, implicit bias.

Compared to white buyers and renters responding to the same listings:

- Asian clients were shown 19% fewer for-sale and 7% fewer rental listings;
- Black clients were shown 18% fewer for-sale listings and 4% fewer rental listings; and
- Latinx clients were shown 7% fewer rental listings and roughly the same number of for-sale listings.

While blatant refusal to show properties to Black, Asian or Latinx clients was not an issue identified in the study, licensees exposed all non-white participants to *fewer* available units than their white counterparts. This subtle form of discrimination still has the adverse effect of providing Black, Asian and Latinx households with fewer options, limiting not just housing choices, but educational and economic access.

Redlining: A history — and an ongoing problem

One of the most insidious forms of discriminatory lending in California's history is **redlining**. *Redlining* is the practice of denying mortgages and under-appraising properties in minority communities based on demographics. The **Housing Financial Discrimination Act of 1977** outlawed the practice in California.

redlining
The practice of denying mortgages and under-appraising properties in minority communities based on demographics, outlawed in California by Housing Financial Discrimination Act of 1977.

Redlining emerged as a practice after the **Great Depression** when the federal government sought to limit foreclosures and stabilize the housing market by classifying communities on a scale from low risk to

high risk for mortgage lenders.

The **Home Owners Loan Corporation (HOLC)** drew maps for over 200 cities nationwide between 1935 and 1940. The purpose of these maps was to color-code and document the **creditworthiness** of neighborhoods. The racial composition of neighborhoods was factored into the grades received, and often proved pivotal in assigning a certain grade.

The HOLC maps grouped neighborhoods into four classifications:

- Grade A: "Best" (colored green), described as the most stable, homogenous and in demand during good times or bad;
- Grade B: "Still desirable" (colored blue), described as somewhat stable and "still good," posing an acceptable risk of default for mortgage lenders;
- Grade C: "Declining" (colored yellow), posing a high risk of default for lenders and described as becoming obsolete with expiring restrictions or a lack of them and "infiltration of a lower grade population"; and
- Grade D: "Hazardous" (colored red), posing the greatest risk of default for lenders and the least stable of all the categories.

Redlining has historically led to a decline in the quality and quantity of housing in communities that were deemed risky. Even though California outlawed the practice in 1977, the effects of the HOLC maps introduced in the 1930s persist today.

The HOLC maps which contributed to redlining practices had measurable effects in subsequent decades. This includes reducing **homeownership rates**, **home values** and **rents** among neighborhoods with lower HOLC map grades like C and D, while also increasing **racial segregation**. [Aaronson, Daniel; Hartley, Daniel Aaron; Mazumder, Bhashkar. (2017) *The Effects of the 1930s HOLC "Redlining" Maps. Accessed March 2022. https://ideas.repec.org/p/fip/fedhwp/wp-2017-12.html*]

Over the 20th century, redlined areas — neighborhoods receiving D grades — became more Black than their bordering C-grade neighborhoods. The gap between D and C boundaries grew steadily from 1930 until the 1970s, before shrinking thereafter.

A similar pattern emerges in C neighborhoods bordering B

neighborhoods. In fact, the effects on housing were more significant and longer lasting along the C-B boundaries than the D-C boundaries.

For example, the gap between C and B home values as of 2010 was 7.5 percentage points. The gap between D and C home values as of 2010 was 2 percentage points.

Economic mobility hampered

Racial housing discrimination is not just morally and ethically reprehensible. It's also bad business. Implicit racial discrimination hinders sales volume in the real estate market, and also ties up rental activity.

Importantly, it was real estate agents, not owners, who engaged in the implicit discriminatory practices found by the HUD investigation.

The study showed that implicit racial discrimination impacts minority renters and buyers by:

- limiting their access to available housing;
- making the housing search longer, costlier and more difficult;
- hampering **economic mobility** by limiting a minority buyer's housing choices in areas with access to better employment and quality schools; and
- reinforcing the de facto racial segregation (redlining) that has gripped many U.S. cities in the years since outright segregation was outlawed.

economic mobility
The ability of an individual, household or family to improve their financial status over the course of years or generations.

Further, **explicit bias** still exists in the real estate profession, though less so today. In these rarer and more overt cases, real estate agents refuse outright to show properties or take applications from members of protected classes.

But the harm of racial, ethnic, and economic segregation reaches far beyond just those who are isolated from the market by these practices. It drags down the larger economy of an entire region – and with it, real estate sales volume – according to research published in the *Journal of Urban Studies*.

Metropolitan areas with high levels of racial and job skill segregation suffered

reduced rates of short- and long-term economic growth between 1980 and 2005, the Urban study found. The future of any community is no less endangered by segregation.

Worse, poverty is very costly to a local economy. Housing discrimination and racial segregation only exacerbate those costs, cutting into the incomes of all people with local vested interests.

California's homeownership rate is low for all ethnicities, typically averaging roughly ten percentage points below the U.S. homeownership rate.

The number one enemy for real estate professionals is a low homeownership rate. With fewer homebuyers and sellers, real estate agents, brokers and mortgage loan originators (MLOs) — along with all the other professionals involved, like appraisers, escrow agents and title insurance officers — have fewer closings, fewer fees and lower incomes.

Doing your part

How can you get involved and help more Latinx, Black and Asian households break the cycle of implicit bias and achieve homeownership?

Real estate agents need to be vigilant for signs of predatory lending. Agents can make sure all clients are fully aware of the details of the mortgage they are agreeing to pay back. The **Consumer Financial Protection Bureau's (CFPB's)** mortgage shopping tools are a safe place to direct homebuyers for homebuying and mortgage guidance.

Real estate professionals also need to maintain high anti-discrimination standards by following the laws set out in **California's Unruh Civil Rights Act**.

To ensure brokers, agents, MLOs and landlords don't violate anti-discrimination law — even unintentionally — professionals need to:

- ask the same questions of all applicants;
- keep records of client interactions; and
- when in doubt, contact a local fair housing expert for advice — find a list of experts at HUD's website.

1. The ability of an individual, household or family to improve their financial status over the course of years or generations is referred to as:

   a. assimilation.
   b. financial literacy.
   c. economic mobility.

Avoid the Risk of Discrimination in Advertising

Implicit signaling

In advertising, a company needs to target audiences effectively and directly. For example, goods marketed toward women are stereotypically packaged in pastels, identifying them as engineered for a feminine audience before you can even say "For Her."

While that might pass muster in retail, applying such a strategy in real estate may amount to **implicit discrimination** or worse – **explicit discrimination**.

For an example of implicit discrimination in advertising, consider an agent who directs Black homebuyers only to neighborhoods with a large Black population. While they may believe they are acting in their client's best interest by guiding them to a community with a similar population, the impact is discriminatory and this activity is unlawful.

Of course, some neighborhoods are not a good fit for every homebuyer. But when selling and renting properties, it is risky to limit your marketing blitz to a single group — even if that group is protected under fair housing laws.

Relatedly, if you are going to use models or stock photography in any of your marketing materials, be mindful to use images of *all types* of people. Do not single out one group in particular, even if the group you choose to single out is a protected group. By relying on just one type of person in your marketing, whether premised on race, gender or other protected class, you are implicitly signaling the

property is not a good fit for others who are not in this group.

Federal protections under the Federal Fair Housing Act (FFHA)

The printing or publishing of an advertisement for the sale or rental of residential property that indicates a wrongful discriminatory preference is a violation of the Federal Fair Housing Act (FFHA). [42 United States Code §3604(c)]

A property sold or leased for residential occupancy is referred to as a dwelling. The discriminatory preference rule applies to all brokers, developers and landlords in the business of selling or renting a dwelling. [42 USC §3603, 3604]

Real estate advertising guidelines are issued by the Department of Housing and Urban Development (HUD). The guidelines are the criteria by which HUD determines whether a broker has practiced or will practice wrongful discriminatory preferences in their advertising and availability of real estate services.

HUD guidelines also help the broker, developer, and landlord avoid signaling preferences or limitations for any group of persons when marketing real estate for sale or rent.

Wrongful discriminatory preferences in advertising

The **selective use** of words, phrases, symbols, visual aids and media in the advertising of real estate may indicate a wrongful discriminatory preference held by the advertiser. When published, the preference can lead to a claim of discriminatory housing practices by a member of the protected class.

Words in a broker's real estate advertisement that indicate a particular race, color, sex, sexual orientation, handicap, familial status or national origin are considered *violations* of the FFHA.

To best protect themselves, a broker – as **gatekeeper** to real estate – refuses to use phrases indicating a wrongful preference, *even if requested* by a seller or landlord.

Preferences are often voiced in prejudicial colloquialisms and words such as restricted, exclusive, private, integrated or membership approval.

Beyond just words

Words are not the only way to discriminate. Selectively using **symbols, images, human models, visuals** and other forms of media indicate preference too.

Housing for senior citizens

Indicating a preference by age is an exclusion from unlawful age discrimination when marketing qualified 55-or-over residences or communities. **Senior housing** is exempt from this particular anti-discrimination advertising rule.

senior housing
Housing intended for persons 55 or 62 years of age and older.

A senior citizen housing project is housing:

- intended for and solely occupied by persons 62 years of age or older; or
- intended and operated for occupancy by persons of 55 years of age or older. [Calif. Civil Code §51.3(b)(1); 42 United States Code §3607(b)]

Landlords and owners of qualified **retirement communities** or senior citizen apartment complexes can exclude children to meet the needs of older persons.

To qualify as senior citizen housing, the development or renovation project must have at least 35 dwelling units and obtain a public report issued by the DRE. [CC §51.3(b)(4)]

Examples of symbols and other visual aids used in advertising include:

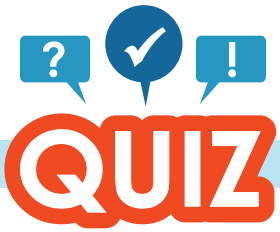
- sexuality pride flags;
- religious images such as a cross or Star of David;
- gender symbols;
- handicapped signs; and
- flags representing nationalities.

As previously discussed, aiming an advertisement at a particular class may lead people outside the group to believe they are not welcome in the area. Also, it may make the seller and their agent look like they *only* want to do business with a few select groups, which is never the desired intent in good brokerage practice.

The phrases above directly **target** protected classes, so it is best to leave them

out of your practice – period. This includes listings and marketing materials, as well as applications and deeds. While some may not sound aggressively prejudiced, even the seemingly harmless phrase "spacious master bedroom" is to be avoided due to the historical underpinning of the expression.

Regardless of what the advertiser meant, these problematic phrases can alienate clients and welcome a discrimination lawsuit.



1. When using models or stock photography in any of your marketing materials, be mindful to use images of:
   a. only the type of people you wish to target.
   b. all types of people.
   c. computer-generated people only.
2. A senior citizen housing project is housing:
   a. intended for and solely occupied by persons 62 years of age or older.
   b. intended and operated for occupancy by persons of 55 years of age or older.
   c. Either a. or b.

"What country were you born in?"

Avoid the Risk of Discrimination in Rental Practices

Discrimination in leasing

A good rule of thumb is to simply not ask a potential or current tenant questions regarding their **protected status**.

For example, since landlords may not discriminate based on a tenant's national origin, landlords may not ask prospective tenants what country they were born in as this can never be a factor in deciding the terms, conditions or privileges for their rental of a dwelling.

To avoid discrimination, landlords need to ask all potential tenants the same **standard questions** to ensure equal treatment. Landlords also ought to limit inquiries to matters that are directly applicable to the potential renters' tenancy or the maintenance of the rental property.

For example, landlords may ask:

- about the presence of pets;
- how many tenants will occupy the property;
- how many parking spaces will be required;
- whether their present landlord will provide a favorable reference;
- whether any of the tenants smoke; and

- whether any of the tenants intend to use a waterbed in the premises.

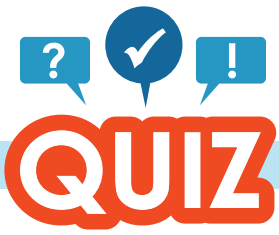
This allows landlords to screen tenants effectively and limits vulnerability to a lawsuit from a potential tenant who believes they were treated unfairly. For example, a landlord may not ask questions about the tenant's:

- marital status;
- religious practices;
- intention to have children;
- national origin;
- disability status; or
- any other protected status.

Some common fair housing violations include:

- refusing to rent, lease or sell housing due to illegal discrimination;
- sexual harassment, particularly demanding sexual favors in return for housing;
- creating documents, such as **covenants, conditions and restrictions (CC&Rs) that discriminate against a protected group;**
- denying a home loan or insurance for discriminatory reasons; and
- failing to reasonably accommodate a disability.

When a landlord is on shaky ground with fair housing laws, it is best to err on the side of caution. The penalties for violating these laws are serious and can include awarding money to the aggrieved individuals involved and paying attorney fees.



1. To avoid discrimination, landlords need to ask all potential tenants:
   a. whether they are a member of a protected class.
   b. the same standard questions to ensure equal treatment.
   c. Both a. and b.

Helping Clients Gain Mortgage Approval

Mortgage lending and the homeownership gap

Bias in mortgage lending is well-documented historically. Though concrete administrative steps have been taken to address it to create a more equitable mortgage market, it still continues in some form today. While the net effect of bias in the mortgage industry and all its manifestations proves difficult to quantify, the fundamental result has been lower homeownership rates and less household wealth for Black and Latinx households.

Here in **California**, the share of mortgage applicants denied a mortgage are:

- 16% of American Indian mortgage applicants;
- 15% of Black applicants;
- 13% of Latinx applicants;
- 13% of Pacific Islander applicants;
- 10% of white applicants; and
- 10% of Asian applicants, according to the 2020 Home Mortgage Disclosure Act (HMDA).

While the disparity in mortgage denial is clear, it of course is not entirely due to discrimination. The high mortgage denial rates for non-white and non-Asian households can be traced to many observable factors, including:

- down payment size;

- credit history;
- debt-to-income (DTI) ratios; and
- job security.

For example, the average Black mortgage applicant listed a 3.5% down payment, well below the 8.9% down payment from applicants averaged across all races.

While direct discrimination by mortgage lenders is not responsible for low down payment amounts, **systemic bias** against minority homebuyers is the underlying cause of this disparity. Thinking back, **redlining** and its ongoing impacts have reduced wealth in Black and Latinx communities, holding back generational wealth and reducing access to benefits like **down payment gifts** and inheritance.

down payment gift
A gift of down payment funds frequently from a family member that is not to be repaid.

In fact, parental transfers of wealth like down payment gifts account for 30% of the Black-white **homeownership gap**, as found in a study by the Consumer Financial Protection Bureau (CFPB). In the U.S., young white households are *twice as likely* to be homeowners as are young Black households.

The result: the homeownership rate amongst Black households in the U.S. is just 52%, while the homeownership rate for white households is 72%.

Assisting clients gain mortgage approval

Real estate brokers and agents are well positioned to open the doors of homeownership for all groups of people, including those who have historically been left out of homeownership. Often times, a *proactive approach* is needed.

First-time homebuyers may be unsure about the mortgage application and pre-approval process, more so if they are the first in their family to purchase housing. Here, brokers and agents need step up their role as a **transaction agent**, helping their buyer through every component of the process.

These transactional duties include:

- helping the buyer locate the most advantageous mortgage terms available in the market;
- oversight of the mortgage application submission process; and
- policing the lender's mortgage packaging process and funding conditions.

Collectively, these activities ensure all documents needed to comply with the

lender's requests and closing instructions are in order. If not, funding cannot take place and closing the sales escrow is jeopardized.

Further, having a couple trustworthy and helpful lenders on hand is crucial. Brokers may suggest these proven lenders to homebuyers to receive a pre-approval letter, which is typically necessary for submitting a successful offer. Homebuyers ought to apply with at least three mortgage lenders so they can choose the best terms.

Editor's note — Keep in mind that an agent receiving payment for referring a client to a mortgage lender is considered a ***kickback****, which is unlawful under the Real Estate Settlement Procedures Act (RESPA). 12 United States Code §2607(d)*

kickback
A fee improperly paid to a transaction agent who renders no service beyond the act of referring when the transaction agent is already providing another service in the transaction for a fee.

Any first-time homebuyer will be assisted by knowing what documents they will need to have available. Further, even after they receive approval, there are several "next steps" that need to be taken once their offer is accepted. Brokers can move the process along by keeping in contact with both the client and their chosen lender.

Getting an approval – next time

What happens when a potential client wants to buy, but is unable qualify?

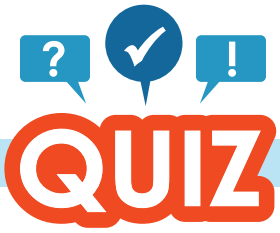
Rather than giving up and simply moving on to the next client, it's important for brokers and agents to take the extra step to help them qualify *next time*.

For example, brokers can inform unsuccessful mortgage applicants about special **mortgage programs** designed for first-time homebuyers. Some of these programs allow more leeway in qualifying.

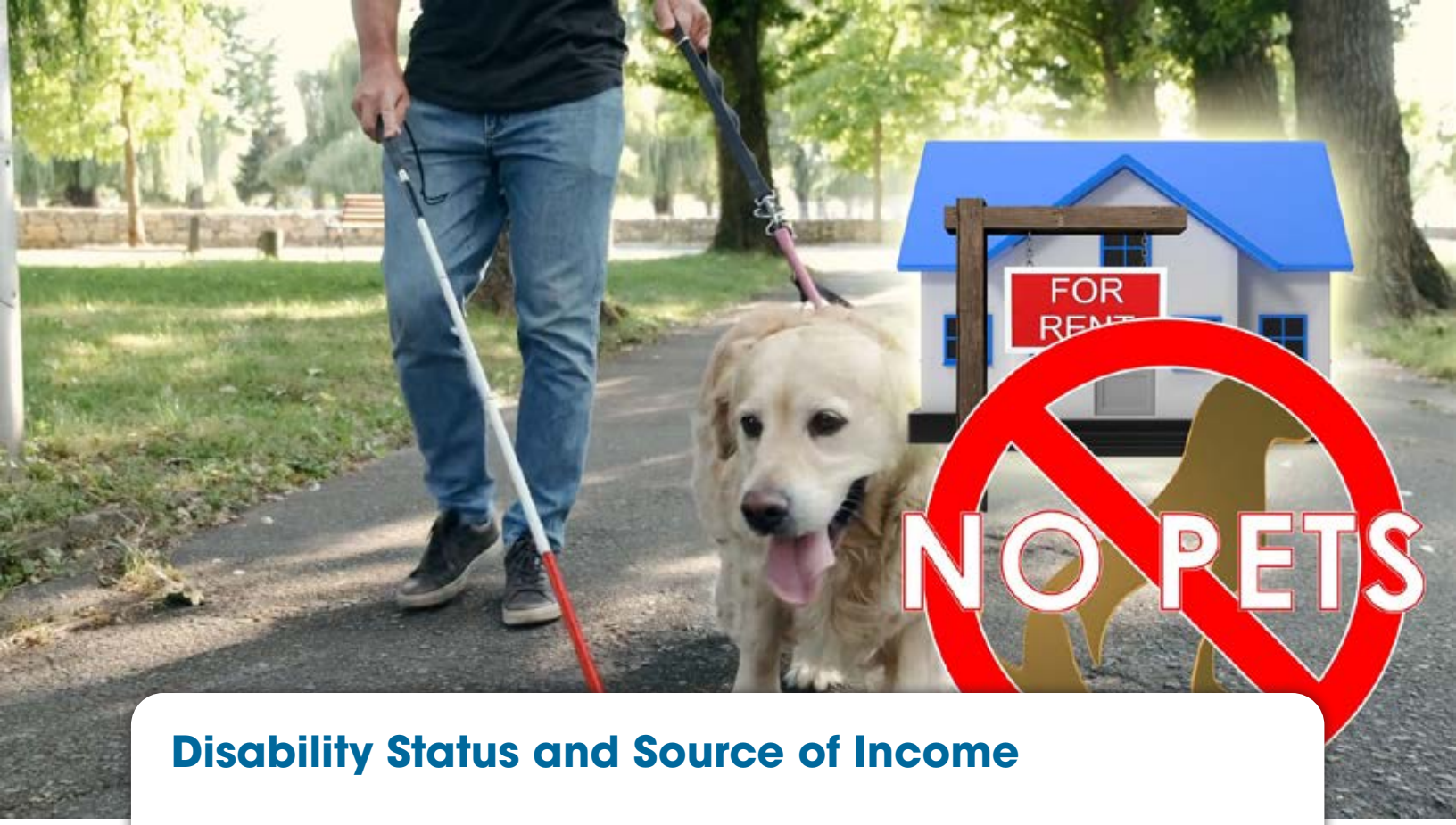
The number one reason for receiving a mortgage denial is a too-high DTI ratio. A homebuyer's DTI is measured by comparing all of their monthly debt obligations (e.g., auto loan payments, student debt, credit card payments, etc.) with their monthly income. In most underwriting circumstances, a lender will not allow a homebuyer's total debt — including a mortgage payment — to exceed 43% of their monthly income.

In many cases, the client will be able to gain mortgage approval after taking a few steps to **pare down debt**. Without being pushy, brokers may continue to

check in every month or so to see where they are in the process. Clients may be discouraged or embarrassed about being denied a mortgage, but it's the broker's job to keep them motivated and on the path to homeownership — not just in "special cases," but for *all clients*.



1. The transactional duties of a transaction agent include helping the buyer locate the most advantageous mortgage terms available in the market and:
   a. oversight of the mortgage application submission process.
   b. policing the lender's mortgage packaging process and funding conditions.
   c. Both a. and b.



Disability Status and Source of Income

Avoiding the top fair housing complaints

As gatekeepers to homeownership, real estate brokers and agents are in a prime position to help close the homeownership gap and ensure quality rental housing for historically marginalized groups.

One of the biggest errors when trying to even the playing field for all groups is to claim to be blind to all differences (e.g. "color blindness"). A more effective approach recognizes and honors the differences in others, creating **empathy**. With greater understanding, individuals may become aware of their own biases, discard stereotypes and embrace the unique backgrounds and experiences of each individual.

empathy
The ability to understand and be sensitive to the feelings of others.

The highest number of fair housing complaints received each year in California — by far — are in regard to **disability status**. [Department of Fair Employment and Housing (DFEH). (2022) 2020 Annual Report.]

California law defines **disability** as a mental or physical impairment, disorder or condition that limits a major life activity, such as working, physical and social

activities. This includes medical diagnoses like HIV/AIDs and cancer. [Calif. Government Code §12926.1(c)]

disability
A mental or physical impairment, disorder or condition that limits a major life activity.

For example, consider a disabled rental applicant who requires the use of a service dog — but the rental unit they are applying for does not allow pets. Even though the no-pet rule applies to all tenants and is not on its face discriminatory, the landlord *may not* refuse to rent a unit to a tenant on the basis that they are disabled and use a:

- **guide dog**, a seeing-eye dog trained by a licensed individual to aid a blind person;
- **signal dog**, trained to alert a deaf or hearing-impaired person to intruders or sounds; or
- **service dog**, trained to aid a physically disabled person with protection work, pulling a wheelchair or fetching dropped items. [Calif. Civil Code 54.1(b)(6)]

Pet addendum

Landlords may, as a matter of general policy, refuse to accept any prospective tenant who wants to occupy a unit with their pet, unless the tenant is disabled and uses a specially trained dog on the premises. [Calif. Civil Code §54.1(b)(5)]

When a landlord allows pets, they will often:

- impose restrictions on the type or size of the pet; and
- require the landlord's written consent to keep the pet on the premises. [See **RPI** Form 551 §6.9 and Form 550 §6.9]

The landlord and tenant may sign and attach a pet addendum that states:

- the type of pet and its name;
- the **security deposit** to be charged for the pet (but limited as part of the maximum security deposit allowed); and
- the tenant's agreement to hold the landlord harmless for any damage caused by the pet. [See **RPI** Form 563]

A landlord who allows pets may not:

- favor declawed or devocalized animals in any advertisement;
- refuse to rent or negotiate for rent to a tenant because their pet has not been declawed or devocalized; or
- require tenants' pets to be declawed or devocalized as a condition of renting the property. [CC §1942.7]

Further, landlords may not charge additional rent or security deposit to tenants with authorized service, guide or signal dogs. [CC §54.2(a)]

Equal opportunity denied

A landlord who refuses to make reasonable accommodations to afford a person with disabilities an **equal opportunity** to use and enjoy their housing — such as through denying them housing due to their use of a service dog — is guilty of practicing **unlawful discrimination**. When the Civil Rights Department (CRD) investigates and finds the landlord practiced unlawful discrimination, the CRD may require the landlord to:

- provide housing that was previously denied;
- pay monetary compensation for any losses or even emotional distress;
- undergo mandatory one-time or regular training to prevent future discriminatory acts;
- pay fees, penalties, fines; and
- undergo monitoring to avoid future discrimination. [Civil Rights Department (CRD). (2020) Disability Discrimination Fact Sheet.]

Another discriminatory activity for which the CRD receives a high number of complaints is discrimination based on **source of income**.

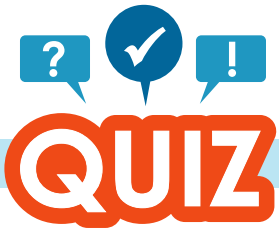
source of income
Lawful, verifiable income paid directly to a tenant, their representative or landlord on behalf of a tenant. This includes public assistance and housing subsidies, such as Section 8 housing vouchers.

section 8 housing
A government housing program for low-income households which provides qualifying tenants with rent subsidies and minimum habitability standards.

As of 2020, government housing vouchers — such as **Section 8 vouchers** — are considered a tenant's source of income in California, and thus are a protected status. In other words, California landlords may not choose to deny housing to a tenant based on their use of housing vouchers. Further, due to the tenant's source of income, the landlords may not:

- advertise a preference or limitation for certain sources of income;
- refuse an application;
- charge a higher deposit or rent;
- treat the tenant differently in any way;
- refuse to renew the lease;
- terminate the tenancy;
- lie about the availability of a unit;
- require additional conditions or rules on the tenancy; or
- restrict the tenant's access to property facilities or services. [Gov C §12927]

Tenants or applicants who believe they have been discriminated against may **file a complaint** with the CRD. The CRD will investigate and attempt to resolve the complaint. However, when the complaint cannot be resolved, the CRD may file a lawsuit against the landlord to seek monetary relief.



1. The highest number of fair housing complaints received each year in California are in regard to:

   a. disability status.
   b. race.
   c. gender identity.

The Inclusive Brokerage

Combat implicit bias before it occurs

To make a living in real estate, it's always best to appeal the widest audience – cast a wide net. This means real estate marketing needs to speak to everyone. Seeking to appeal to only a certain type of demographic, even with the best of intentions, will leave out opportunities to work with everyone else.

Worse, a **real estate advertisement** that indicates a bias against or preference for particular race, color, sex, sexual orientation, handicap, familial status or national origin is considered a violation of the Federal Fair Housing Act (FFHA). Even when a real estate professional doesn't mean to discriminate, problematic wording, phrases or images can alienate clients. Not only is this simply bad for business, it may also welcome a discrimination lawsuit.

The best way to avoid discriminatory advertisements is to take an *active approach* to being inclusive.

For example, advertisements that use single-gender pronouns (he or she) unnecessarily exclude half of all readers from a broker's potential client base and tend to incite protests. For more **inclusive advertising**, brokers do not need to clutter ads with multiple gender pronouns and titles — or clarify their intention to address all genders. Rather, speaking in the second person (you) or using the third person (they) covers all bases.

Simplicity is the best approach. Always avoid salutations that isolate a specific

gender, such as "sir" or "madam," and instead opt for generic terms like "homeowner." Alternatively, drop titles altogether.

To be inclusive, it's also helpful to create advertising and other transaction-related content in **multiple languages**.

Over one-in-four California residents were born in another country. For perspective, the national average for **foreign-born residents** is just one-in-eight. Three-quarters of this population is documented or U.S. citizens. Half of California's migrant population is from Latin America and 39% are from Asia. [Public Policy Institute of California. Immigrants in California. (2019)]

With such a diverse population, creating content in languages that are most common in each particular community is reasonable and good practice. Not just one or the other – both.

Hire and work with a diverse workforce

When seeking to serve a diverse community of clients and combat implicit bias before it occurs, the best thing a broker can do is hire and work with a diverse community of agents and other professionals.

For example, when advertising for an available position, employers proactively include an **Equal Opportunity Employment (EOE) statement**. The EOE statement is a recognition that bias often happens during the employment process, but the employer's EOE is a step toward countering that bias by promoting a diverse applicant pool.

The EOE statement includes the employer's commitment to hiring a diverse and inclusive workforce. For example: *XYZ Brokerage is an equal opportunity employer. We do not discriminate on the basis of race, color, religion, sex, gender identity, sexual orientation, pregnancy, national origin, age, disability or genetic information*.

No longer than a brief paragraph, EOE statements make it clear that the employer wishes to employ a workforce representative of the full range of society. The broker may wish to elaborate to show their earnest wish to employ a diverse workforce, outlining their willingness to provide reasonable accommodations, or even highlighting who they are as a company culture. For example: *XYZ Brokerage seeks qualified applicants from all backgrounds and we encourage diverse applicants to apply, including women, people of color, people with disabilities, LGBTQ people and veterans.*

Other steps a broker may take to ensure equity in their hiring and employment practices include:

- basing **agent-broker fee-splits** on identifiable factors, such as transaction volume or years of experience, upholding the *equal pay for equal work standard*;
- responding promptly and thoroughly to any complaints of discrimination from agents or clients; and
- making **reasonable accommodations** in the workplace to ensure protected groups are not excluded from employment, such as allowing time off for religious holidays and making adjustments for employees with disabilities.

Further, employers with 15 or more employees need to post the *EEO is Law* poster, which summarizes EEO law and directs employees how to make a formal complaint, in a conspicuous location in the office. [42 United States Code §2000e-10 (a); U.S. Equal Employment Opportunity Commission.]

Employers with fewer than 15 employees are *not* required to display the *EEO is Law* poster, but all employers are required to follow the **equal pay for equal work** standard. [29 Code of Federal Regulations §1620 et seq.]

The **gender pay gap**, which sees women systemically earn less money doing the same job as men, is mainly a product of implicit bias on behalf of employers. This also may exist in the context of salary-based office staff who perform administrative work within a real estate brokerage office. This disparity is implicit as employing brokers don't generally *intend* to pay female office staff less than a male equivalent doing a similar job, but their hidden expectations, assumptions and attitudes may cause women to receive less pay than men.

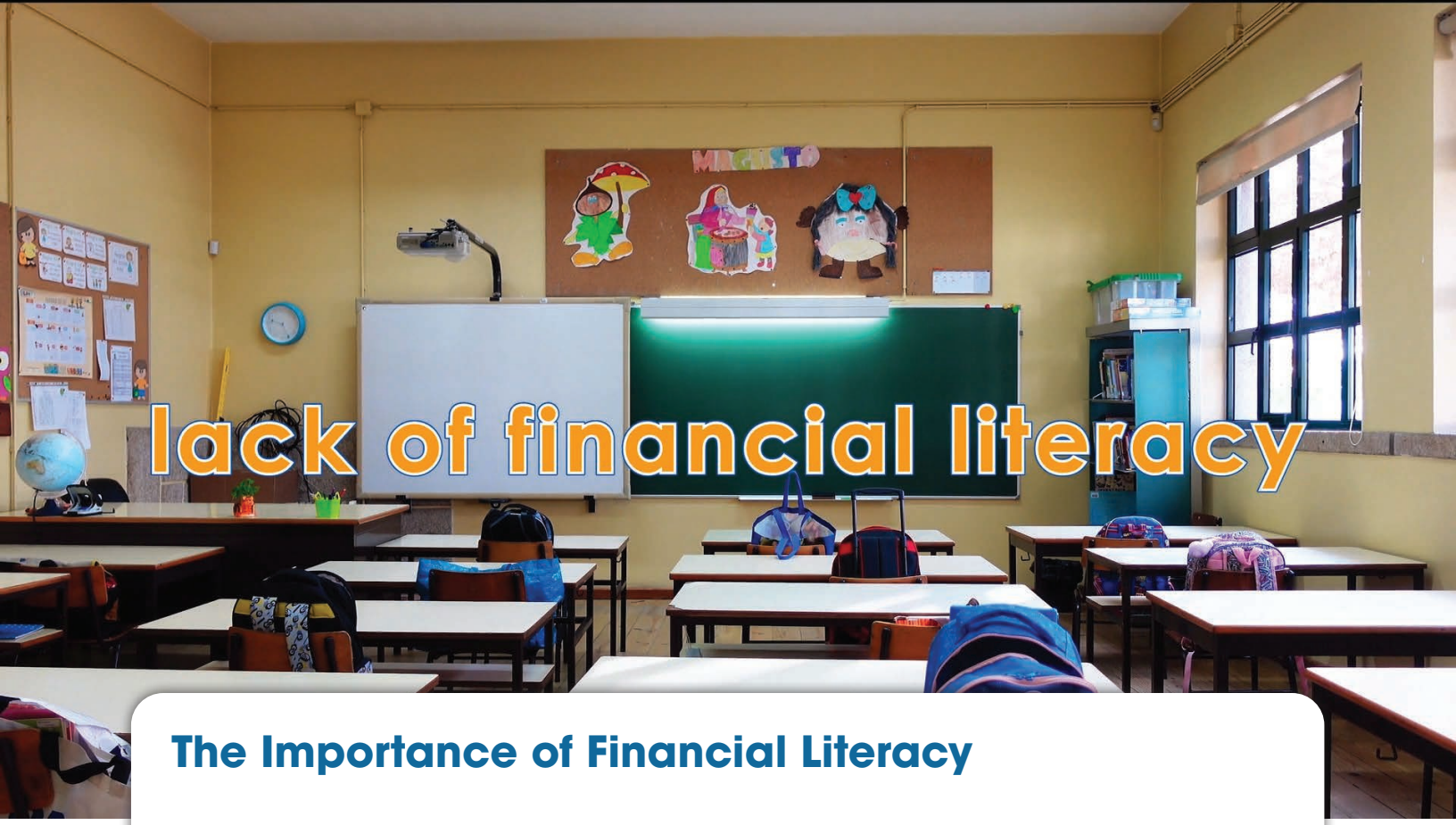
gender pay gap
The systemic difference in pay between male and female employees.

Women employed as full-time real estate brokers or sales agents earn on average 70 cents on the dollar compared to men in the same full-time employment, at the national level. On average, that's a difference of:

- $415 a week; or
- $21,580 a year. [Bureau of Labor Statistics. (2021) Highlights of Women's Earnings in 2020.]

Beyond hiring a diverse workforce and seeking out a diverse group of professionals to work with, ensuring equal pay and equal access to employment are crucial to rooting out systemic implicit bias.

1. Over _____ California residents were born in another country.
   a. one-in-two
   b. one-in-four
   c. one-in-six



The Importance of Financial Literacy

Educate your buyers

Households from all walks of life ought to have an equal chance at homeownership.

However, the greatest obstacle many individuals face is a lack of *financial acumen*, which is usually built over years of exposure to different financial strategies and products.

California is one of just five states in the nation with no **financial literacy** education requirements for K-12 public schools. Further, only 20% of teachers feel confident enough to teach on the subject, according to the Council of Economic Education. [Council for Economic Education. Survey of the States – 2022.]

financial literacy
The ability to understand and apply personal financial skills, including budgeting, saving for retirement, investing and qualifying to borrow money.

Without basic financial literacy required in school, there is a lot of catching up to do for clients seeking to become homeowners — especially when these clients have no family history of homeownership, as is significantly more likely for minority homebuyers. Financial literacy teaches homebuyers how to elevate and maintain their credit scores, pay off debts and save — all crucial to qualifying for a mortgage.

Brokers who encourage their first-time homebuyer clients to ask questions will improve understanding and homeownership outcomes, while narrowing the financial literacy gap. Each time the agent or broker speaks with these clients, they ought to end each conversation with "and do you have any questions for me?"

Chances are, they will have many.

Likewise, brokers need to encourage all clients to ask questions of their *lender*. As the biggest financial investment of their lives, taking out a mortgage ought to leave the homebuyer with zero uncertainty.

While first-time homebuyers may naturally ask their broker plenty of questions, there are also numerous things they may not have the peripheral vision or experience to do know they need to ask about. That's where the broker's initiative and intuition comes in.

Additional costs of ownership

A first-time homebuyer client likely knows about how much cash on hand they need for a **down payment**. But some additional costs the broker may need to prepare first-time homebuyers for are:

- **mortgage insurance**;
- **closing costs**;
- the **supplemental tax bill** the homeowner will receive shortly after closing;
- any **initial repairs** needed to make the home livable; and
- the true costs of maintenance and upkeep. [See **RPI** Form 306]

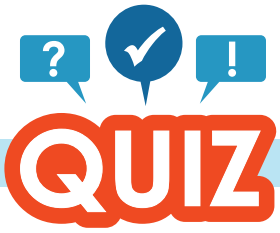
Other aspects of the transaction the first-time homebuyer may be unaware of include:

- the **time it takes to close** — having never experienced a closing before, they won't realize that it typically takes 30-45 days from their offer being accepted to closing;
- the **home inspection** — the buyer needs to make their offer contingent on a satisfactory home inspection, even if the contingency makes their offer less attractive to the seller;
- choosing **homeowners' insurance** — required by the lender, the homebuyer needs to know they have options when choosing a homeowners' insurance provider and that the costs can vary based on coverage and the provider; and

- the **tax deductions** available to homeowners, including mortgage interest deductions (MIDs) and deductions on property taxes and bonded assessments.

Being upfront with first-time homebuyer clients about these additional costs and transaction steps will avoid any confusion or surprise on their part.

This additional communication also improves homeownership outcomes, and of course, shrinks the **homeownership gap**.



1. _____ literacy teaches homebuyers how to elevate and maintain their credit scores, pay off debts and save — all crucial to qualifying for a mortgage.

   a. Linguistic
   b. Financial
   c. Cross-cultural

2. Aspects of the transaction the first-time homebuyer may be unaware of include the time it takes to close, the tax deductions available to homeowners and:

   a. the home inspection process.
   b. choosing homeowners' insurance.
   c. Both a. and b.

Implicit Bias: Glossary

C

Civil Rights Act 6

A federal law which provides broad protections to numerous classes of individuals in the United States against discriminatory activity

Civil Rights Department 12

A state agency designated with protecting Californians from housing, employment, and public accommodation discrimination.

D

disability 37

A mental or physical impairment, disorder or condition that limits a major life activity.

down payment gift 33

A gift of down payment funds frequently from a family member that is not to be repaid.

E

economic mobility 23

The ability of an individual, household or family to improve their financial status over the course of years or generations.

empathy 36

The ability to understand and be sensitive to the feelings of others.

Equal Credit Opportunity Act 8

A 1974 federal enactment prohibiting lenders from discriminating against borrowers from a protected class.

explicit bias 2

Blatant discrimination which causes real estate licensees to unlawfully refuse to show properties or take applications from members of a protected class

F

familial status 7

A status which indicates a household includes individuals under the age of 18

Federal Fair Housing Act (FFHA) 6

A collection of policies designed to prevent discrimination in the access to housing based on an occupant's inclusion in a protected class.

financial literacy 44

The ability to understand and apply personal financial skills, including budgeting, saving for retirement, investing and qualifying to borrow money.

G

gender pay gap 42

The systemic difference in pay between male and female employees.

I

Implicit Association Test (IAT) 3

A publically available online test designed to measure subconscious attitudes and beliefs held by individuals.

implicit bias 2

Actions which are not openly discriminatory but yield discriminatory results.

K

kickback 34

A fee improperly paid to a transaction agent who renders no service beyond the act of referring when the transaction agent is already providing another service in the transaction for a fee.

P

predatory lending 16

The practice of targeting individuals unprepared or underqualified for homeownership with relaxed mortgage standards, luring borrowers into taking out a mortgage with higher fees and subprime terms.

R

racial wealth gap 16

The disparity of wealth held amongst different racial and ethnic groups.

redlining 21

The practice of denying mortgages and under-appraising properties in minority communities based on demographics, outlawed in California by Housing Financial Discrimination Act of 1977.

S

section 8 housing 39

A government housing program for low-income households which provides qualifying tenants with rent subsidies and minimum habitability standards.

segregation.....19

The systemic act of separating households by race, which, in real estate, limits minority household access to higher quality jobs, better schools and other resources that disproportionately benefit white households.

senior housing.....28

Housing intended for persons 55 or 62 years of age and older.

source of income.....38

Lawful, verifiable income paid directly to a tenant, their representative or landlord on behalf of a tenant. This includes public assistance and housing subsidies, such as Section 8 housing vouchers.

steering.....17

An unlawful housing practice that includes words or actions by a real estate sales licensee intended to influence the choice of a prospective buyer or tenant. A violation of federal fair housing provision that seek to eliminate discrimination in the sale or rental of housing.

subprime mortgage.....17

A mortgage made to a borrower based on loose underwriting standards and resulting in a high risk of default.

U

Unruh Civil Rights Act.....12

A California law which prohibits discrimination by a business establishment based on sex, race, color, religion, ancestry, national origin, disability or medical condition. A real estate practice is a business establishment.

Office Management & Supervision: Video™

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Brokerage Activities: Agent of the Agent

Introduction to agency

As brokerage services became more prevalent in California in the mid-20th century and the public demanded greater consistency and competence in the rendering of these services, the state legislature began standardizing and regulating:

- who is eligible to become licensees and offer brokerage services;
- the duties and obligations owed by licensees to members of the public; and
- the procedures for soliciting and rendering services while conducting licensed activities on behalf of clients.

Collectively, the standards set the minimum level of conduct expected of a licensee when dealing with the public, such as **competency and honesty**. The key to implementing these professional standards is the **education and training** of the licensees.

Individuals who wish to become real estate brokers are issued a broker license by the **California Department of Real Estate (DRE)** only after completing extensive real estate related course work and meeting minimum experience requirements. On receiving the license, brokers are presumed to be competent in skill and diligence, with the expectation that they will conduct themselves in a manner which rises above the minimum level of duties owed to clientele and other members of the public.

For these reasons, the individual or corporation which a buyer or seller, landlord or tenant, or borrower or lender retains to represent them in a real estate transaction may only be a licensed **real estate broker**.

To retain a broker to act as a real estate agent, the buyer or seller enters into an employment contract with the broker, called a **listing agreement**. [See **RPI** Forms 102 and 103]

listing agreement
A written employment agreement used by brokers and agents when a client retains a broker to render real estate services as the agent of the client.

Broker vs. sales agent

Brokers are in a distinctly different category from sales agents. Brokers are authorized to deal with members of the public to offer, contract for and render brokerage services for compensation, called **licensed activities**. Sales agents are not. [Calif. Business and Professions Code §10131]

A real estate salesperson is strictly an agent of the employing broker. Agents cannot contract in their own name or on behalf of anyone other than their employing broker. Thus, an agent cannot be employed by any person who is a member of the public. This is why an agent's license needs to be handed to the employing broker, who retains possession of the license until the agent leaves the employ of the broker. [Bus & P C §10160]

Only when acting as a representative of the broker may the sales agent perform brokerage services which only the broker is authorized to contract for and provide to others, called **clients**. [**Grand** v. **Griesinger** (1958) 160 CA2d 397]

clients
Members of the public who retain brokers and agents to perform real estate related services.

Further, a sales agent may only receive compensation for the real estate related activities from the employing broker. An agent cannot receive compensation directly from anyone else, e.g., the seller or buyer, or another licensee. [Bus & P C §10137]

Thus, **brokers** are the **agents** of the members of the public who employ them, while a broker's *sales agents* are the *agents of the agent*, the individuals who render services for the broker's clients by acting on behalf of the broker. [Calif. Civil Code §2079.13(b)]

As a result, brokers are responsible for all the activities their agents carry out within the *course and scope* of their employment. [**Gipson** v. **Davis Realty Company** (1963) 215 CA2d 190]

1. To retain a broker to act as a real estate agent, the buyer or seller enters into an employment contract with the broker called a(n):

   a. listing agreement.
   b. Agency Law Disclosure.
   c. Finder's Fee Agreement.

2. _____are authorized to deal with members of the public to offer, contract for and render brokerage services for compensation, collectively called licensed activities.

   a. Brokers
   b. Agents
   c. Both a. and b.

Responsibility for Continuous Supervision

On-the-job training and continuous policing

When a broker employs a sales agent to act on behalf of the broker, the broker is to exercise **reasonable supervision** over the activities performed by the agent. Brokers who do not actively supervise their agents risk having their licenses suspended or revoked by the Department of Real Estate (DRE). [Calif. Business and Professions Code §10177(h)]

Here, the employing broker's responsibility to the public includes:

- *on-the-job training* for the agent in the procedures and practice of real estate brokerage; and
- *continuous policing* by the broker of the agent's compliance with the duties owed to buyers and sellers.

The sales agent's duties owed to the broker's clients and others in a transaction are equivalent to the duties owed them by the employing broker. [Calif. Civil Code §2079.13(b)]

The duties owed to the various parties in a transaction by a broker, which may be carried out by a sales agent under the employing broker's supervision, oversight and management, include:

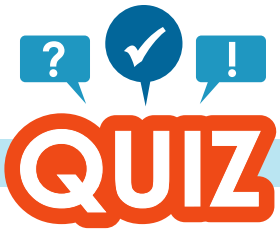
- the *utmost care, integrity, honesty and loyalty* in dealings with a client; and
- the use of *skill, care, honesty, fair dealing and good faith* in dealings with

all parties to a transaction in the disclosure of information which adversely affects the value and desirability of the property involved. [CC §2079.16]

The employing broker's management

To ensure a broker's agents are diligently complying with the duties owed to clientele and others, employing brokers need to establish office policies, procedures, rules and systems relating to:

- *soliciting* and obtaining buyer and seller listings and *negotiating* real estate transactions of all types;
- the *documentation* arising out of licensed activities which may affect the rights and obligations of any party, such as agreements, disclosures, reports and authorizations prepared or received by the agent;
- the *filing, maintenance and storage* of all documents affecting the rights of the parties;
- the handling and safekeeping of *trust funds* received by the agent for deposit, retention or transmission to others;
- *advertisements*, such as flyers, brochures, press releases, multiple listing service (MLS) postings, etc.;
- agents' compliance with all federal and state laws relating to *unlawful discrimination*; and
- the receipt of regular *periodic reports* from agents on their performance of activities within the course and scope of their employment. [California Department of Real Estate Regulations §2725]



1. An employing broker's responsibility to the public includes:

   a. on-the-job training for the agent in the procedures and practice of real estate brokerage.

   b. continuous policing by the broker of the agent's compliance with the duties owed to buyers and sellers.

   c. Both a. and b.

Business and Licensed Activities

Development of a business model

One method a broker uses to implement the requirement for supervision of employed agents is to develop a **business model**. So intended, the broker outlines the means and manner by which agents produce and service listings, and how purchase agreements are negotiated and closed.

business model
A plan establishing the means and manner by which listings are produced and serviced, and how purchase agreements are negotiated and closed by a broker's agents.

The creation of a plan for office operations logically starts by establishing categories for itemizing administrative and licensed activities, then a written presentation of the conduct required of agents to achieve the broker's objectives for each item.

Categories of business and **licensed activities** include:

licensed activities
Dealing with members of the public to offer, contract for and render real estate brokerage services for compensation.

- *administrative rules*, covering a description of the general business operations

of the brokerage office, such as office routines, phone management, sign usage, budgetary allocations for agent-support activities (advertising, FARMing, etc.), agent interviews, goal setting and daily work schedules;

- *procedural rules*, encompassing the means and methods to be used by agents to obtain measurable results (listings, sales, leases, mortgages, etc.);
- *practical rules*, focusing on the documentation needed when producing listings, negotiating sales, leases or mortgages and fulfilling the duties owed by the broker to clientele and others;
- *compliance checks*, consisting of periodic (weekly) and event-driven reports (a listing or sale) to be prepared by the agent, and the review of files and performance schedules by the broker, office manager or assistants, such as listing or transaction coordinators; and
- *supervisory oversight*, an ongoing and continuous process of training agents and managing their activities which fall within the course and scope of their employment.

The rules and procedures established by the broker to meet their responsibility to manage and oversee the conduct of their agents when acting on behalf of the broker needs to be agreed to in writing between the broker and the employed agents.

A written **employment agreement** details the duties of the sales agent and the agent's need to comply with an office manual which contains the broker's policies, rules, procedures and other conduct the broker deems necessary to fulfill their responsibility for supervision. [See **RPI** Forms 505 and 506]

Components of a business model

Within each category of activity covering the broker's management of their agents' conduct for producing, servicing and negotiating listings and sales, is a list of items to be considered.

Administrative

- E&O insurance
- workers' compensation insurance
- automobile insurance binder
- general comprehensive business insurance
- agent policy manual (on procedural, substantive and compliance

activities)

- new agent qualifications and interview procedures
- institutional advertising franchise affiliation
- trade organization membership
- MLS subscriptions
- employment contracts with sales agents
- agent pay, advances, and escrow disbursements
- production goals
- phone/floor-time coverage
- hours/agents' work schedules
- business cards
- storage of documents (three years)
- office meetings/attendance
- agent contribution to expenses
- bank trust accounts
- general business bank accounts

Organizational Procedures

- forms to be used
- use of coordinators
- use of office equipment
- use of affiliated services
- use of controlled businesses
- attorney inquiry/ referral to broker
- trust fund handling (deposit and log)
- email content
- public record inspection
- servicing property listings (MLS, signs, ads, property profiles, open houses, correspondence, showings, check lists, rents, etc.)
- servicing buyers (listings, property profiles, broadcasts, wants, showings, qualifying, check lists, etc.)
- client lists and follow-up

Substantive Activities

- taking property listings (addenda and disclosure check lists, deposits, property profiles, further approvals, fee setting, seller profiles, etc.)
- preparing offers (documents/disclosures and addenda checklists, duty checklists, advice on use of arbitration, forfeiture, escrow, title, misc. provisions, fee provisions, etc.)
- FSBO submission of offers (fee arrangements, listings, dual agency, etc.)
- preparation of documents, use of attorneys, added provisions

Compliance

- pay contingent on file audit and completeness
- listing logs transaction logs
- trust fund logs periodic reports
- listing reports
- sales reports
- schedule of report due dates
- other events which trigger notices or reports to management

Supervision

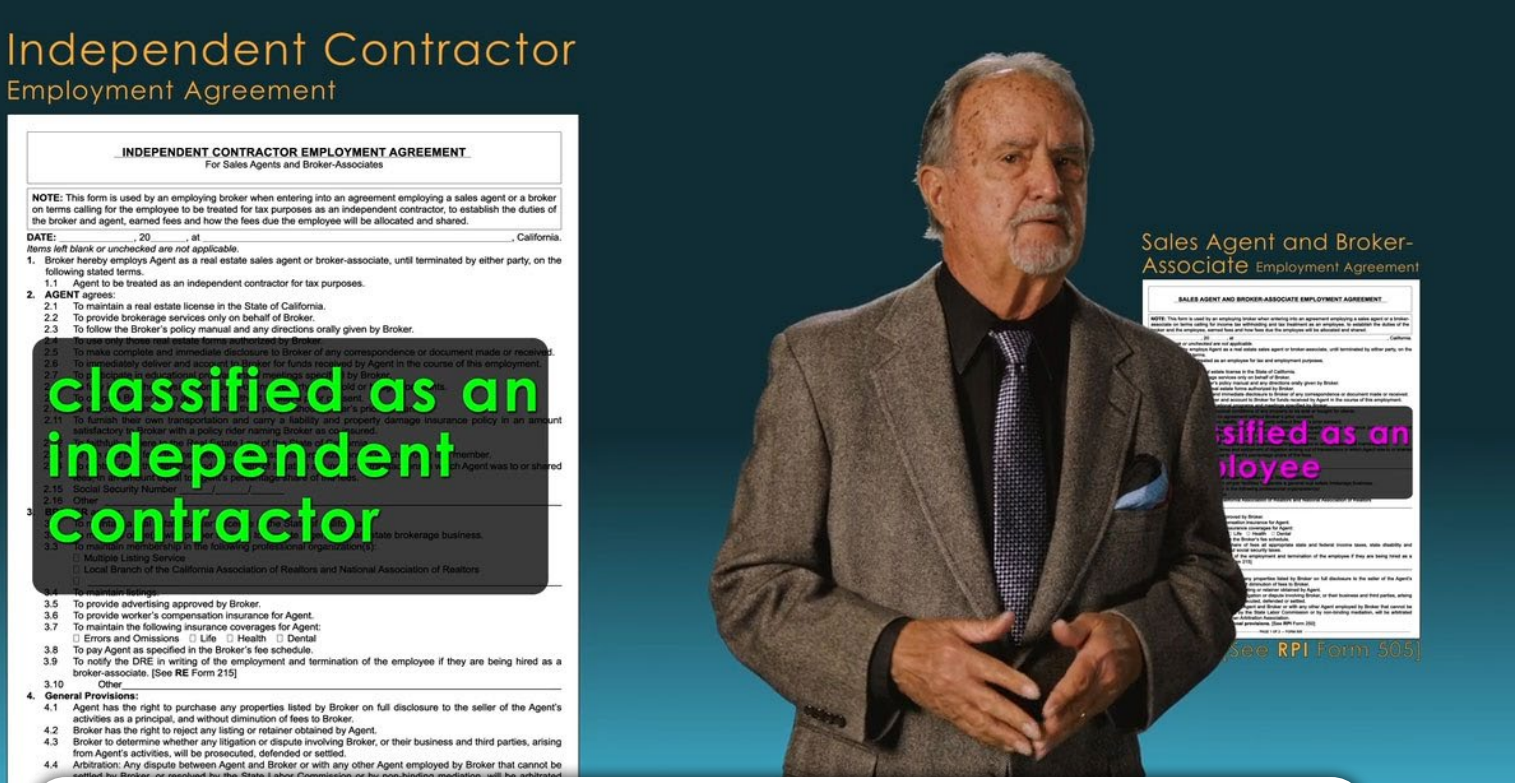
- continuous daily oversight
- constant follow-up on compliance with procedures and substantive activities
- instructions on propriety of acts within the course and scope of employment
- degree of enforcement being tight and disciplined, or lax and allowing great discretion
- use of assistants to provide oversight

1. Using a(n) _____, a broker outlines the means and manner by which agents produce and service listings, and how purchase agreements are negotiated and closed.

   a. fictitious business name
   b. business model
   c. corporate filing

2. A(n) _____ details the duties of the sales agent and the agent's need to comply with an office manual which contains the broker's policies, rules, procedures and other conduct the broker deems necessary to fulfill their responsibility for supervision.

   a. listing agreement
   b. affiliated business arrangement disclosure
   c. written employment agreement



Licensed Employees of the Broker

Agent of the agent

A Department of Real Estate (DRE) licensee acting on behalf of a broker is both an **agent** and **employee** of their employing broker. Thus, a licensee who acts under the supervision of a broker, whether they are a **salesperson** or **broker-associate**, represents the broker as an *agent of the broker*. [Calif. Civil Code §2079.13(b)]

An agent's right to a fee arises under the agent's written **employment agreement** with their broker, not a *listing agreement* with the client which is entered into with the broker. Through the broker-agent *employment agreement*, the agent is entitled to a share of the fees received by the broker on sales, leases or mortgage originations in which the agent participated. [See **RPI** Forms 505 and 506]

RPI (Realty Publications, Inc.) publishes two employment agreements covering all material aspects of the employment used by a broker employing a licensee to perform agent duties on their behalf. These employment agreements are:

- **Sales Agent and Broker-Associate Employment Agreement** [See **RPI** Form 505]; and
- **Independent Contractor Employment Agreement — For Sales Agents and Broker-Associates**. [See **RPI** Form 506]

Brokers typically negotiate fee sharing arrangements which call for the use of an **independent contractor (IC) agreement** to document their employment of agents. [See **RPI** Form 506]

Independent contractor (IC)
A salesperson employed by a broker under an employment arrangement which avoids income tax withholding and unemployment benefit payments by the broker.

Alternatively, brokers may choose other pay and tax withholding arrangements documented by an **employee agreement** form. [See **RPI** Form 505]

An *IC agreement*, in contrast with an *employee agreement* form, is used to avoid withholding and employer contributions by real estate brokers. [See **RPI** Form 506 §2.13]

Regardless of the written employment agreement used and signed by the agent, the broker and agent are *DRE* compliant.

Despite the labels given to these agent employment forms, an agent or broker-associate is always an employee of the broker under California's labor law. Thus, the broker is liable as an employer for their agent's wrongful conduct. Even if an IC agreement is used to document the employment, an agent may not permissibly act independently of the broker. The broker employing agents using an IC agreement still owes a duty of supervision to the agent as well as a mandated **worker's compensation** policy. [See **RPI** Form 506]

Both **RPI** *employment agreements* include provisions covering:

- broker supervision of licensed agent activities;
- agent obligations owed to their broker, including providing auto insurance coverage and naming the broker as an additional insured;
- broker obligations owed to their agents, including maintaining membership in professional organizations agreed to and providing *worker's compensation insurance*; and
- duties owed to clients and the public.

Also, the written employment agreement needs to spell out the **compensation** the agent is to receive for representing the broker in soliciting and negotiating listings, purchase agreements, leases and financing. [DRE Regs. §2726; see **RPI** Forms 505 and 506]

Most sales agents receive compensation from their brokers based on a negotiated percentage of **contingency fees** received by the brokers for completed sales, leases or mortgages solicited, negotiated or processed by the agents.

Both types of employment agreements require all documents and funds received on listings and sales to be entered into and taken in the name of the broker. Also, all advertising and business cards identify the agent as acting for the broker as an

associate licensee.

Further, the agent is subject to supervision by their broker since employing brokers are mandated to actively manage their brokerage business. This DRE mandated supervision cannot be contracted away or eliminated by use of an IC agreement. Thus, a broker may not permit their agents to have total discretion in their handling of listings or negotiating sales, leases or mortgages.

The (not so) independent contractor

Whether the broker withholds state and federal income tax on payment of an agents' compensation depends on the type of employment agreement the broker and agent enter into. [See **RPI** Forms 505 and 506]

A sales agent licensed by the DRE and employed by a broker under an *IC agreement* and paid based on the broker's receipt of a contingency fee will not be treated as an employee for purposes of income tax *withholding* or payroll *contributions*. [Internal Revenue Code §3508]

The chief advantage for a real estate broker to use an IC agreement is the simplification of the bookkeeping process. An IC agreement avoids **withholding** for income taxes or Medicare and social security benefits from the agent's fee while also avoiding employer contributions.

In turn, the broker files a 1099 report with the Internal Revenue Service (IRS) naming each agent and stating the fee amount each received as an employee of the broker under a contingent-fee, IC agreement.

To further simplify disbursement of the agent's share of the fee, some brokers instruct and authorize **escrow** to disburse to the agent the amount of fees due

Business income

A sales agent entering into an IC agreement reports their fees received from their broker as **business income (Schedule C)**. In turn, the agent expenses all the business-related costs of operations incurred while acting within the course and scope of their employment with the broker. It does not matter what degree of control the broker actually exercises over the agent's activities, whether none, enough to satisfy DRE supervisory requirements or total oversight as needed for first year licensees.

However, even though the agreement is called an "independent contractor" agreement — an arrangement designed solely for income tax reporting purposes — the agent remains an agent of their employing broker and not a separate operator independent of their broker.

When testing the conduct of an agent while engaged in real estate related activities, the IC provision in the broker-agent employment agreement cannot and does not change the agent's classification as an agent of the broker under California real estate and labor laws. [**Gipson** v. **Davis Realty Company** (1963) 215 CA2d 190]

Thus, brokers who use an IC agreement are not to delude themselves to believe that somehow the agent may permissibly act independently of the broker with no supervision.

the agent from the broker. These fees accrue to the broker on the close of a sales escrow. However, this "through system" of payment leaves the broker without adequate records for 1099 and workers' compensation reporting and audits.

Agent imposes liability on broker

Consider a sales agent who is employed by a broker under an IC agreement. The broker gives the agent *total discretion* in handling of clients and documentation of listings and sales.

As a matter of *risk management*, the IC agreement includes a provision calling for the agent to hand the broker a binder for liability insurance coverage for the agent's car, naming the broker as an insured. The IC agreement also requires all documents and funds received on listings and sales to be entered into and taken in the name of the broker, and all advertising and business cards to identify the agent as acting for the broker as an associate licensee.

One day, while the sales agent is driving to list a property, the agent collides with another vehicle, injuring the driver. The driver makes a demand on the agent's broker to pay for the driver's money losses incurred due to the agent's negligence.

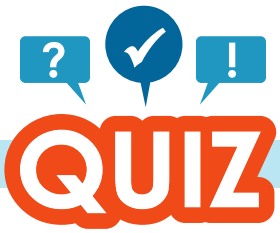
The broker rejects the demand, claiming the agent is an independent contractor, not an agent (much less an employee) of the broker, and thus the broker has no liability for the losses inflicted on the driver by the agent.

The driver claims the broker is liable for their losses since the agent is a representative

of the broker and was acting within the *course and scope* of their employment when the injuries occurred.

Can the driver injured by the agent's negligence recover their money losses from the agent's broker?

Yes! The sales agent is the *agent of the broker* as a matter of law, without concern for the type of employment agreement they have entered into.



1. A salesperson employed by a broker under a(n) _____ employment arrangement avoids income tax withholding and unemployment benefit payments by the broker.

   a. independent contractor
   b. employee
   c. verbal

Additional Duties of the Employing Broker

Business liability insurance, professional liability coverage and unemployment insurance benefits

In spite of the independent contractor (IC) employment agreement allowing total discretion to the agent in the conduct of handling of listings and sales, the agent is continuously **subject to supervision** by the broker. Sales agents are agents of the broker, without regard to the tax purpose of their employment agreement.

The broker who hires agents who use their own vehicles to conduct brokerage activities needs to be a named insured on the agent's car insurance policy as a matter of the broker's risk management. The employing broker also needs to maintain general comprehensive business liability insurance and professional liability coverage, also known as **errors and omissions insurance**, or simply, **E&O insurance**.

In part, supervision is critical to the reduction of the broker's exposure to risks of liability for their sales agents' failure to inspect, disclose, advise and care for clients.

Under real estate law, a sales agent is considered both an *agent and an employee* when acting within the course and scope of employment with a broker. [**Grand** v. **Griesinger** (1958) 160 CA2d 397]

However, an agent is not always treated as an employee under state and federal income tax withholding rules.

For example, licensed real estate sales agents, as well as broker-associates, are excluded employees for purposes of the **California Unemployment Insurance Law**. Even though a sales agent is considered both an agent and an employee under California real estate law, a broker does not have to contribute to the state unemployment insurance fund on behalf of the agent. In turn, the agent cannot collect unemployment benefits from the state if terminated from the employ of the broker.

Receipt of compensation by a licensed real estate agent under an employment agreement, paid as a *contingency fee* for closing transactions, is the **only test required** for the broker to avoid paying unemployment benefits. When the agent is paid a **contingency fee**, not an hourly wage, the agent will be denied unemployment benefits regardless of the level of supervision and control the broker exercises over the agent's real estate related activities. [Calif. Unemployment Insurance Code §650]

contingency fee
A fee received as compensation on the occurrence of an event, such as closing a sale, or an incentive bonus paid upon successfully completing or hitting certain benchmarks.

A sales agent is entitled to payment of minimum hourly wages from a broker if the agent is classified as an *employee* by California labor laws. This labor law classification is unrelated to tax law treatment. A labor law employee comes about due to the broker's conduct, including **constant supervision** and total control over the agent's **means, manner and mode** of engaging in activities requiring a real estate license.

However, as *agents* of their broker, most agents by the nature of daily scheduling for appointments, property viewings and document preparation have a high level of discretion and control over when they conduct different aspects of their business. This is especially true of the hours spent outside of their broker's office.

Typically, the agents' time in the office spent at the desk, or on the phones or floor, rarely take up more than one day a week, usually less than 20% of the time spent on real estate related listings and sales. Little additional time is spent in the office at staff meetings. As a result, agents are rarely considered employees, except for the public policy purpose of judging their conduct as a licensee under California real estate law.

As an *outside salesperson* who regularly works more than half of their time away from their place of employment, selling items or obtaining contracts for services, a real estate sales agent is excluded from collecting a **minimum wage** from their broker. [Calif. Labor Code §1171]

Workers' compensation coverage for employees

Brokers often ignore or are unfamiliar with **workers' compensation** requirements for their agents. Erroneously, employing brokers often believe real estate agents and broker-associates working for them under IC agreements are not employees.

However, under labor laws, a broker's employees include:

- their licensed sales agents (including ICs);
- other brokers working under their license as broker-associates; and
- their licensed and unlicensed administrative staff. [Lab C §2750.5]

A broker who is **unlawfully uninsured** or forces their employees to carry their own workers' compensation insurance faces:

- a *stop order* from the Division of Labor Standards Enforcement (DLSE) under the California Department of Industrial Relations (DIR), preventing the broker from conducting business until proof of insurance is provided;
- *civil penalties* and fines up to $100,000; and
- *reimbursement claims* from current and former agents for premiums they paid for workers' compensation coverage. [California Department of Real Estate Bulletin, Fall 2004, Page 10]

For a broker who employs one or more agents, the broker's workers' compensation insurance policy is in addition to policies for any business, vehicle and E&O insurance coverage.

Exclusions under workers' compensation law

Arrangements exist which exclude workers' compensation insurance requirements for:

- **broker-owners**; and
- **corporate officers** and **directors**.

The broker-owner of a sole proprietorship is not required to obtain workers' compensation coverage for themselves. They are not an employee, they are the self-employed owner.

When a broker and their spouse (or child or parent) are the **sole owners** of the individually owned or corporate brokerage company, workers' compensation insurance coverage for the owners is not compulsory.

Thus, only **immediate family members** who are the *sole owners* of the company are excluded from workers' compensation coverage for themselves. However, the broker's spouse or relative needs to be clearly defined as part owner, either as a general partner or as an officer of the corporation. [Lab C §4150]

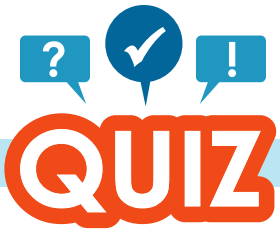
Immediate family members (a spouse, child or parent), licensed or unlicensed, who are not co-owners and are employed by the broker are required to be covered by workers' compensation — as are all other employees of the broker. This includes the spouse of the broker who is a licensee under their supervision, whether or not the broker employs any other person. [Lab C §3700]

Officers and directors of a corporation are not required to have workers' compensation coverage for themselves if they are paid only as owners of the corporation.

However, an officer or director is to be covered by workers' compensation insurance if:

- they render services as an agent of the corporation for a fee (e.g., taking a listing, negotiating for clients); and
- the corporation is also owned by non-officer owners. [Lab C §3351(c)]

Here, when officers or directors are the sole owners of the corporation, an officer rendering real estate-related services for a fee need not be covered by workers' compensation insurance.



1. Under real estate law, a sales agent is considered _____ when acting within the course and scope of employment with a broker.

   a. just an agent
   b. just an employee
   c. both an agent and an employee

Setting Standards for Recruiting Agents

Recruits are a reflection of you – the broker

Consider you are a broker who intends to operate a *small*, *medium* or *large brokerage*. One of your goals as the broker is to increase revenue by **recruiting new agents**.

The process of recruiting agents into your brokerage can take several different paths for different business models. Some brokers hire as many agents as they can *squeeze* into their offices, while others recruit only agents and broker-associates with track records that exceed typical production standards.

Regardless of your **business model**, the process of recruiting always includes:

buisness model
A plan establishing the means and manner by which listings are produced and serviced, and how purchase agreements are negotiated and closed by a broker's agents.

- a **recruiting goal**;
- a **plan of action**; and
- **minimum standards**.

Setting a *recruiting goal* requires you to determine how many agents you plan to

hire, and how you plan to locate them. Prospective recruits may include:

- pre-license prospects;
- newly licensed agents; and
- experienced agents.

Once your recruiting goal is set, prepare a *plan of action*. This plan determines:

- who is in charge of soliciting potential recruits;
- the source of the prospects (i.e., co-op agents on recent closings, MLS rosters);
- the media used to solicit recruits (i.e., physical mail, email, telephone calls); and
- the scripts used to solicit, set the appointments and interview the prospects.

Once the plan is set in motion and the interviewing begins, how do you – as the broker – decide who to hire?

Minimum standards vary by brokerage and by the type of prospect you are recruiting. Either way, you need to define your standards based on your goals. Remember, your team players are a reflection of you – the broker – their coach.

Characteristics of a successful agent

Below are *seven habits and characteristics* found in great agents to be considered by brokers:

1. **A positive, energetic attitude.** A positive attitude brings new energy to your office. Agents with a good outlook are more likely to push through rejection. Most importantly, they know they must endure many "no's" to get to the "yes's" — a key component of every successful salesperson.
2. **Initiative to set and achieve goals.** Self-motivated agents have the initiative to set their own goals and follow through. These agents know what they want, and how to get it.
3. **Willingness to create and follow a schedule based on their goals.** Sales is about setting daily routines and schedules. The willingness to follow a schedule is vital to the plan. Otherwise, agents may be traveling on the road to nowhere, attempting to reach destinations without roadmaps.
4. **Discipline to stay consistent in their lead-generating activities.** Although there are many ways to generate leads, the well-disciplined agent will commit to a lead generation program, and work it consistently. For instance, is the agent working a FARM territory, or do they rely on online advertising? Consistency is key to achieving the goals set out by the agent, regardless

of the means.

5. **Knowledge of sales and closing scripts and a commitment to practice them regularly.** Another attribute of successful agents is being well versed in sales scripts, or willing to learn without hesitation. These agents are steps ahead of agents that "wing it." Selling real estate is highly competitive. Knowing what to say, what questions to ask, and how to listen makes an agent appear professional and experienced. Knowledge of scripts often allows less experienced agents to compete with the "heavy hitters" on a level playing field.
6. **Openness to continued learning and education.** Once these skills are learned, they are to be honed by practice. A daily practice routine to keeping scripts memorized and internalized helps agents become expert negotiators and objection handlers. Continued learning and education keeps agents up to speed with the changing market, strategies and technology.
7. **Versatility to adapt to diverse clients and situations.** In addition to sales skills, an agent who is versatile is able to adjust and adapt to a diverse pool of clients and situations. A versatile agent maintains control of the situation, and adapts quickly to resolve any snags encountered along the way. Frustration is also avoided with versatility, allowing an agent to increase productivity by closing more deals – deals potentially lost to lack of training and skills.

And as the final step in the process of recruiting, once the broker has located and hired a staff of agents, the broker needs to ensure their agents are conducting themselves as intended. Otherwise, the broker is exposed to an unnecessary **risk of loss** without an administrative structure to verify their conduct.

Therefore, **continuous oversight** and policing limit unilateral changes, distortions and deviations from agent conduct acceptable to the broker.

Oversight requires:

- the commitment of financial and human resources to report unacceptable conduct;
- the holding of training meetings; and
- the proper maintenance of client files.

Sexual harassment prevention

As of January 1, 2021, employers with five or more employees need to provide at least two hours of sexual harassment prevention training to all supervisory employees and at least one hour of training to all nonsupervisory employees every two years.

New employees and those newly assuming a supervisory position need to complete their training within six months of hire or assumption of supervisory position.

This law affects real estate brokers and agents, despite their independent contractor status.

*Editor's note — The **Civil Rights Department** publishes free online sexual harassment prevention training courses that satisfy California's legal training requirements at https://calcivilrights.ca.gov/shpt/*

1. Continuous broker oversight requires the commitment of financial and human resources to report unacceptable conduct and:

   a. the holding of training meetings.
   b. the proper maintenance of client files.
   c. Both a. and b.

Interviewing Agents

Income and expense data worksheet

To assist the agent in an analysis of potential earnings, an **income and expense data worksheet** is prepared by the agent. The agent enters the approximations made by the broker for the various expenses a typical agent may experience during their first year with the brokerage office. [See **RPI** Form 504]

The agent uses the worksheet to further analyze income, expenses, cash reserves and the sales goal they determine are necessary to provide an acceptable after-tax income for personal living expenses.

As a prerequisite to an agent's use of an *income and expense data worksheet*, the agent needs to collect income data during an interview with a prospective broker, including:

- the *price range* of property the agent is most likely to list and sell;
- the *number of sales* the agent is likely close in that price range during the first year;
- the *gross broker fees* generated by the number of sales during the first year; and
- the *share of the gross broker fees* the agent will receive under the fee-sharing schedule offered by the broker.

The likely *gross fees* the broker is to receive and the agent's share of those fees are

entered on the worksheet as a result of the interview. [See **RPI** Form 504 §§1 and 2]

Ultimately, the **sales goal** set by the agent is reflected in the amount of after-tax income the agent seeks for themselves. [See **RPI** Form 504 §11]

Until the worksheet is filled out accurately, projecting fees to be received by the agent, estimating expenses to be incurred and attempting to set sales volume goals or probable after-tax earnings is an uneducated guess.

The broker supplies information

Brokers, by experience, tend to be more organized than agents.

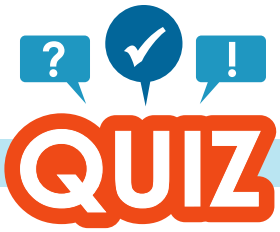
Brokers who employ agents are also better able to anticipate the income and expenses an agent will incur than recently licensed agents. It is the *broker* who is best able to draw a conclusion about an agent's future with the broker's office, not an agent new to the world of real estate sales or who has been languishing in another office due to inadequate or nonexistent planning and organization.

A broker's primary objective when hiring agents is to increase the gross broker fees received by the office without a disproportionate increase in operating expenses. For the broker to make hiring a productive endeavor, the broker needs to organize an agent **selection and evaluation plan** to avoid the *turnover of agents* who remain with the office for only a short period of time.

Long-term employment of agents contributes to a favorable industry-wide reputation for the broker, and provides a return to the broker for the time and energy invested with each agent during the employment process and the agent's start-up period. Energy, money, time and enthusiasm all wane fast when the turnover of talented agents in an office is due to the failure of unrealistic expectations held by the agents.

A broker's full disclosure — upfront and prior to employment — covering the agent's likely income and expenses, and why the fee sharing and expenses allocations are reasonable, leads to a **realistic expectation** of income by the agent.

Monthly and quarterly sales goals may then be set at levels designed to meet projected earnings when the agent is employed by the broker.



1. An agent seeking employment from a broker uses a(n) _____to assist them in an analysis of their potential earnings working with the brokerage.

   a. profit and loss statement
   b. balance sheet
   c. income and expense data worksheet

2. A broker's primary objective when hiring agents is to:

   a. increase the gross broker fees received by the office without a disproportionate increase in operating expenses.
   b. maximize operating expenses by ensuring the agent has access to the most extensive office amenities and perks.
   c. Both a. and b.

A Broker's Management of Unlicensed Assistants

Administrative and nondiscretionary activities on a broker's behalf

Brokers licensed by the **California Department of Real Estate (DRE)** may hire **unlicensed assistants** to perform administrative activities on their behalf and on behalf of their agents.

unlicensed assistant
An individual hired by a broker to perform nondiscretionary administrative activities that do not require a license, such as reviewing documents or helping at an open house, on behalf of the employing broker or their agents.

All employees of a broker need to be hired under written contracts of employment, including *unlicensed assistants*. [See **RPI** Form 507]

Further, a broker who manages transient housing or apartment complexes may hire unlicensed assistants to perform *administrative* and *nondiscretionary duties*. All of these unlicensed assistants act only under the broker's supervision and control. [Calif. Business and Professions Code §10131.01(a)]

When assisting a broker who engages in the origination of consumer mortgages, an unlicensed assistant may perform administrative duties, such as information gathering and mortgage processing — activities which do not require a real estate license or **mortgage loan originator (MLO)** license endorsement. [Bus & P C §10137]

Thus, brokers may assign tasks to their unlicensed employees, such as:

- *handling documents*;
- performing *tenant-related functions*;
- *canvassing* for prospective clients;
- *opening a property* to third-party service providers; and
- *communicating* with parties to a transaction.

However, all unlicensed personnel performing on the broker's behalf need to do so with the broker's permission and their activities **continuously supervised**. [California Department of Real Estate Real Estate Bulletin, Winter 1993]

Handling documents

A common activity for an unlicensed employee is to act as a **transaction coordinator (TC)**.

Here, the assistant, as *TC*, handles a sales file opened by an agent, reviews transaction documents from the client and confirms their completeness.

Documents and forms reviewed by a TC include:

- purchase and lease agreements, or other contracts;
- disclosure forms and reports;
- inspection reports; and
- escrow and title reports and forms.

Here, the TC is tasked with **confirming the completeness** of the documents. Any form or document not complete or fully executed by all required participants is brought to the attention of the agent. Only on the agent's instruction may the document be forwarded to the client or participant for signing or acknowledgement of receipt.

TCs and assistants may prepare documents as instructed by the agent. Once complete, all documents prepared by the assistant are then reviewed by the agent or broker prior to delivery to any participant in the transaction. [See **RPI** Form 507 §2.5]

On instructions from the agent, an assistant may deliver or obtain documents relating to the transaction directly to and from the client. They may also obtain signatures on documents from any participant in the transaction. However, an unlicensed assistant may not discuss the content or significance of the document with any participant to the transaction — an activity requiring a *DRE license*. [DRE Bulletin, Winter 1993; see **RPI** Form 507 §2.6]

Property management: licensed and unlicensed activities

An employee hired to assist the broker in the rental and leasing of residential complexes, other than single family units, can be either licensed or unlicensed.

Unlicensed employees may perform tenant-related activities, such as:

- showing rental units and facilities to prospective tenants;
- providing prospective tenants with information about rent rates and rental and lease agreement provisions;
- providing prospective tenants with rental application forms and answering questions regarding their completion;
- accepting tenant screening fees;
- accepting signed lease and rental agreements from tenants; and
- accepting rents and security deposits. [Bus & P C §10131.01(a)(1)]

Licensed employees may perform *any activities* unlicensed employees perform. However, licensed employees are additionally able to perform activities relating to contacts with the landlord, as opposed to the tenant, about the leasing, care of the property and accounting.

Activities which only licensed employees may perform include:

- landlord-related solicitations;
- entering into property management or leasing agent agreements with the landlord;
- listings and rental or lease negotiations;
- care and maintenance of the property;
- marketing of the listed space; and
- accounting.

Owner and power-of-attorney licensing exemptions

An individual owns and operates income-producing real estate. As the **owner-operator**, they locate and qualify tenants, prepare and sign occupancy agreements, deliver possession, contract for property maintenance, collect rent, pay expenses and mortgages, serve any notices and file any *unlawful detainer (UD)* actions to evict tenants.

Does the owner-operator need a Department of Real Estate (DRE)

broker license to perform these activities?

No! The owner of income-producing real estate does not need a real estate broker license to operate as a *principal*. The owner-operator is not acting on behalf of someone else as an agent when managing their own property. [Bus & PC §10131(b)]

On the other hand, if the owner-operator decides to hire an individual to take over the general management of the apartment complex, the individual employed to act as property manager needs to under most circumstances be licensed by the DRE as a California real estate broker.

Also exempt from licensing is an individual who has been given authority to act as an "attorney in fact" under a **power of attorney** to *temporarily manage* a landlord's property. [Bus & P C §10133(a)(2); see **RPI** Form 447]

However, a *power of attorney* may not be used as authority to continuously manage real estate and does not substitute for a broker license.

Consider a landlord who can no longer handle the responsibilities of managing their property due to illness. The landlord grants a power of attorney to a friend to manage the property. The landlord pays their friend for performing property management tasks, including locating tenants, negotiating leases and collecting rent.

After the landlord's recovery from their illness, they continue to employ their friend to perform these management tasks.

Does the landlord's friend need a real estate broker license to perform property management tasks on a regular, on-going basis in exchange for a fee, even though the landlord has given them a power of attorney?

Yes! The power-of-attorney exemption may only be used in situations where the landlord is compelled by necessity, such as a vacation or illness, to authorize another person to complete a specific or isolated transaction.

A person receiving a fee for the continuous performance of property management tasks requiring a broker license may not rely on the power-of-attorney exemption to avoid licensing requirements. [**Sheetz** v. **Edmonds** (1988) 201 CA3d 1432]

Allowing access to property

With the property owner's permission, an unlicensed assistant may open the property to third-party service providers or transaction participants such as appraisers or pest control companies to perform inspections or repairs related to the transaction. [See **RPI** Form 507 §2.7]

However, an unlicensed assistant may not provide information to the service provider or transaction participant regarding the property unless they provide it as transmitted from a *data sheet* the agent has prepared. The assistant is also required to disclose the source of the data to the person receiving the information. [DRE Bulletin, Winter 1993]

Open house and marketing

With the property owner's consent, an assistant may perform *nondiscretionary activities* while helping an agent at an open house for the sale of a property, such as:

- providing pre-printed facts sheets which the agent has prepared;
- arranging appointments; and
- greeting the public. [See **RPI** Form 507 §2.8]

Under the agent's supervision, assistants may also prepare and design advertising, brochures and flyers in connection with the sales transaction.

However, when assisting an agent at an open house, assistants may not:

- show the property;
- discuss pricing, terms and conditions of the sale; or
- discuss amenity features of the property (e.g., neighborhood, schools, etc.).

Further, any solicitation beyond providing information approved by the agent, such as a flyer, may only be conducted by the agent.

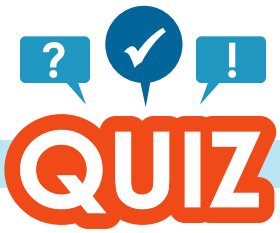
Limited communications

Assistants may communicate directly with principals regarding:

- the timing of the delivery of reports or other information needed; and
- any information relating to the performance and completion of third-party services. [See **RPI** Form 507]

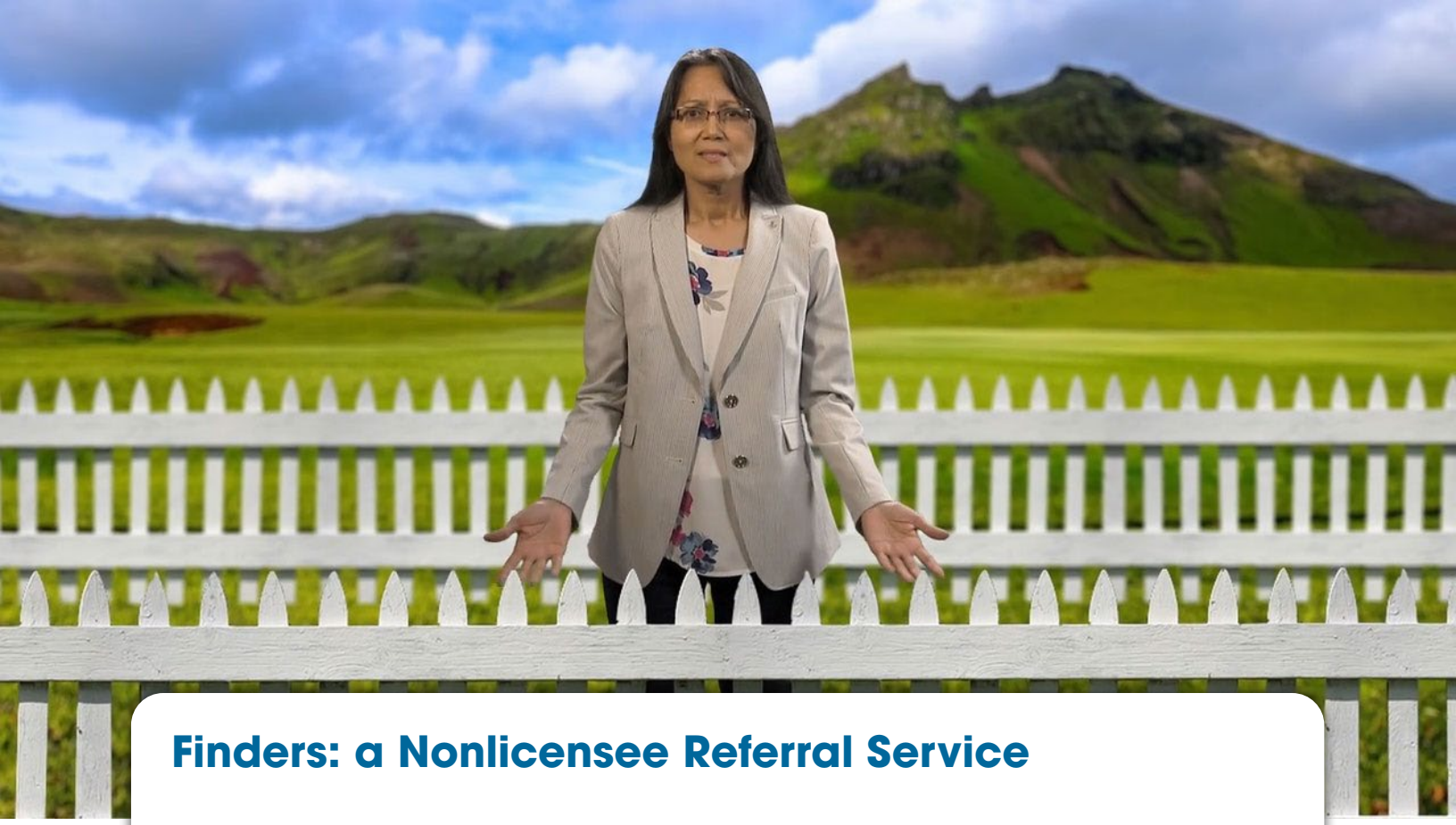
When communicating with the public, assistants may also provide facts to others from writings which the agent has prepared — again advising on the source of the data.

Hiring unlicensed assistants provides time-saving and organizational benefits and is essential to effectively managing the business activities of brokers and agents. Understanding the limitations imposed by the DRE and state law allows brokers to delegate activities to their assistants without crossing the line into *licensed activities*.



1. Unlicensed assistants employed by a property manager may not:
   a. accept tenant screening fees.
   b. provide prospective tenants with rental application forms.
   c. conduct rental or lease negotiations with a tenant.

2. When assisting an agent at an open house, an unlicensed assistant may not:
   a. arrange appointments.
   b. discuss the pricing, terms and conditions of the sale.
   c. provide pre-printed fact sheets which the agent has prepared.



Finders: a Nonlicensee Referral Service

A broker's use of unlicensed finders

Licensed brokers and sales agents employed by principals owe a **fiduciary duty** to the principals they represent. *Fiduciary duties* require licensees to perform on behalf of their clients with the utmost care and diligence.

fiduciary duty
The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

However, an **unlicensed finder** has no such fiduciary duty and does not act in the same capacity as a licensed agent or broker. A finder is someone who identifies and refers potential real estate clients or participants to a broker, agent or principal in exchange for a fee.

Limitations are placed on the *conduct* of a finder. A finder lacks legal authority to participate in any aspect of property information dissemination or other transactional negotiations. [Calif. Business and Professions Code §§10130 et seq.]

Further, though California statute and case law have in the past permitted finders to *solicit* prospective buyers, sellers, borrowers, lenders, tenants or landlords for *referral* to real estate licensees or principals, the Department of Real Estate

(DRE), as the regulatory agency, prohibits finders from continually soliciting lead information on behalf of another. Thus, a finder is only permitted to — occasionally and not as a business practice — *provide the contact information* of an individual who may become a participant in a real estate transaction. [**Tyrone** v. **Kelley** (1973) 9 C3d 1; 78 Attorney General Opinion 71 (1995)]

Finder referrals and limitations

A **finder** in California may only:

finder
An individual who identifies and refers potential clients to brokers, agents or principals in exchange for the promise of a fee on an occasional and nonrecurring basis.

- *introduce parties*;
- provide referrals on an *occasional* and nonrecurring basis; and
- enter into a *Finder's Fee Agreement* with principals or brokers for compensation. [See **RPI** Form 115]

For example, a past client of a real estate broker may act as a finder by providing the broker with the contact information of a prospective buyer known to the *finder*, and entering into an agreement with the broker for a finder's fee.

However, a finder may not:

- solicit participants to a real estate transaction;
- take part in any negotiations [Bus & P C §10131(a)];
- discuss the price;
- discuss the property; or
- discuss the terms or conditions of the transaction. [**Spielberg** v. **Granz** (1960) 185 CA2d 283]

Thus, continuing the above example, though the finder may provide the broker with contact information of a prospective client they happen to know, the finder may not seek out prospective clients for the broker. Further, their involvement is limited to introducing the buyer to the broker — the finder may not participate in the transaction or carry out activities requiring a real estate license.

A finder who crosses into any aspect of negotiation which leads to the creation of a real estate transaction needs a real estate license as they are both *soliciting* and *negotiating*. Unless licensed, an individual who enters into negotiations (supplying property or sales information) cannot collect a fee for services rendered — even

if they call it a **finder's fee**.

finder's fee
The fee paid to an individual who referred a client to a broker, agent or principal.

The finder is subject to a penalty of up to $20,000 and/or a six-month jail term for engaging in brokerage activities without a license. [Bus & P C §§10137, 10139]

In addition, a broker who permits an unlicensed employee to solicit clients or perform any other type of "licensed" work may have their license suspended or revoked. [Bus & P C §§10131, 10137]

Employment of finders

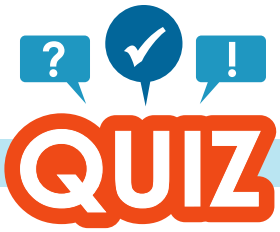
The employment of unlicensed *finders/locators* of buyers and sellers will extend the agent's business to bring earnings to a level sufficient to sustain their sought-after standard of living. This is permissible. State and federal regulations on this arrangement are straightforward and compliance is relatively easy. These regulations address the *relationship* between:

- the finder/locator and the broker/agent; and
- members of the public and finders/locators acting on behalf of brokers/agents.

All employees of a broker must be hired under *written contracts* of employment. This includes licensed agents, administrative staff and finders. Written contracts are entered into to delineate the responsibilities each has undertaken. Provisions limit their conduct to what regulations allow for their licensed or unlicensed status. [See **RPI** Form 115, 505, 506 and 510]

These employments, the finder included, are not casual relationships since a fee is paid by the broker. Casual relationships the broker/agent develop with friends, neighbors, past clientele or social contacts are a word-of-mouth network of good will and "viral adverts" which generate referrals for which no fee is paid.

Employed individuals *generate business* for the broker/agent and thus are paid. However, the employed finder is limited to locating and introducing new clientele for the broker/agent.



1. A(n) _____ is an individual who identifies and refers potential clients to brokers, agents or principals on an occasional and nonrecurring basis in exchange for a fee.

   a. real estate speculator
   b. exchanger
   c. finder

2. A finder in California may:

   a. take part in negotiations.
   b. discuss the terms and conditions or a transaction.
   c. only introduce parties.

Referral Fees and Business Development

Methods of generating business and finding clientele

A broker and their agents need to develop methods for **generating business**. If not, their business model will produce insufficient numbers of clientele to provide enough earnings to keep them from being driven out of the real estate brokerage profession.

Many methods for finding and soliciting clientele exist. The source of clients most often discussed is the *referral*. In fact, agents not employed by media/franchise brokers are said to live by referrals alone.

Brokers also cooperate among themselves, as in broker-to-broker **referrals** between different segments of the brokerage community. For example, a property manager refers a homebuyer to an MLS sales agent, or an MLS agent refers a prospective tenant to a property manager.

When an agent refers a prospective client to another agent, a referral fee agreement is used to document the referral. [See **RPI** Form 114]

A *referral* is between licensees and is not to be confused with a finder's fee agreement, as a finder is an unlicensed individual employed for the purpose of locating clients for a broker and their agent. Referral fees involve other licensees or other industry participants.

Brokers and agents in single family residence (SFR) sales rarely develop a client

base of homebuyers large enough to sustain a decent standard of living from sales fees generated solely by transactions handled on behalf of these prior clients. Thus, a *business model* for finding and locating clients on a *regular basis* must include sources other than clients personally located by the broker.

Many methods exist to generate new clients. Advertising through printed and electronic/digital media to solicit clients is fundamental promotion and expected by all.

On the other hand, finding and locating a client becomes a more focused and arduous task when a broker's business model expands beyond exclusive use of media, into the time consuming but rewarding task of *personally soliciting clients*. This effort is designed as an additional method for generating clientele.

Licensed agents place themselves directly between their employing broker and the prospective client when:

- the employing broker "refers" clients directly to their agent;
- an agent takes "floor time" to solicit new clients who call in response to media advertising and the "brand name" the broker has established;
- an agent canvasses a neighborhood or section of the community in a classic on-going *farming operation* to find and solicit new clientele (for their broker, but branding themselves in the process); or,
- an agent extends their reach to potential buyers and sellers of SFRs by inducing both licensed and unlicensed individuals to be "team members" who locate and solicit clientele for the agent (and the broker), activities which are permitted by both the Real Estate Settlement Procedures Act (RESPA) and Department of Real Estate (DRE) regulations.

Fee sharing by a broker under RESPA

RESPA's goal is to prohibit activity which artificially drives up the cost buyers and sellers pay for services needed to close a sale. Artificial costs include duplicate fees charged for services implicitly covered by the provider's basic fee. *Double dipping* is the concern.

Real Estate Settlement Procedures Act (RESPA)
A federal law governing the behavior of service providers on a federally-related mortgage which prohibits them from giving or receiving unlawful kickbacks.

RESPA, like conditions stated in a *title insurance policy*, initially sets out a blanket rule as the starting point for arriving at the final conditions.

RESPA's opening statement of purpose says that no *referral fee* can be paid or received by a settlement service *provider* (broker/escrow/lender) who will be rendering transactional services in exchange for compensation in a RESPA sale (concurrent origination of mortgage financing as part of a one-to-four unit residential sale).

Likewise, a title insurance policy's initial statement proclaims no encumbrance of any type exists on the title being insured. The policy provisions then proceed to list exclusions, exceptions, and conditions which nearly neuter the initial general statement.

Here too, RESPA codes provide several exceptions allowing fee sharing by a broker in a mortgage financed home sale. These exceptions permit the broker to conduct orderly *business development* for their brokerage income which does not violate the RESPA principle of avoiding *double dipping* (referrals among providers within a sales transaction) or *surcharges*.

RESPA exceptions

Two *RESPA exceptions* go to the heart of sourcing new clientele and sharing fees by brokers:

- referral fees paid to or received from other brokers, known as a **horizontal disbursement** from one broker to another, but only if neither broker is involved as a mortgage broker or lender in the home sale transaction [12 CFR §1024.14(g)(1)(v)]; and
- fees paid by the broker to the broker-employed licensed sales agents or *unlicensed finders*, known as a **vertical disbursement** within the broker's office, not paid to providers or third parties connected to or to be connected to a resulting home sale transaction. [12 CFR §1024.14(g)(1)(vii)]

While both of these exceptions to RESPA permit payment of fees under federal law, DRE regulations limit the conduct of these individuals when actually rendering services for fee permitted by RESPA.

While the RESPA exceptions allow **fee-splitting** activity, DRE regulations require *fee splitting* to be limited exclusively to:

fee-splitting
When fees made to a broker are split vertically with employed staff, licensed or unlicensed, or split horizontally among other brokers.

- payments between brokers (who then may split the fee vertically with

agents they employ); or

- payments by a broker to their employees, licensed or unlicensed.

Thus, while RESPA allows agents and finders who are employed by a broker to receive fees from the broker for *generating business*, DRE regulations and statutory/case law set forth the *limits of conduct* each type of employee may undertake with the clientele.

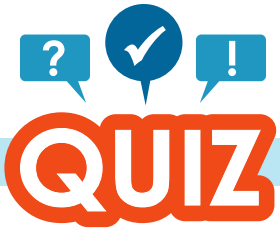
To satisfy RESPA, the employment of a finder must be under an agreement where the employee-finder is obligated to report to the broker every prospect located of the sort the broker is looking for. The employee-finder's sole purpose is to generate business for their broker and the finder does not have the freedom, by contract, to refer a prospect to just any broker. [12 CFR §§1024.2(b), 1024 Appendix B, examples 11; **Zalk** v. **General Exploration Co.** (1980) 105 CA3d 786]

Three classes of *finders* with different expectations for a referral fee exist under RESPA:

- *friends* or past *customers* who pass on tips to brokers and/or sales agents;
- *individuals* who sell "lead lists" to brokers; and
- *bona fide employees* of brokers who generate business for their employing broker, classified as **financial services representatives (FSRs).**

Generally, a finder's fee is a lump sum amount or a percentage of the fee received by the broker on a transaction which is closed due to the finder's referral.

Only sound economics control the amount of the fee a broker or agent should pay a finder for a lead.



1. When an agent refers a prospective client to another agent, a written _____ is used.

   a. finder's fee agreement
   b. referral fee agreement
   c. listing agreement

A Broker's Use of Supervisors

Delegated supervision, not agency

The broker employing agents is required under the California Department of Real Estate's (DRE's) **supervisory scheme** to *reasonably supervise* sales agents' activities. Reasonable supervision includes establishing policies, rules, procedures and statements to review and manage:

supervisory scheme
Policies and rules established by the California Department of Real Estate controlling a broker's oversight of licensed and unlicensed individuals employed by the broker.

- transactions requiring a real estate license;
- documents having a material effect upon the rights or obligations of a party to the transaction;
- the filing, storage and maintenance of documents;
- the handling of trust funds;
- advertisement of services that require a license;
- sales agent's knowledge of anti-discrimination laws; and
- reports of the activities of the sales agents. [Department of Real Estate Regulation §2725]

The broker may employ other licensees, such as an **office manager** or **transaction coordinator**, to carry out their supervisory responsibility to review documents and maintain files.

office manager
A licensee hired by a broker to fulfill the supervisory responsibility of reviewing documents and maintaining office files.

transaction coordinator (TC)
A licensed or unlicensed individual hired to assist an agent or broker to process documents, contracts and disclosures in a real estate file.

The review of documents and file maintenance is not just a mechanical function. It comprises a *meaningful review* of the activities of every employed licensee regarding:

- location of errors, such as in mathematical computations, and in contract and escrow provisions; and
- completeness, accuracy and timeliness of disclosures.

The broker, office manager or transaction coordinator reviewing documents ensures the sales agent cures any unacceptable documentation at the *earliest possible moment*.

Without corrective activity, the broker is exposed to liability for money losses caused by others through an error committed by their agents.

A **written agreement** to carry out the broker's responsibility for oversight and management of their sales agents' activities in sales, leasing and mortgage transactions will be entered into between the broker and the licensed office manager or transaction coordinator they employ. [See **RPI** Form 510]

While the office manager or transaction coordinator is assigned administrative duties, their primary responsibility is to review all correspondence and documents made or received by the agents on behalf of the broker.

No liability avoided by delegating oversight

Even though the broker employs the services of an office manager or transaction coordinator, the broker retains the overall *supervisorial responsibility*. Thus, the broker is to ultimately review the acts of the office manager, transaction coordinator, and in turn, each sales agent. [DRE Reg. 2725]

Supervision of non-licensed individuals

A broker employed as a **property manager** of a multi-unit residential property may employ **non-licensed individuals** to perform administrative property management duties.

Under the supervision of a licensed real estate broker, a non-licensed employee of the broker may:

- show rentals;
- provide and accept preprinted rental applications;
- accept deposits, fees and rents;
- give information about the rental schedule and provisions contained in the rental/lease agreement, underwritten instruction from the broker; and
- receive signed rental/lease agreements from prospective tenants. [Bus & P C §10131.01]

The broker may employ others to carry out their responsibility to supervise the activities of their non-licensed employees, including:

- another licensed real estate broker; or
- a licensed sales agent employed by the broker, if the sales agent has at least two years full-time experience as a sales agent during the preceding five-year period. [DRE Reg. §2724]

The broker's delegation of the responsibility to supervise their non-licensed employees will be included in a written agreement with the manager or transaction coordinator hired.

The actions of a sales agent or broker in the employ of a broker are considered the acts of the employing broker. [Calif. Civil Code §2079.13(b)]

The broker is mandated to perform constant and substantial supervision over their sales agents. Failure to do so subjects the broker to suspension or loss of their license. [Bus & P C §10177(h)]

Office manager and transaction coordinator liability

Office managers and **transaction coordinators** are employees representing the broker. Like a sales agent, the office manager represents the broker and will be licensed by the DRE. [DRE Reg. §2724]

While acting as an office manager or transaction coordinator, the office manager or transaction coordinator owes the employing broker a duty to supervise. It is the broker who, in turn, is responsible to the client for any breach in agency duty caused by the office manager's or transaction coordinator's failure to supervise and correct an agent's errors or omissions.

However, the office manager or transaction coordinator may have to *indemnify* the broker for failure to supervise as agreed. [**Walters** v. **Marler** (1978) 83 CA3d 1]

While most supervisory responsibility may be *assigned* to an office manager or transaction coordinator, the agency duty the broker owes to a client in a transaction may not be *delegated* to others. The broker's agency obligations to the public cannot be avoided. [**Barry** v. **Raskov** (1991) 232 CA3d 447]

1. When a broker employs the services of an office manager or transaction coordinator, the broker:

   a. is relieved of all supervisorial responsibility.

   b. still retains overall supervisorial responsibility.

   c. is responsible for supervising only the office manager or transaction coordinator.

Marketing and Advertising

Choose your brand

In the real estate profession, *image is everything*. How potential clients see you determines whether or not they will want to hire you – and if they will remember you and your office when their need for a real estate service arises.

In marketing yourself and your agents, set yourself apart from competitors in your area, without becoming so specific that you cut out a large segment of the market. For instance, branding yourself as simply "the short sale expert" is great for a few potential clients, but not for most.

One direct way to do this is to brand yourself as the **neighborhood expert**. This works for buyers and sellers of all home types in the neighborhood, and is easily customizable for each neighborhood you may market to, called your **FARM**.

FARM
A real estate marketing campaign designed to build an awareness of a licensee's real estate services that are offered within a targeted neighborhood or community.

Be truthful when choosing your brand. If you've never worked with seniors before, don't tout yourself as a specialist in senior living.

Likewise, if your marketing materials are to include a headshot, don't use a picture

taken twenty years ago. If you choose to include your picture, have a professional photo taken every two or three years. A **current picture** avoids awkwardness or confusion when a client finally meets you.

FARMing: cultivating new leads then harvesting

FARMing is a business event undertaken to convert a set of neighborhoods into a vibrant collective of owners, branded to turn to the dedicated agent. This creation of yourself as the "go to agent" can be fully accomplished within two years through dedicated, consistent FARMing.

Step 1: Find a mentor

Tag along (or team up) with an experienced agent who is a long-time FARMer. Observe the agent's strategies and scripts. Ask questions. Likely, they will be happy to show you the ropes. Since your chosen FARM will not overlap with their area, you will not present direct competition.

Step 2: Choose your FARM

Choose the neighborhood or community you will FARM. The first choice is one you know well already. Acquire a map of the area — city planning is most helpful for this — and decide on boundaries and routes.

Create a FARMing goal based on:

- how many doors you can realistically knock on per day; and
- how many deals you need to make in a year to meet your financial goals. [See **RPI** Form 504]

Consider the fee you receive per transaction as it varies based on the area you FARM. If you live in a neighborhood with little annual turnover or low-tier home prices, consider commuting to a more profitable center.

Start by knocking on 50 doors a day — an amount likely to require two hours at most and provide 20 contacts. If you need to close more transactions each year, increase the investment of your time door knocking.

Once familiar with your chosen FARM, *catalog the status* of individual properties on a spreadsheet (distressed appearance, negative or positive equity, length of ownership, price paid, current value, tenant occupied, etc.). This knowledge enables you to adjust your marketing strategy for each category of home.

Step 3: Prepare a script

An effective script includes:

- a proper greeting;

- a brief introduction of yourself and your business;
- opening questions to the potential client;
- answers to their common questions; and
- a closing.

Devote time to practicing your script every day to help you internalize the script and make it your own. Most importantly, listen to the homeowner. Don't get caught up in the script to the point of reciting or lecturing.

Step 4: Craft your FARM materials

Create a flyer or handout appropriate to your area so homeowners have something by which to remember you. The best flyer brags about your recent sales, but you may also include:

- sales made within your office;
- local market activity; or
- various tips for homeowners.

A creative personal style helps you stand out from the competition. Alternatively, magnetized notepads or schedules that can be affixed to a refrigerator ensure your name stays fresh in their minds.

Each time you make a contact, harvest their email address. Always ask for the names and emails of three people they know who are interested in buying or selling, and not just within the FARM. Set up an email database and send out a drip letter once a month. This email newsletter may contain your recent sales, local market activity or an adapted FARM letter.

Expect to spend $3,000-$6,000 a year on mailings and handouts — one deal from the effort will make up for the investment.

Step 5: FARM past clients

Keep in touch with previous clients and people who have befriended you. They are your best source of business. Make a database of past clients and friends with their particular holidays, such as birthdays and anniversaries. Send cards on these special days, and consider sending a bulk email to past clients each time you close a listing. This lets them know you remain successful and willing to help in their next move or acquisition.

Consistency, persistence and commitment is key. It takes 3-5 years before FARMing begins to pay off with a steady stream of transactions. Consider each door knock an investment in a future client for your career. Meanwhile, continue using your talent prospecting.

Explore all possible leads. Ask if the homeowner knows of any neighbors or friends who are considering buying or selling, and get their names. If a good lead does not answer the door during the week, go back on the weekend.

A 50% effort yields a 50% return. Make a schedule for your FARMing activities and stick to it. Dedication is good, and pays well. Do not expect a relaxed schedule and *easy money*.

Market your brand

Now that you have the perfect brand for your business, how do you put yourself out there and get more clients? *Infuse your brand* into all forms of marketing, including your:

- agent website;

Consider (or reconsider) a catchy slogan

While you want clients to remember your name, you certainly don't want them to roll their eyes when they think of it.

Stay away from cringe-worthy **slogans**, especially ones that are inappropriate — even if you think it's funny, it won't be the case for your whole client base. You will also want to ensure the pictures or graphics you use to depict your business are family-friendly.

However, if you come up with a catchy slogan that's fun, inoffensive and helps clients remember your name, then go for it. This also works well for agents who don't yet have a specialty. Instead, they can let potential clients know what other advantage working with them offers.

Choose the characteristic you want to highlight, like *honest, friendly* or *speedy*.

However, don't be generic when branding your business. Fit your chosen brand characteristics to your specific talents and personality. Start by including your name in the slogan: "Betty Brown, the speedy agent."

Better yet, make it rhyme so your potential clients can easily remember you: "Don't clown around, sell it fast with Betty Brown."

You can also use your slogan to highlight your real estate specialty: "The South Bakersfield Expert," or "Selling South Bakersfield since 1988."

- professional email signature;
- business cards;
- FARM materials that you drop off while door knocking in the neighborhood(s) you FARM;
- signs; and
- mailed marketing materials which you send to former and potential clients.

If you specialize in multiple forms of real estate, order different business cards for each specialty. That way, if you run into someone interested in buying their first home, you can hand them the business card which says "The first-time homebuyer specialist." Likewise, when you speak with a residential investor, you can hand them your "Residential investment specialist" card.

Plan the timing of your strategy, be consistent, and keep in mind it will take several months or even years before you notice an effect. Thus, it's important to set aside time in your schedule and money in your budget to market yourself over several months.

If you're completely new to real estate marketing, it will likely take three-to-five years before marketing your brand pays off with a reliable stream of clients. On the other hand, if you already have past clients but are changing your brand to

Avoid these common mistakes

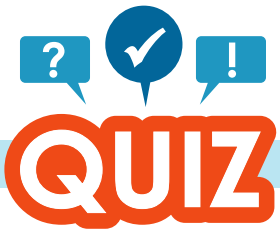
Once you've nailed down your brand image and marketing strategy, go back to check for common errors before implementing it. Once you've built a brand, it's difficult to change, especially if you've made a *negative impression* on your community — so get it right the first time.

Avoid:

- using all capital letters to describe yourself or your services — it comes off as insincere, more like a used car salesperson than a trustworthy professional;
- misspellings or grammatical mistakes — this makes you look either unintelligent or unable to pay attention to detail, which are traits clients don't want in their real estate agent; and
- giving up on your brand strategy after only a few months of marketing, as it will take months or years before the payoff is noticeable.

reflect a need in the community, the results will arrive somewhat sooner.

Also consider investing in a couple out-of-the-box marketing strategies. For instance, become "the engaged real estate agent" by sponsoring a stretch of highway or volunteering to sponsor a local youth sports team. Your sincerity and service to the community become part of your brand — not to mention the opportunities you'll find to meet new clients while engaging with other community volunteers.

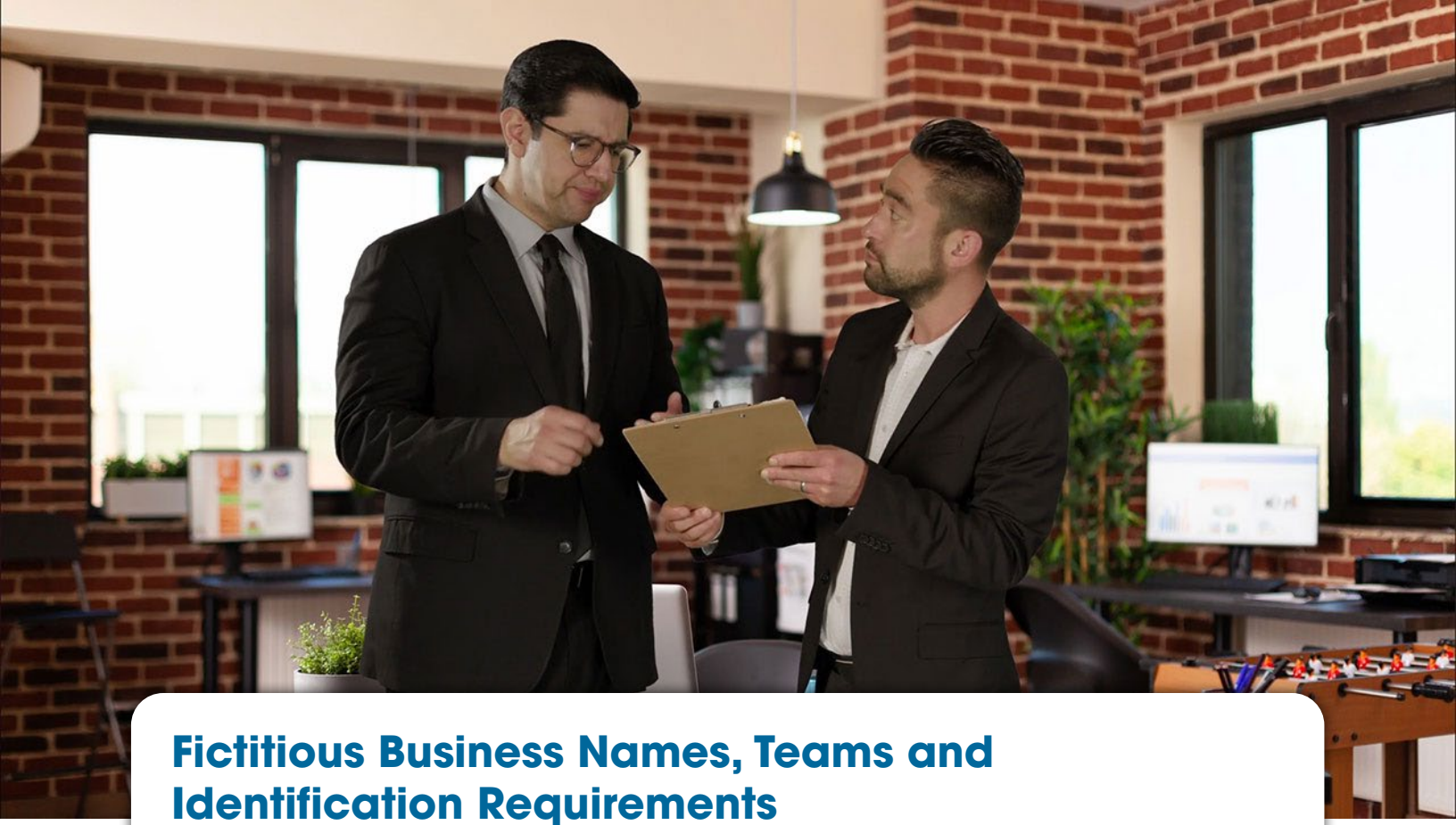


1. A real estate marketing campaign designed to build awareness of a licensee's real estate services that are offered within a targeted neighborhood or community is referred to as a(n):

   a. plateau.
   b. plantation.
   c. FARM.

2. Once you create a brand for your real estate services, you need to:

   a. promptly try a different brand to determine which is more effective.
   b. consistently infuse your brand into all forms of marketing.
   c. use it selectively and in limited situations



Fictitious Business Names, Teams and Identification Requirements

Identify the broker – always

When advertising, all real estate licensees are required to provide their name, California Department of Real Estate (DRE) license number, Nationwide Mortgage Licensing System (NMLS) ID number (if applicable) and their **responsible broker's identity.** This must be included on:

- real estate purchase agreements;
- business cards;
- stationary;
- advertising flyers;
- television advertisements;
- print advertisements;
- electronic media;
- directional signs; and
- any other materials soliciting business from the public. [Calif. Business and Professions Code §10140.6]

The *responsible broker's identity* is defined as the employing broker's name, or name and license number, not merely a team name or fictitious business name filed by the sales agent with the broker's authorization. [Bus & P C §10159.7]

"For sale", rent, lease, "open house" and directional signs are exempt from containing the above identification information only if they:

- display the responsible broker's name, or name and license number, without reference to a broker-associate or sales agent; or
- do not display information identifying a licensee.

Is your team playing by the rules?

Real estate brokers and corporations often use **fictitious business names** when conducting activities requiring a real estate license.

> **fictitious business name**
> The name under which a business or operation is conducted, also known as a d.b.a. ("doing business as...").

Before using a *fictitious business name* when rendering real estate services requiring a license, a broker needs to first obtain an individual or corporate broker license from the DRE bearing the fictitious name.

A real estate salesperson may not use a fictitious business name that is not identified with their employing broker. [Bus & P C §10159.5; California Department of Real Estate Regulation §2731]

These days, many real estate licensees have joined other licensees with similar goals and work ethics. They have created **teams** to improve the level of services offered to their clients. In turn, their per-agent earnings are increased. In the process, they often adopt fictitious names to title their joint operation.

The use of "team names" such as "The John Smith Team" or "John Smith & Associates" are often included on "For Sale" signs, business cards and other promotional marketing pieces. Both team names and fictitious business names are subject to the state rules governing their use.

Rules for fictitious business names and team names

An employing broker may authorize a real estate salesperson they employ to file an application with the county clerk to obtain a fictitious business name under which the salesperson may conduct business. The salesperson is required to:

- deliver to the DRE an application signed by the broker requesting permission to use a county-approved fictitious business name identified with the broker's license number;
- pay any associated fees to the county or DRE; and

- maintain ownership of the fictitious business name subject to the control of their broker.

To reduce filing requirements, a **team name** is now defined separately from a fictitious business name. A *team name* is not considered a fictitious business name triggering the above requirements if the team name:

- is used by two or more real estate licensees who work together to provide licensed real estate services under an employing broker;
- includes the surname of at least one of the licensees in conjunction with the term "associates," "group" or "team"; and
- does not include the term "real estate broker," "real estate brokerage," "broker" or "brokerage," or any other term suggesting the licensees are offering real estate brokerage services independent of a broker.

"Independent" real estate professionals

Under California law, real estate agents cannot provide or advertise real estate services independent of their employing brokers. In practice, agents are *agents of the agent* — their employing broker who is tasked with the legal obligation to review, oversee, inspect and manage the practices of the agents they employ.

Thus, agents cannot brand themselves as *"independent real estate practitioners"* who provide real estate services without the supervision of an employing broker.

Further, it is a violation of real estate law if a fictitious business name does not reference the affiliation of the agent's employing broker. Noncompliance by an agent or employing broker may result in:

- disciplinary action by the DRE;
- criminal prosecution; or
- both DRE disciplinary action and criminal prosecution. [DRE Licensee Advisory September 2015]

Fundamentally, if a DRE-licensed agent intends to act and advertise as an "independent" or "freelance" licensee, they need to obtain a **broker license**.

Any marketing materials using a fictitious business name or team name need to conspicuously display:

- the licensees' names and license numbers; and
- the broker of record's identity as prominently as the fictitious business name or team name.

1. The name under which a business or operation is conducted is referred to as a(n):

   a. pet name.
   b. fictitious business name.
   c. slogan.

Duty to DRE to Keep Records

Three-year record retention period

All records of an *agent's activities* on behalf of a client during the listing period are retained by the agent's broker for **three years**. [Calif. Business and Professions Code §10148]

The *three-year period* for retaining the buyer's or seller's activity file for DRE review begins to run on the closing date of a sale or from the date of the listing if a sale does not occur. Upon notice, the records will be made available for inspection by the Commissioner of Real Estate or their representative, or for an audit the Commissioner may order. [Bus & P C §10148]

How can brokers avoid storage costs related to bulky transaction files and other real estate documents? Nix the paper and file them digitally.

The DRE requires brokers to retain real estate documents for three years if the documents were:

- used in a transaction requiring a real estate broker's license; and
- executed or obtained by the broker or broker's agent.

Upon notice by the DRE, these records need to be made available for examination, inspection, and copying by a DRE representative.

As an alternative to paper, brokers may use **electronic image storage media** to retain and store copies of all documents executed by the broker and their agents

in connection with any transaction performed under the broker's license.

Electronic image storage media

Copies of real estate documents (i.e. listings, purchase agreements, deposit receipts, canceled checks, trust fund records, etc.) may be stored on an *electronic image storage media* if the following requirements are met:

- the electronic storage is non-erasable and does not allow changes to the stored document or record;
- the stored document is made or preserved as part of the regular course of business;
- the original record was prepared by the broker or the broker's employees at or near the time of the event reflected in the record;
- the custodian of the record is able to identify the stored record, the mode of its preparation, and the mode of storing it;
- the electronic storage contains a reliable indexing system that provides ready access to a desired document or record, appropriate quality control of the storage process, and date-ordered arrangement of stored documents; and
- records copied and stored are retained for three years. [DRE Regs. §2729(a)]

Brokers also need to maintain a means of viewing these stored documents at their office, and provide a paper copy of any document or record requested by the DRE. [DRE Regs. §2729(b)]

Planning for digital storage

The first step in converting to digital storage is to digitize files and record keeping. To avoid scanning closed files and converting them from paper to digital formats, maintain files in digital format from the beginning. Otherwise, brokers can convert paper documents into *digital format* as the transaction progresses, creating a digital file as they go.

As part of planning for electronic storage of records, brokers first need to determine where and how their records will be stored. The three most common options are:

- online;
- networked; and
- removable media.

It is good practice to select appropriate media and systems for maintaining records for the required period of time. Thus, files may need to be refreshed, transferred to

new media, or migrated to a different format.

To get started, all paper files need to be converted to digital format. This is best accomplished by either:

- scanning documents; or
- adapting a paperless system of forms and using electronic signatures.

Online storage allows immediate access to stored files on the internet. Properly secured online storage provides access to **authorized users only**.

A popular method of online storage is known as cloud storage. Files "on the cloud" are stored by a third-party and accessed through their web service.

However, as with any outside provider, it is important to do some research regarding possible accessibility issues and the security of confidential files. It is best to ask questions about cloud provider policies and procedures for storing, preserving and providing access to files and records.

In addition, be cautious, as cloud networks can go down causing delays in accessing files. Also, most cloud storage requires payment of monthly or annual fees.

Offline storage

Another method of electronic storage includes **offline media**, such as *storage area networks (SANs)*. SANs allow access to remote drives with the same convenience of internal hard drives. These files can also be easily accessed by any authorized user within the network.

Removable media are files that cannot be accessed immediately. These files are stored offline. This type of media includes:

- external hard drives;
- DVD+/-R;
- SD cards; and
- flash drives.

However, using removable media can be risky.

This method requires safe keeping so data does not become corrupt by any external influence, such as excessive heat or demagnetizing.

Even when properly cared for, all digital and electronic storage media and hardware have limited life expectancy. Hardware and software may also be replaced by rapid advances in technology. Therefore, careful planning is

imperative depending on the length of time a file is to be stored.

Maintain backup copies of all stored materials preferably in an off-site, geographically different location that does not share the same disaster threat.

Create policies and procedures for backing up files. Develop procedures for labeling storage media. Each external label is to contain information unique to what is stored.

1. All records of an agent's activities on behalf of a client during the listing period are retained by the agent's broker for:

   a. one year.
   b. two years.
   c. three years.

Office Management & Supervision: Glossary

B

business model 7, 22

A plan establishing the means and manner by which listings are produced and serviced, and how purchase agreements are negotiated and closed by a broker's agents.

C

clients 2

Members of the public who retain brokers and agents to perform real estate related services.

contingency fee 2

A fee received as compensation on the occurrence of an event, such as closing a sale, or an incentive bonus paid upon successfully completing or hitting certain benchmarks.

F

FARM 47

A real estate marketing campaign designed to build an awareness of a licensee's real estate services that are offered within a targeted neighborhood or community.

fee-splitting 41

When fees made to a broker are split vertically with employed staff, licensed or unlicensed, or split horizontally among other brokers.

fictitious business name 54

The name under which a business or operation is conducted, also known as a d.b.a. ("doing business as...").

fiduciary duty.....35

The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

finder.....36

An individual who identifies and refers potential clients to brokers, agents or principals in exchange for the promise of a fee on an occasional and nonrecurring basis.

finder's fee.....37

The fee paid to an individual who referred a client to a broker, agent or principal.

I

independent contractor (IC) 18

A salesperson employed by a broker under an employment arrangement which avoids income tax withholding and unemployment benefit payments by the broker.

L

licensed activities.....7

Dealing with members of the public to offer, contract for and render real estate brokerage services for compensation.

listing agreement.....2

A written employment agreement used by brokers and agents when a client retains a broker to render real estate services as the agent of the client.

O

office manager.....44

A licensee hired by a broker to fulfill the supervisory responsibility of reviewing documents and maintaining office files.

R

Real Estate Settlement Procedures Act (RESPA) 40

A federal law governing the behavior of service providers on a federally-related mortgage which prohibits them from giving or receiving unlawful kickbacks.

S

supervisory scheme 43

Policies and rules established by the California Department of Real Estate controlling a broker's oversight of licensed and unlicensed individuals employed by the broker.

T

transaction coordinator (TC) 44

A licensed or unlicensed individual hired to assist an agent or broker to process documents, contracts and disclosures in a real estate file.

U

unlicensed assistant 26

An individual hired by a broker to perform nondiscretionary administrative activities that do not require a license, such as reviewing documents or helping at an open house, on behalf of the employing broker or their agents.

Agency: Video™

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Who is an Agent Under Agency Law?
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Primary Duties Owed
The highest good faith 7

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Introduction to Agency

Authority to represent others

An **agent** is described as "*One who is authorized to act for or in place of another; a representative...*" [Black's Law Dictionary, Eleventh Edition (2019)]

agent
One who is authorized to represent another, such as a broker and client, or sales agent and their broker.

An **agency relationship** exists between principal and agent, and employer and employee.

The California **Department of Real Estate (DRE)** was created to oversee licensing and police a minimum level of *professional competency* for individuals desiring to represent others as *real estate agents*. This mandate is pursued through the education of individuals seeking an original broker or salesperson license. It is also pursued on the renewal of an existing license, known as *continuing education*. The education is offered in the private and public sectors under government certification.

Department of Real Estate (DRE)
A government agency which oversees, regulates, administers and enforces California real estate law as practiced by licensees.

Agency in real estate related transactions includes relationships between:

- *brokers* and members of the public (clients or third parties); and
- licensed *sales agents* and their brokers.

The extent of representation owed to a client by the broker and their agents depends on the *scope of authority* the client gives the broker. Authority is given:

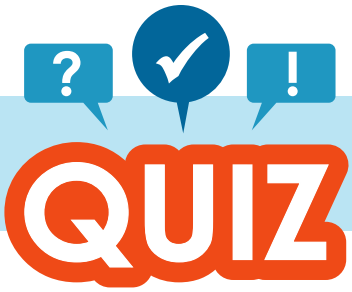
- orally;
- in writing; or
- through the client's conduct with the broker.

Agency and *representation* are synonymous in real estate transactions.

A broker, by accepting an exclusive employment from a client, undertakes the task of aggressively using **due diligence** to represent the client and attain their objectives. Alternatively, an open listing only imposes a *best efforts* standard of representation until a match is located and negotiations begin, which imposes the due diligence standard for the duration of negotiations.

An agent is an individual or corporation who represents another, called the **principal**, in dealings with third persons. Thus, *a principal can never be their own agent. A principal acts for their own account, not on behalf of another.*

principal
A person, individual or entity acting as a buyer or seller, and represented by a broker and their agents.



1. Agency and _____ are synonymous in real estate transactions.

   a. independence
   b. representation
   c. self-interest

2. A broker, by accepting an exclusive employment from a client, undertakes the task of using _____ to represent the client and attain their objectives.

   a. due diligence
   b. only the minimal effort needed
   c. due deceit

Three Parties Under Agency Law

- Principal
- Agent
- Third Persons

Who is an Agent Under Agency Law?

The representation of others

The representation of others undertaken by a real estate broker is called an agency.

Three parties are referred to in agency law: a principal, an agent and third persons. [Calif. Civil Code §2295]

In real estate transactions:

- the *agent* is the real estate broker retained to represent a client for the purposes hired;
- the *principal* is the client, such as a seller, buyer, landlord, tenant, lender or borrower, who has retained a broker to sell or lease property, locate a buyer or tenant, or arrange a mortgage with other persons; and
- *third persons* are individuals or associations (corporations, limited partnerships and limited liability companies) other than the broker's client, with whom the broker has contact as an agent acting on behalf of their client.

Real estate jargon

Real estate jargon used by brokers and agents tends to create confusion among

the public.

When the jargon is used in legislative schemes, it adds statutory chaos, academic discussion and consternation among brokers and agents over the duties of the real estate licensee.

For example, the words "real estate agent," as used in the brokerage industry, mean a *real estate salesperson employed by and representing a real estate broker*. Interestingly, real estate salespersons rarely refer to themselves as *sales agents*; a broker never does. Instead, agents frequently call themselves "broker-associates," or "Realtors," especially if they are affiliated with a local trade union. The public calls licensees "realtors," the generic term for the trade, much like the term "Kleenex."

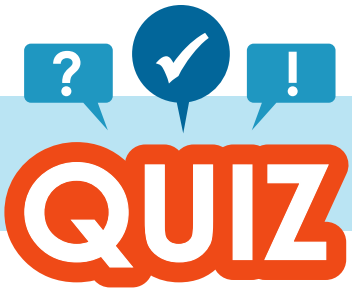
Legally, a client's real estate agent is defined as a *real estate broker who undertakes representation of a client in a real estate transaction*. Thus, a salesperson is legally *an agent of the agent (their broker)*.

Fundamental to a real estate agency are the **primary duties** a broker and their agents owe the principal. These duties are distinct from the **general duties** owed by brokers and agents to all other parties involved in a transaction.

Subagency" jargon

The word "subagency" suffers from even greater contrasts. *Subagency* serves both as:

- jargon for fee-splitting agreements between Multiple Listing Service (MLS) member brokers in some areas of the state; and
- a legal principle for the authorization given to the third broker by the seller's broker or buyer's agent to also act as an agent on behalf of the client, sometimes called a *broker-to-broker arrangement*.



1. A salesperson is legally an agent of:
   a. the client.
   b. the customer.
   c. their broker.

Knowledge and Ability

Primary Duties Owed

The highest good faith

Primary duties owed to a client in a real estate transaction include:

- a *due diligence investigation* into the subject property;
- *evaluating* the financial impact of the proposed transaction;
- *advising* on the legal consequences of documents which affect the client;
- *considering* the tax aspects of the transfer; and
- *reviewing* the suitability of the client's exposure to a risk of loss.

To care for and protect both their clients and themselves, all real estate licensees need to:

- *know* the scope of authority given to them by the employment agreement;
- *document* the agency tasks undertaken; and
- *possess* sufficient knowledge, ability and determination to perform the agency tasks undertaken.

Collectively, these are known as **fiduciary duties**. Fiduciary duties are the duties owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence. Again, these are the highest standards owed to the principal the broker represents.

Alternatively, the broker owes a limited, non-client **general duty** to voluntarily provide critical factual information to the opposing party in a transaction.

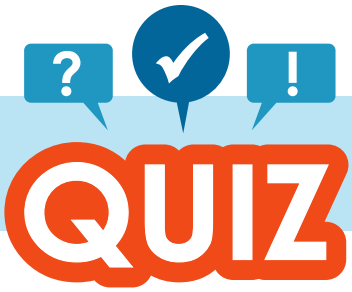
A licensee needs to conduct themselves at or above the minimum acceptable levels of competency to avoid liability to the client or disciplinary action by the DRE.

Creation of the agency relationship

An agency relationship is created in a real estate transaction when a *principal* employs a broker to act on their behalf. [CC §2307]

A broker's representation of a client, such as a buyer or seller, is properly undertaken on a written employment agreement signed by both the client and the broker. A written employment agreement is necessary for the broker to have an enforceable *fee agreement*. This employment contract is loosely referred to in the real estate industry as a "listing agreement." [**Phillippe** v. **Shapell Industries, Inc.** (1987) 43 C3d 1247] [See **RPI** Forms 102 and 103]

The broker's agency can also be created by an oral agreement or conduct of the client with the broker or other individuals. However, fee arrangements are unenforceable if no written agreement exists.

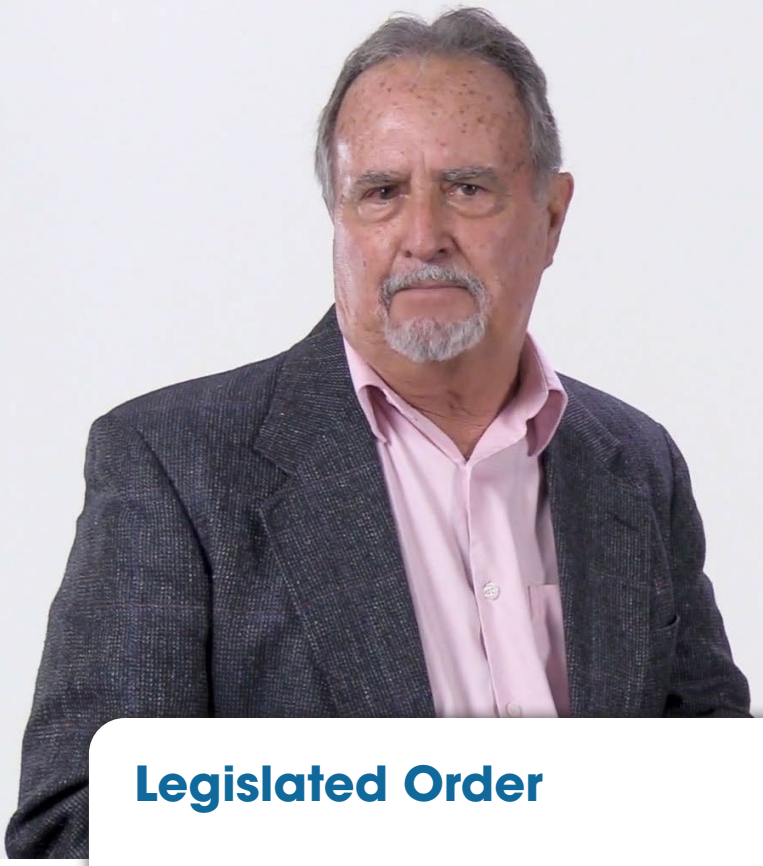


1. The primary duties owed to a client in a real estate transaction are collectively known as:

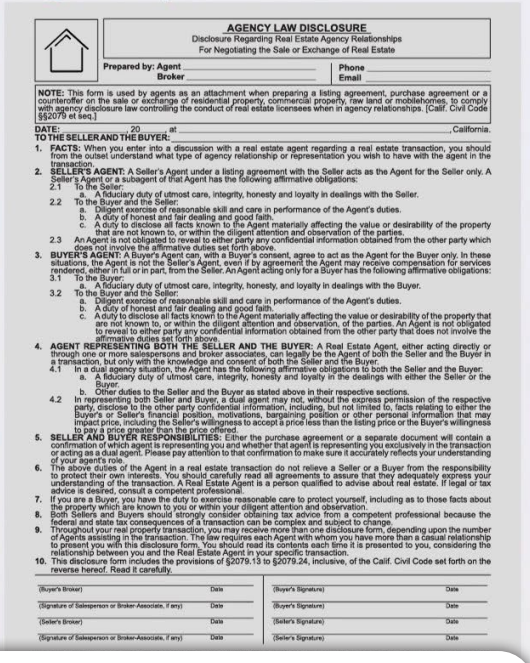
   a. general duties.
   b. fiduciary duties.
   c. limited duties.

2. A written employment agreement is necessary for:

   a. the broker to have an enforceable fee agreement.
   b. a valid agency to be created.
   c. Both a. and b.



Agency Law Disclosure



AGENCY LAW DISCLOSURE
Disclosure Regarding Real Estate Agency Relationships
For Negotiating the Sale or Exchange of Real Estate

Prepared by: Agent _____ Phone _____
Broker _____ Email _____

NOTE: This form is used by agents as an attachment when preparing a listing agreement, purchase agreement or a counteroffer on the sale or exchange of residential property, commercial property, raw land or mobilehomes, to comply with agency disclosure law controlling the conduct of real estate licensees when in agency relationships. [Calif. Civil Code §§2079 et seq.]

DATE: _____, 20__ at _____, California.
TO THE SELLER AND THE BUYER:

1. **FACTS:** When you enter into a discussion with a real estate agent regarding a real estate transaction, you should from the outset understand what type of agency relationship or representation you wish to have with the agent in the transaction.
2. **SELLER'S AGENT:** A Seller's Agent under a listing agreement with the Seller acts as the Agent for the Seller only. A Seller's Agent or a subagent of that Agent has the following affirmative obligations:
   2.1 To the Seller:
   a. A fiduciary duty of utmost care, integrity, honesty and loyalty in dealings with the Seller.
   2.2 To the Buyer and the Seller:
   a. Diligent exercise of reasonable skill and care in performance of the Agent's duties.
   b. A duty of honest and fair dealing and good faith.
   c. A duty to disclose all facts known to the Agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of the parties.
   2.3 An Agent is not obligated to reveal to either party any confidential information obtained from the other party which does not involve the affirmative duties set forth above.
3. **BUYER'S AGENT:** A Buyer's Agent can, with a Buyer's consent, agree to act as the Agent for the Buyer only. In these situations, the Agent is not the Seller's Agent, even if by agreement the Agent may receive compensation for services rendered, either in full or in part, from the Seller. An Agent acting only for a Buyer has the following affirmative obligations:
   3.1 To the Buyer:
   a. A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Buyer.
   3.2 To the Buyer and the Seller:
   a. Diligent exercise of reasonable skill and care in performance of the Agent's duties.
   b. A duty of honest and fair dealing and good faith.
   c. A duty to disclose all facts known to the Agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation, of the parties. An Agent is not obligated to reveal to either party any confidential information obtained from the other party that does not involve the affirmative duties set forth above.
4. **AGENT REPRESENTING BOTH THE SELLER AND THE BUYER:** A Real Estate Agent, either acting directly or through one or more salespersons and broker associates, can legally be the Agent of both the Seller and the Buyer in a transaction, but only with the knowledge and consent of both the Seller and the Buyer.
   4.1 In a dual agency situation, the Agent has the following affirmative obligations to both the Seller and the Buyer:
   a. A fiduciary duty of utmost care, integrity, honesty and loyalty in the dealings with either the Seller or the Buyer.
   b. Other duties to the Seller and the Buyer as stated above in their respective sections.
   4.2 In representing both Seller and Buyer, a dual agent may not, without the express permission of the respective party, disclose to the other party confidential information, including, but not limited to, facts relating to either the Buyer's or Seller's financial position, motivations, bargaining position or other personal information that may impact price, including the Seller's willingness to accept a price less than the listing price or the Buyer's willingness to pay a price greater than the price offered.
5. **SELLER AND BUYER RESPONSIBILITIES:** Either the purchase agreement or a separate document will contain a confirmation of which agent is representing you and whether that agent is representing you exclusively in the transaction or acting as a dual agent. Please pay attention to that confirmation to make sure it accurately reflects your understanding of your agent's role.
6. The above duties of the Agent in a real estate transaction do not relieve a Seller or a Buyer from the responsibility to protect their own interests. You should carefully read all agreements to assure that they adequately express your understanding of the transaction. A Real Estate Agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional.
7. If you are a Buyer, you have the duty to exercise reasonable care to protect yourself, including as to those facts about the property which are known to you or within your diligent attention and observation.
8. Both Sellers and Buyers should strongly consider obtaining tax advice from a competent professional because the federal and state tax consequences of a transaction can be complex and subject to change.
9. Throughout your real property transaction, you may receive more than one disclosure form, depending upon the number of Agents assisting in the transaction. The law requires each Agent with whom you have more than a casual relationship to present you with this disclosure form. You should read its contents each time it is presented to you, considering the relationship between you and the Real Estate Agent in your specific transaction.
10. This disclosure form includes the provisions of §2079.13 to §2079.24, inclusive, of the Calif. Civil Code set forth on the reverse hereof. Read it carefully.

(Buyer's Broker)	Date	(Buyer's Signature)	Date
(Signature of Salesperson or Broker-Associate, if any)	Date	(Buyer's Signature)	Date
(Seller's Broker)	Date	(Seller's Signature)	Date
(Signature of Salesperson or Broker-Associate, if any)	Date	(Seller's Signature)	Date

Legislated Order

The agency law disclosure

As real estate practice matures in California, rules and regulations need to be created to protect society from harm while allowing transactions to be economically beneficial for all involved. However, when professional misconduct of real estate licensees is mishandled by the brokerage community and related trade groups, legislative and judicial forces are compelled to intervene.

As a result of licensee misconceptions about the duties they owe to members of the public and the public's lack of awareness, the California legislature enacted the **agency disclosure law**. The goal is to better inform the public (and licensees) in an effort to eliminate some of these deficiencies.

The real estate agency disclosure law addresses two separate sets of agency-related matters on real estate transactions:

- an **Agency Law Disclosure**, also known as the **Disclosure Regarding Real Estate Agency Relationships**, setting out the "rules of agency" which control the conduct of real estate licensees when dealing with the public in an agency capacity [See **RPI** Forms 305-1 and 550-1]; and
- an **agency confirmation provision**, contained in documents signed by principals used to negotiate the purchase or leasing of real estate and lease agreements with a term exceeding one year, declaring the agency relationships undertaken by each of the brokers with the participants in the transaction. [See **RPI** Form 150]

agency confirmation provision
A provision in all purchase agreements and counteroffers disclosing the agency of each broker in the transaction.

*Editor's note — Two identical versions of the agency disclosure exist for leasing as part of both the "disclosure" and "property management" series of RPI forms. Either may be used when negotiating a listing, offer/letter of intent (LOI) or agreement for the lease of real estate for a period greater than one year. [See **RPI** Forms 305-1 and 550-2]*

In creating an agency scheme, the California legislature established uniform real estate terminology and brokerage conduct covering **targeted transactions**, as specified later in this section.

This agency law disclosure is presented in a two-page form. The exact wording of its content is dictated by statute. [CC §2079.16] [See **RPI** Forms 305, 305-1 and 550-2]

Targeted by law vs. recommended as best practice

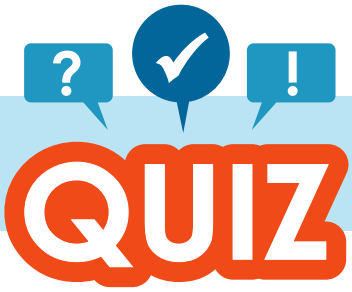
The real estate agency disclosure law previously applied only to one-to-four unit residential sales and leases for greater than one year. It has since been expanded to include more diverse types of property.

The **Agency Law Disclosure** needs to be presented to all parties when listing, selling, buying, exchanging or leasing for a term greater than one year:

Agency Law Disclosure
Restatement of agency codes and cases which establish the conduct of real estate licensees. It is delivered to all parties in targeted sales and leasing transactions.

- single family residential property;
- multi-unit residential property with more than four dwelling units;
- commercial property;
- vacant land;
- a ground lease coupled with improvements; or
- manufactured homes. [Calif. Civil Code §§2079.13(k), 2079.14]

At its core, the Agency Law Disclosure form is a restatement of pre-existing agency codes and case law on agency relationships in all real estate transactions. [See **RPI** Forms 305, 305-1 and 550-2]



1. Agency Law Disclosure sets out the rules of agency which control the conduct of:

   a. real estate licensees when acting as a principal.
   b. real estate licensees when dealing with the public in an agency capacity.
   c. real estate principals with dealing with licensees.

2. SELLER'S AGENT: A Se

3. BUYER'S AGENT: A Buy

The Uniform Jargon of Agency Law

Uniform jargon and agency law

The Agency Law Disclosure was created for use by brokers and their agents to educate and familiarize principals with:

- a uniform jargon for real estate transactions; and
- the various agency roles licensees undertake on behalf of their principals and other parties in a real estate transaction.

The Agency Law Disclosure defines and explains the words and phrases commonly used in the real estate industry.

These industry terms are used to express:

- the *agency relationships* of brokers to the parties in the transaction;
- *broker-to-broker* relationships; and
- the *employment relationship* between brokers and their agents.

A **buyer's agent** and **seller's agent** are mentioned but not defined. Legally, the agent in a real estate transaction is the licensed real estate broker. Thus, the word "agent" used in the disclosure is not a reference to the broker's agents but to the broker, who is always by law an agent when using their license to represent a client and earn a fee. Ironically, a broker rarely refers to themselves as an agent — in practice, the term is used to refer to a broker's employed sales agents.

buyer's agent
An agent representing the buyer. Also known as a selling agent.

seller's agent
An agent representing the seller. Also known as a listing agent.

Two sections on the face of the Agency Law Disclosure, entitled "seller's agent" and "buyer's agent," address the duties owed to the seller and buyer in a real estate transaction by these otherwise undefined brokers.

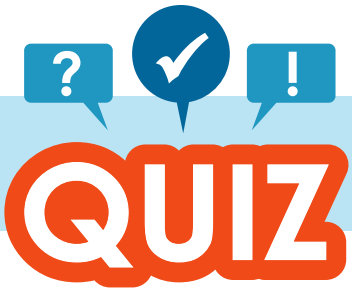
The seller's broker is correctly noted as being an agent for the seller, and is also known within the trade as a *listing broker* or *listing office*. The buyer's broker is known as a *buyer's agent. However, peculiar to real estate brokerage, the buyer's broker is also known as the selling agent*, a term the Agency Law Disclosure used prior to 2019.

Yet, they are selling nothing; they are locating property and negotiating to buy suitable property on behalf of their buyer client.

The Agency Law Disclosure does not mention, much less define, the broker's role as an **exclusive agent** for either the buyer or seller. However, the separate agency confirmation provision included in all targeted transactions calls for the broker to make this distinction known to all the parties involved. The mandated provision requires the broker to characterize their conduct with the parties as the agent of the seller or buyer exclusively, or both as a dual agent.

exclusive agent
An agent who is acting exclusively on behalf of only one party in a transaction.

These exclusive characterizations of agency conduct have no relationship to employment under exclusive listings to sell or buy property. The seller's agent with an exclusive right-to-sell listing understands the prospective buyer may turn out to be one of their buyer clients. This representation of opposing parties makes the broker a non-exclusive **dual agent**.

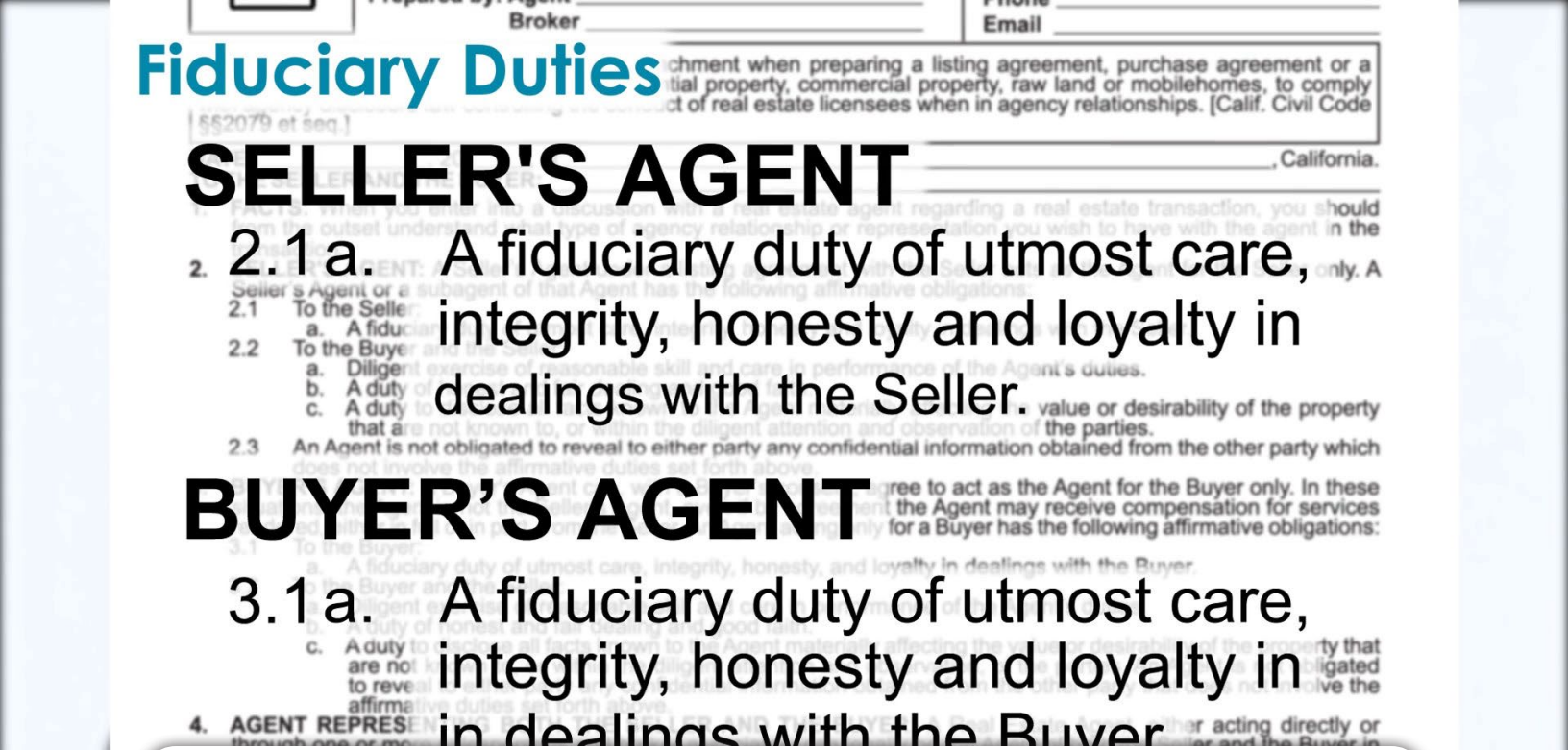


1. A seller's agent representing the seller is also known as a(n):

   a. selling agent.
   b. listing agent.
   c. dual agent.

2. An agent who is acting exclusively on behalf of only one party in a transaction is known as a(n):

   a. exclusive agent.
   b. dual agent.
   c. transaction agent.



The Participants, their Brokers and the Duties Owed

305]

Broker obligations

The Agency Law Disclosure states the generally accepted principles of law governing the conduct of brokers who are acting as agents solely for a seller or a buyer.

Two categories of **broker obligations** arise in a transaction, including:

- the *special* or *primary agency duties* of an agent which are owed by a broker and their agents to their principal, known as **fiduciary duties**; and
- the *general duties* owed by each broker to all parties in the transaction, requiring them to be honest and avoid deceitful conduct, known as **general duties.**

fiduciary duty
The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

In addition to the use requirements for the Agency Law Disclosure form, a separate, long-mandated **agency confirmation provision** is also required on all targeted transactions. **[**See **RPI** Form 150]

The *agency confirmation* provision declares the agency relationships each broker may have with the principals in the specific transaction underway. With the agency confirmation included in written negotiations to purchase, this relationship is consented to by all parties when they sign the documents.

The agency confirmation provision discloses each broker's actual agency relationship presently existing with the participants. Further, it memorializes the relationship established by the broker's and their agents' conduct with the principals in a transaction. The agency relationship confirmed is the broker's legal determination of the actual agency created by their prior and present conduct with the parties.

Other agency related conflicts may exist for the broker or agent with other parties or service providers in a transaction, such as a dual agency relationship or conflict of interest. These are set out and disclosed in other forms. [See **RPI** Form 117 and 527]

The Agency Law Disclosure form contains the wording for the agency confirmation provision to be included in targeted transactions. However, the confirmation provision in the Agency Law Disclosure form is not filled out or used in lieu of the agency confirmation provision contained in a document such as a purchase agreement.

The agencies to be confirmed by each broker in the purchase agreement are not known at the time of the initial employment when the Agency Law Disclosure is first presented to the principal. For example, the agency in a potential future sales transaction cannot be determined, much less confirmed, at the time the broker firsts presents their seller with the Agency Law Disclosure form. [CC §2079.17(d)]

When two brokers are involved in a targeted transaction, each broker needs to disclose whether they are acting as the agent for the buyer or the seller. Alternatively, when only one broker is involved, they need to confirm whether they and their agents are acting as the *exclusive agent* for one party or as a dual agent for both the buyer and seller.

Written disclosures tend to eliminate later disputes over agency duties. Agency conflicts discovered when in escrow often become the basis for cancelling a transaction, the payment of a brokerage fee, or both. [**L. Byron Culver & Associates** v. **Jaoudi Industrial & Trading Corporation** (1991) 1 CA4th 300]

What is targeted?

The Agency Law Disclosure needs to be presented to all parties in ***targeted*** *transactions.* However, not all transactions are targeted. For example, targeted transactions do not include arranging the secured interests of lenders and

borrowers under trust deeds or collateral loans.

The sale, exchange or creation of interests in transactions targeted by the agency disclosure law include transfers of:

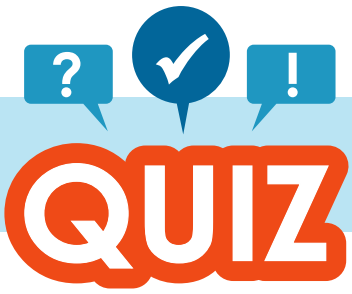
- fee simple estates in real estate or registered ownerships for mobilehomes;
- life estates;
- existing leaseholds with more than one term remaining, such as ground leases coupled with improvements; and
- multi-unit residential property with more than four dwelling units; and
- leases created for more than one year. [CC §2079.13(m)]

The Agency Law Disclosure needs to be attached to the following documents and signed by all parties in targeted transactions:

- a seller's listing [See **RPI** Form 102];
- a buyer's listing [See **RPI** Form 103];
- a purchase agreement [See **RPI** Form 150 and 159];
- an option to purchase [See **RPI** Form 161 and 161-1]
- an exchange agreement [See **RPI** Form 171];
- a counteroffer, by attachment or by reference, to a purchase agreement containing the disclosure as an attachment [See **RPI** Form 180];
- any letter of intent (LOI) prepared and submitted on behalf of a buyer [See **RPI** Form 185];
- a residential or commercial lease agreement for a term exceeding one year [See **RPI** Form 550 and 552 –552-8]; and
- an offer to lease. [See **RPI** Form 556]

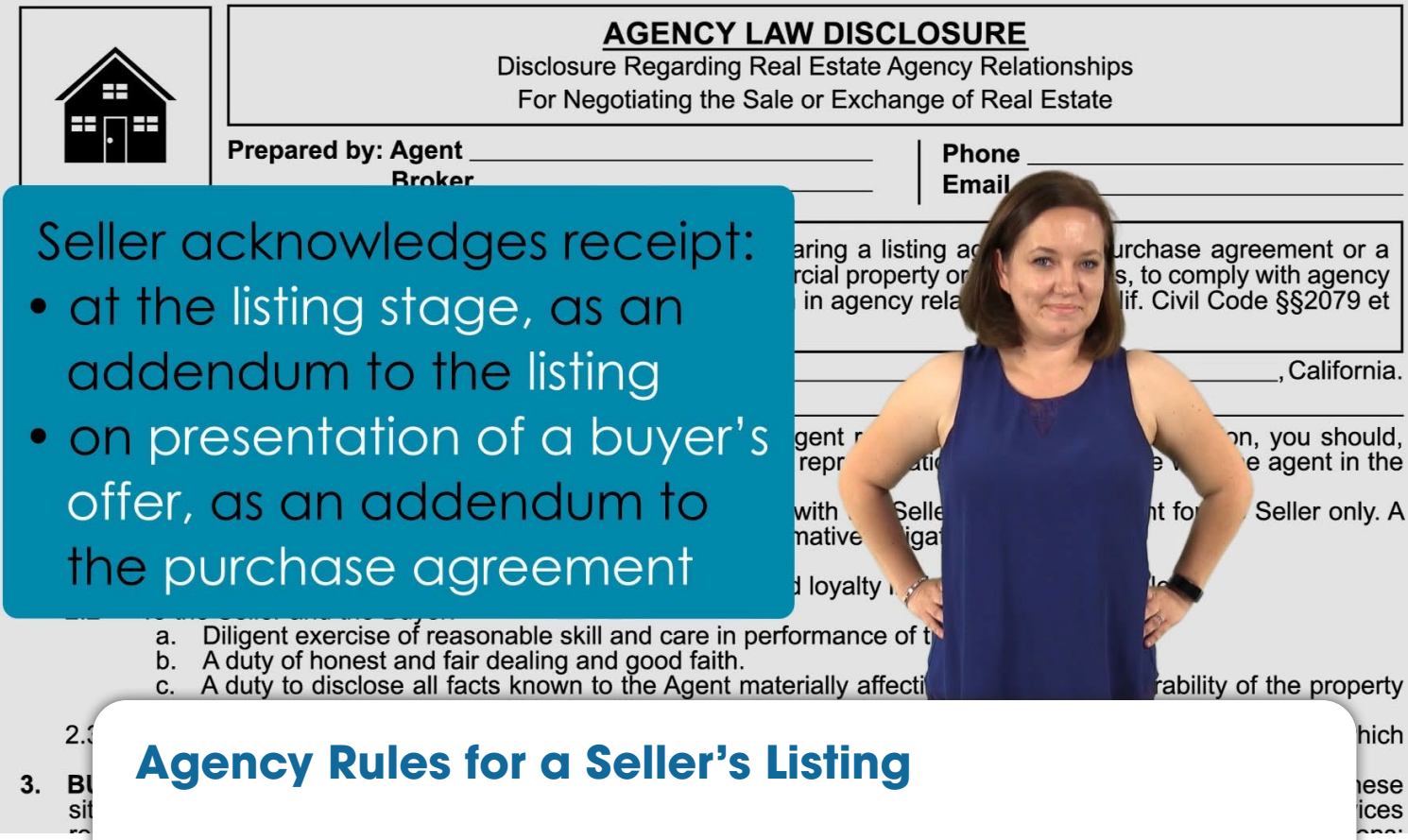
However, there are exceptions. The Agency Law Disclosure is not required on negotiations and agreements concerning:

- property management;
- financing arrangements; and
- month-to-month rental agreements.



1. The Agency Law Disclosure is not required on negotiations and agreements concerning:

   a. a month-to-month rental agreement.
   b. a purchase agreement for one-to-four unit residential property.
   c. a residential or commercial lease agreement for a term exceeding one year.



Agency Rules for a Seller's Listing

Agency rules for a seller's listing

Consider a seller's listing, open or exclusive, employing a broker and their agents to sell a targeted property. Here, the Agency Law Disclosure is required as an addendum to the seller's listing agreement. [CC §2079.14(a)]

Failure of the seller's agent to provide the seller with the Agency Law Disclosure prior to entering into the listing agreement is a violation of disclosure laws. As a consequence of this upfront failure, the broker will lose the fee on a sale if challenged by the seller. The loss of the fee is not avoided by a later disclosure made as an addendum to a purchase agreement or escrow instructions. [**Huijers** v. **DeMarrais** (1992) 11 CA4th 676]

The **Agency Law Disclosure** is also required when listing and submitting offers on a long-term ground lease on a property coupled with improvements that is being conveyed to a buyer and will be security for any purchase-assist financing. [CC §§2079.13(k), 2079.13(m), 2079.14]

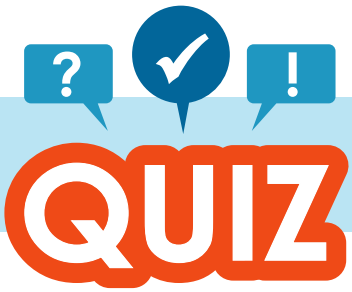
The seller's signature acknowledges receipt of the Agency Law Disclosure at both:

- the listing stage, as an addendum to the listing; and
- on presentation of a buyer's offer, as an addendum to the purchase agreement. [CC §2079.14]

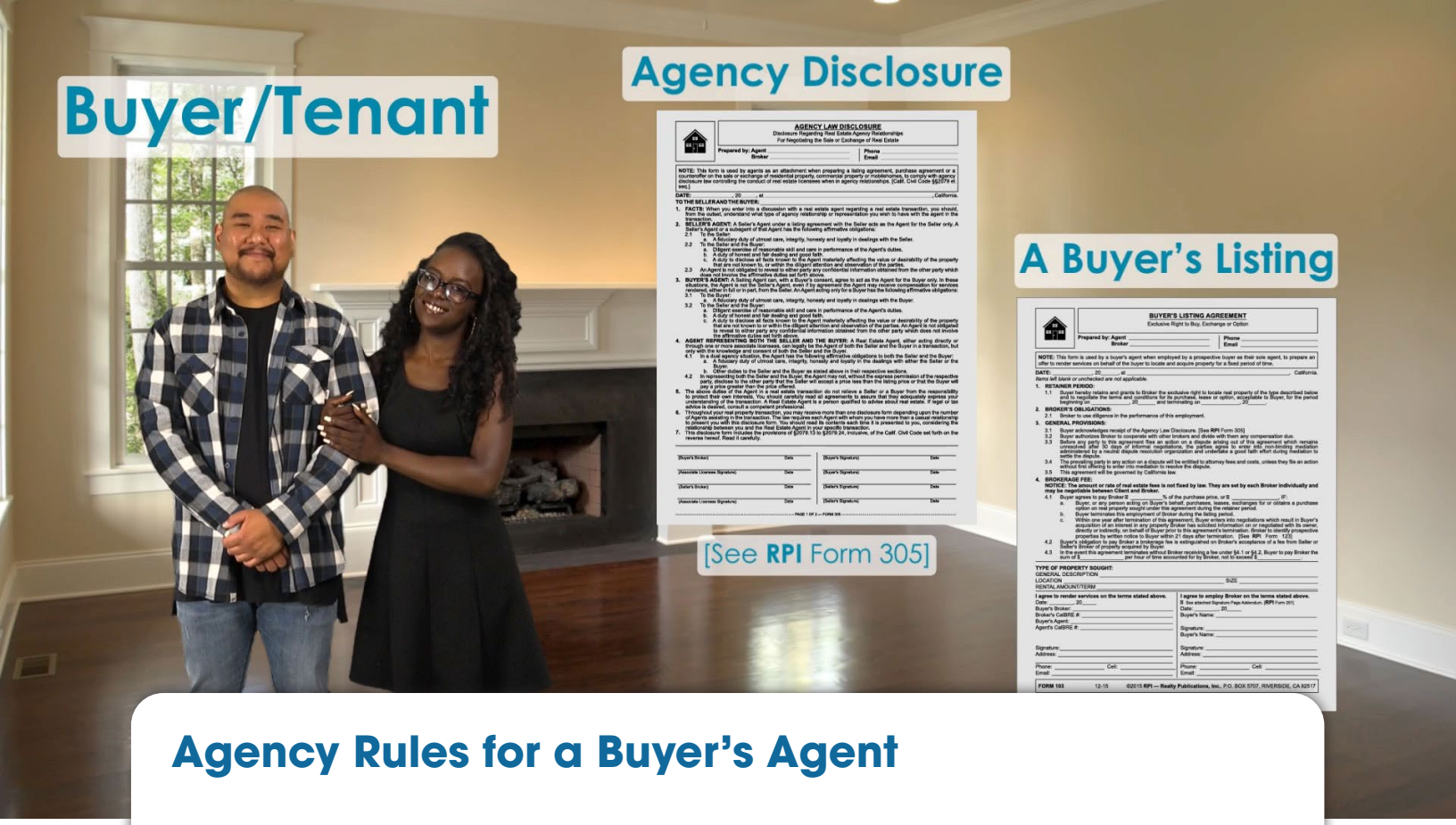
Thus, the Agency Law Disclosure is treated by the seller's agent as a *preliminary*

and compulsory listing event, if the listing broker expects to enforce collection of a brokerage fee on a later sale of the property. The Agency Law Disclosure is signed by the seller and handed back to the broker or their agent before settling down to finalize the listing to which it will be attached.

Further, when the broker or their sales agent fails to hand the seller the Agency Law Disclosure at the listing stage, the listing, and thus the agency, can be cancelled by the seller at any time. When the Agency Law Disclosure is not delivered up front with the listing, the seller may cancel payment of the fee due their broker after the transaction is in escrow and the brokerage fee has been further agreed to.



1. The seller's signature acknowledges receipt of the Agency Law Disclosure:
   a. at the listing stage as an addendum to the listing.
   b. on presentation of a buyer's offer as an addendum to the purchase agreement.
   c. Both a. and b.



Agency Rules for a Buyer's Agent

The buyer's agent perfects their fee

The buyer's agent provides the Agency Law Disclosure form to the buyer prior to their signing any writing that initiates negotiations contemplating a sale. [CC §2079.13]

For example, the Agency Law Disclosure form is attached when an agent prepares a LOI to be signed by a prospective buyer for a purchase. As is well understood, an LOI commences negotiations in a transaction between prospective buyers and sellers.

*Editor's note — Agency disclosure law requires a buyer's agent provide the Agency Law Disclosure form as soon as practicable prior to execution of an offer to purchase. Thus, as a matter of good practice, the disclosure form is best provided and signed by the buyer when entering into a buyer's listing agreement, as this is the moment affirmative agency duties commence. [See **RPI** Form 103 and 111]*

For the buyer's broker to protect themselves against loss of the fee due to the seller's broker's failure to timely disclose, the buyer's broker needs to perfect their right to collect their portion of any brokerage fee to be paid by the seller. Here, the buyer's broker's share of the fee to be paid by the seller needs to be agreed to be paid directly to the buyer's broker under the terms of the purchase agreement and escrow instructions.

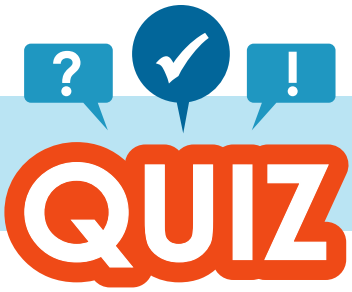
Also, the Agency Law Disclosure form needs to be attached as a signed addendum

to the buyer's purchase agreement offer submitted to the seller.

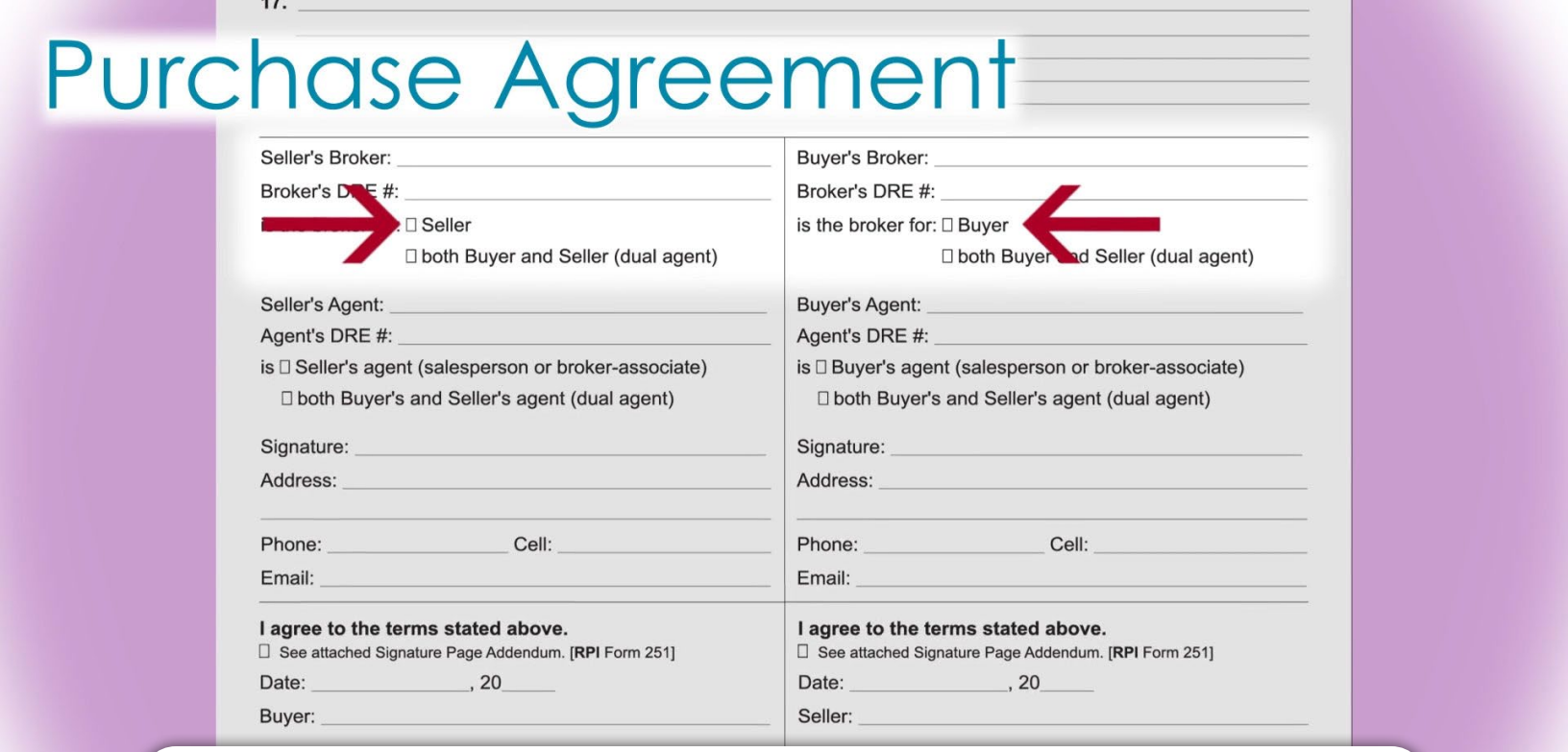
However, the buyer's broker might erroneously agree to let the seller's broker receive the entire fee from the seller. Under this risky arrangement, the seller's broker pays the buyer's broker a share of the fee under their separate *fee-sharing agreement*.

However, when the seller's broker fails to obtain a signed Agency Law Disclosure as an addendum to the listing, the seller may legally avoid paying their broker their fee. Thus, when the seller has not agreed to directly pay the buyer's broker, a risk for the buyer's broker is created. If the seller refuses to pay their broker the entire fee for lack of disclosure, the buyer's broker is left without a fee as agreed from the seller's broker.

For the buyer's broker to protect their fee, the seller needs to agree in the body of the purchase agreement that the seller will pay both brokers themselves.



1. The buyer's agent provides the Agency Law Disclosure form to the buyer:
   a. prior to their signing any writing that initiates negotiations contemplating a sale.
   b. after signing any writing that initiates negotiations contemplating a sale.
   c. anytime as an addendum prior the close of escrow.



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Agency Confirmation Provision

Mandated for purchase agreements

The agency relationship of brokers and their agents to their principals is required to be disclosed to all parties in *targeted transactions*. This includes the sale, exchange or long-term lease of a one-to-four unit residential property, commercial property or mobilehome. [Calif. Civil Code §2079.17(d)]

This relationship is disclosed in the **agency confirmation provision** located in all written negotiations to purchase or lease, and lease agreements. [CC §2079.17]

agency confirmation provision
A provision in all purchase agreements and counteroffers disclosing the agency of each broker in the transaction.

The *agency confirmation provision* states the existence or nonexistence of each broker's *fiduciary agency* with the various parties to the transaction. Each broker identifies the party they are acting on behalf of as their agent in the transaction. Thus, one broker does not state the agency relationship of any other broker involved in the transaction. For example, the buyer's broker does not include the seller's broker's agency in the agency confirmation and broker identification provisions in the purchase agreement form. [CC §2079.17(a); see **RPI** Form 150]

Further, an *Agency Law Disclosure* is provided each time any broker prepares a purchase agreement. The separate disclosure confirms the broker's specific agency in the transaction, and is attached as a referenced addendum.

The Agency Law Disclosure is an explanation of the duties owed to each party in a transaction by the broker and agents involved. [CC §2079.17(d)]

The Agency Law Disclosure is signed by the buyer, then signed by the seller on an acceptance of the offer or submission of a counteroffer.

Editor's note — This is discussed primarily in the context of an agent representing a buyer or seller. However, the same rules of conduct apply for an agent of a tenant or landlord.

Statutory jargon

The contents of the agency confirmation provision require the broker and their agents to first understand the statutory definitions of:

- agent;
- seller's agent, also referred to as a **listing agent**;
- buyer's agent, also referred to as a **selling agent**;
- subagent; and
- dual agent.

The statutory definitions of these agency terms and their meanings are oftentimes different from the jargon used among brokers and agents in the multiple listing service (MLS) environment.

For example, by statutory definition, an agent retained by a client is always a broker. This broker is usually represented through the efforts of licensed sales agents employed by the broker. In the jargon of the real estate industry, a sales agent employed by the broker is always called an "agent." In practice, a licensed broker never refers to themselves or other brokers as agents.

By statute, the agent employed by a broker is defined as an **associate licensee** — an *agent of the agent*, not an agent of the client. [CC §2079.13(a), 2079.13(b)]

associate licensee
A sales agent employed by a broker.

Only the broker can be an agent of a client. Sales agents are not permitted to have clients. Sales agents are always employees of the *client's agent* — the broker.

However, for income tax purposes, agents may be classified in employment contracts with their broker as independent contractors. [Calif. Business and Professions Code §10132] [See **RPI** Form 506]

Use of the agency confirmation provision

Both the agency confirmation provision and the separate Agency Law Disclosure are required to be part of a purchase agreement on all offers and acceptances negotiated by brokers on targeted transactions.

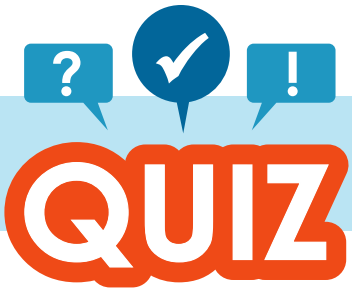
In practice, the buyer's agent is the broker who prepares and presents a purchase agreement to the buyer for their signature.

Thus, the buyer's broker or their agent will:

- attach the Agency Law Disclosure as an addendum to the purchase agreement;
- fill out the buyer's agent's agency confirmation provision in the purchase agreement; and
- obtain the buyer's signature on the agency law disclosure and the purchase agreement.

Before submitting the buyer's purchase agreement to the seller, the seller's broker confirms their agency with the seller. The seller's broker does so by filling out the seller's broker confirmation, noting the agency relationship established by their conduct with the seller.

Consider a seller's **counteroffer** which incorporates all the provisions of the buyer's offer, as most do. Here, the seller has signed a writing which includes by reference the confirmation of the broker's agency. All the seller needs to sign is the counteroffer and the Agency Law Disclosure.



1. The agency confirmation provision states the existence or nonexistence of each broker's _____ with the various parties to the transaction.

   a. general agency.
   b. fiduciary agency
   c. subagency status

Dual Agency as an Authorized Practice

Simultaneous representation

A **dual agent** is a broker who simultaneously represents the best interest of *opposing parties* in a transaction, e.g., both the buyer and the seller. [Calif. Civil Code §2079.13(e); see **RPI** Form 117]

dual agency
The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction.

Dual agency has always been proper brokerage practice. It is a situation that arises naturally in the course of representing buyers and sellers. However, the existence of a dual agency needs to be promptly disclosed to each client. [CC §2079.17]

A broker who fails to promptly disclose their dual agency at the moment it arises is subject to:

- the loss of their brokerage fee;
- liability for their principals' money losses; and
- disciplinary action by the California Department of Real Estate (DRE). [Calif. Business and Professions Code §10176(d)]

For example, a broker locates property sought by a buyer the broker has been working with. On determining the property is one the buyer is interested in purchasing, the broker solicits and receives a written listing agreement from the owner selling the property. The broker does not disclose their present agency relationship with the buyer to the seller. The buyer makes an offer to purchase the property which is accepted by the seller. Under the fee provision in the buyer's offer, the seller agrees to pay the broker a fee.

Before closing, the seller discovers the broker's working relationship with the buyer to locate property, and the seller cancels the escrow instructions. The broker demands payment of their fee for locating the buyer.

Can the broker recover their fee?

No! The broker failed to disclose their dual agency to the seller when it arose, i.e., at the time the broker entered into the listing with the seller. [**L. Byron Culver & Associates** v. **Jaoudi Industrial & Trading Corporation** (1991) 1 CA4th 300]

Dual agency and conflict of interest

A **conflict of interest** exists for a broker when:

- the broker has a positive or negative *bias* toward the opposing party in a transaction or a person indirectly involved in the client's transaction; and
- that *bias* may compromise the broker's ability to freely recommend action or provide guidance to the party they agreed to represent.

conflict of interest
When a broker or agent has a positive or negative bias toward a party in a transaction which is incompatible with the duties owed to their client.

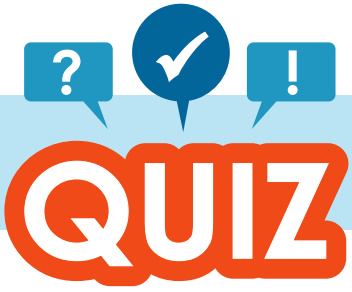
Viewed another way, a *conflict of interest* arises when:

- a broker or their agent, acting on behalf of a client, has a competing professional or personal bias; and
- the bias hinders the broker or agent's ability to unreservedly fulfill the fiduciary duties they have undertaken to advise and act on behalf of the client.

The *conflict of interest* which exists when acting as a dual agent is handled by timely disclosure to all parties. Disclosure is made prior to providing a buyer with information on a property listed with the broker, or taking a listing from a seller when the broker already represents a buyer who will make an offer. [See **RPI** Form 527]

Disclosure of a conflict, such as a dual agency situation, allows the principals to take the disclosed bias into consideration in further discussion with the broker and in negotiations with the opposing party.

The disclosure and consent to the dual agency does not neutralize the bias disclosed. However, it does neutralize the element of deceit which, if left undisclosed, is a breach of the broker's fiduciary duty.



1. The agency relationship that results when a broker represents both the buyer and seller in a real estate transaction is known as a:

   a. secret agency.
   b. dual agency.
   c. Either a. or b.

Undisclosed Knowledge of Confidential Pricing Information

Both clients are entitled to advice

When a dual agency is established in a one-to-four unit residential sales transaction, and both parties are represented by the same broker, the broker may not pass on **confidential pricing** information to the opposing parties. For example, when the broker is a dual agent, the broker and their agents may not tell the seller the price the buyer is willing to pay, or tell the buyer the price the seller is willing to accept.

Confidential pricing information needs to remain the undisclosed knowledge of the dual agent, unless authorized to release the information in a writing signed by the principal in question. [CC §2079.21]

The decision by the broker not to release pricing information needs to be made and maintained from the moment the dual agency arises, the same moment the dual agency is disclosed.

The dual agency conflict typically arises when the buyer is an existing client who has received property information from the broker and is now exposed to or expresses an interest in property listed by the broker. This conflict of dual agency occurs before the purchase agreement is prepared, including its agency confirmation provision.

Dual agency and diminished benefits

A broker owes their client the duty to pursue the *best business advantage* legally and ethically obtainable. However, by nature, the dual agent is prevented from actively achieving this advantage for either client. The dual agent cannot take sides with one or the other during negotiations. Here, a natural inability exists to negotiate the highest and best price for the seller, while also negotiating the lowest and best price for the buyer.

Generally, clients of a dual agent do not receive the full range of benefits available from an exclusive agent. This holds true even when different agents employed by the same broker each work with different parties to the same transaction.

Remember: the *legal agent* for a buyer or seller in a transaction is the broker who employs the agents involved handling negotiations. It is not the broker's agents who are under contract with the clients, but their employing broker.

In-house transactions which involve the broker as a dual agent make it particularly difficult for the broker to **oversee and supervise** dual agency negotiations.

Typically, one agent employed by the broker enters into an exclusive sales listing with a seller. At the same time, another agent in the broker's employment works separately with a buyer to locate qualifying properties listed with other brokers.

The broker only becomes a dual agent if the buyer decides to buy an in-house listing after reviewing other brokers' listings. The buyer's exposure to properties beyond those listed with the broker creates an agency relationship between the buyer's agent and the buyer. This in turn creates a dual agency situation for the broker when the buyer later purchases an in-house listing. Here, the agent of the seller and the agent of the buyer are employed by the same broker, who is now a legal agent of both the seller and buyer concurrently.

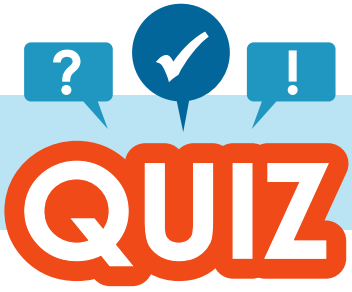
However, there is an improper tendency in transactions involving only one broker and two of their agents to automatically designate the broker as a dual agent. In this instance, the buyer may be a party to whom only *general duties* regarding property disclosures are owed by the broker and their agents. Thus, no specific agency duties are owed the buyer and a dual agency does not arise.

For example, consider a buyer who simply responds to the broker's "For Sale" sign, open house or marketing ads. Without being shown unlisted properties or properties listed with other brokers, the buyer directly makes an offer on a property listed "in-house" with the same broker.

The buyer's inquiry and review of properties is limited to properties listed with the broker. Further, the agent who merely receives the buyer's offer does not negotiate on behalf of the buyer or engage in other advisory conduct that then

imposes an agency duty. Thus, the resulting sales transaction is on a property listed with the broker to a buyer who has only been shown properties listed with the broker, conduct that does not create an agency relationship with the buyer. [**Price** v. **Eisan** (1961) 194 CA2d 363]

However, there remains, as always, the listing broker's *general nonfiduciary duty* owed to all other parties in the transaction who are not the broker's clients, including the non-client buyer.



1. When a dual agency is established in a one-to-four unit residential sales transaction and both parties are represented by the same broker, the broker may not:

   a. encourage the seller to hire a home inspector.
   b. discuss general financing options to the buyer.
   c. pass on confidential pricing information to the opposing parties.

Subagency

Agency and fee sharing concepts

The *agency relationship* of the buyer's broker is determined by the conduct of the brokers and their agents, not by the seller's payment of a broker fee to the broker. Nor is it determined by splitting the fee received by the seller's broker.

Thus, neither a **subagency** duty owed the seller, nor a *dual agency* relationship with the buyer and seller, is imposed on the buyer's broker simply because the seller pays the buyer's broker a fee. This fee-agency rule applies whether the seller pays the fee directly to the buyer's broker, or indirectly when the seller's broker initially receives the entire fee. [Calif. Civil Code §2079.19]

subagent
An individual who has been delegated agency duties by the primary agent of the client, not the client themselves.

Brokers and agents working for buyers to locate suitable property are not considered agents of the seller simply because they show their buyers properties listed with other brokers. Buyer's brokers do not typically conduct themselves as subagents of the seller or as dual agents representing both seller and buyer.

Subagent vs. fee-sharing buyer's broker

A seller's **listing agreement** authorizes the listing broker to cooperate with other brokers. Thus, the seller's broker may share property information with other brokers and share any brokerage fee due from the seller. [See **RPI** Form 102 §4.2]

Listing agreements do not authorize the seller's broker to delegate to other brokers the authority to also act on behalf of the seller to **locate buyers** and obtain offers to purchase as the seller's agent.

When another broker acts on behalf of a seller at the request of the seller's broker, a subagency with the seller has been established by the brokers. Further, the broker acting as the subagent is not employed by the seller's brokers as a *broker-associate*.

However, a provision in a listing agreement may authorize the seller's broker to create a subagency between their seller and another broker. With authority, the seller's broker, acting on behalf of the seller, may employ another brokerage office as a subagent to also act on behalf of the seller to market the property.

Subagency: MLS membership myth

The membership of a buyer's broker in a **multiple listing service (MLS)** is not conduct that creates a dual agency or subagency relationship with any seller whose property is listed for sale with another broker who is a member of the MLS.

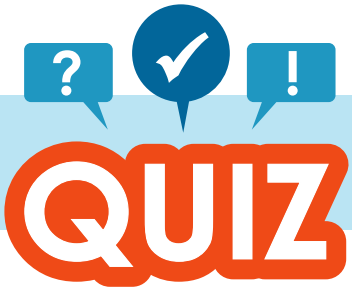
multiple listing service (MLS)
An association of real estate agents pooling and publishing the availability of their listing properties.

Agency, whatever the type, is created either by *contract* or by the *conduct of a broker* when interacting with a buyer or seller. Agency is not established by entering into trade memberships or by receipt of a fee paid by the seller. [CC §2307]

Subagency duties differ greatly from those misleading subagency concepts often generated at the MLS level. The claimed "MLS subagency" arose out of erroneous notions held about the nature of *cooperation* between brokers in fee-sharing arrangements.

The focus within the MLS for determining agency relationships in the past was improperly placed on the relationship between the MLS brokers. The analysis overlooked the relationship each broker had with their client in a sales transaction.

For a broker to become a subagent appointed by the seller's broker, the broker needs to be in contact with the buyer but conduct themselves solely as the seller's representative throughout all negotiations with the buyer.



1. An individual who has been delegated agency duties by the primary agent of the client, not the client themselves, is referred to as a(n):

   a. dual agent.
   b. free agent.
   c. subagent.

When an Opinion Becomes a Guarantee

Representing future events to buyers

Occasionally, a buyer will ask the seller's agent or their own agent what they *"believe, contemplate, anticipate or foresee"* will occur in the future regarding ownership of a particular property.

An honest response to such a question is naturally limited to the agent's knowledge and expertise on the subject. The opinion given in response will always be **speculation**, based on the observations, knowledge and beliefs of the agent about the likelihood an event or condition will occur in the future. Thus, statements by the buyer's agent will be either:

- couched in words such as "anticipation," "estimation," "prediction" or "projection," denoting their statement is an **opinion** about an uncertain future event; or

opinion
A statement by an agent concerning an event or condition which has not yet occurred based on readily available facts.

- worded as an *assurance* the events and conditions, as presented, will occur, a response reaching the level of a **guarantee**.

The difference between the wording used by an agent to express an opinion or a guarantee exposes the agent to liability when:

- the buyer acts in reliance on the information by making an offer or eliminating a contingency to acquire property; and
- the event or condition fails to occur.

An opinion is a statement by a broker or their agent concerning an event or condition which has not yet occurred. To be classified as an opinion, the statement developed by the agent needs to be based on readily available facts and their knowledge on the subject. However, it is the nature of an opinion that the event or conditions speculated to come about may not actually occur.

In an opinion, the event or condition expressed is not a factual representation. The event or condition expressed has not occurred and does not exist at the time the opinion is given.

Alternatively, a **fact** is an existing condition, presently known or knowable by the agent, due to the ready availability of data or information. Facts are the subject of disclosure rules, not the rules of opinion. However, "guesstimates" and wishful assumptions are not opinion.

fact
An existing condition which is presently known or readily knowable by the agent.

Special circumstances may impose liability

An *opinion* is a belief that is honestly held. It is based on a reasonable, although sometimes faulty, analysis by the agent giving the opinion of property information known or readily available. The opinion does not by itself create any liability if the event does not occur.

However, several **special circumstances** may surround an agent's giving of an opinion which creates an environment raising their statement to the status of a *misrepresentation*.

If *special circumstances* exist, the broker and their agent are *exposed to liability* for the losses caused by the failure of the predicted event, activity or condition to occur.

Special circumstances which may cause a failed prediction to be an actionable misrepresentation include:

- an opinion given by an agent to a person they owe a fiduciary duty, such

as between the seller's agent and the seller or the buyer's agent and the buyer [**Ford v. Cournale** (1973) 36 CA3d 172];

- an opinion given to a buyer by a seller's agent who holds themselves out as **specially qualified** or possessing expertise about the subject matter of the transaction [**Pacesetter Homes, Inc.** v. **Brodkin** (1970) 5 CA3d 206];
- an opinion given by a seller's agent or seller who has superior knowledge on the subject matter, implying they have inside information not available to the buyer [**Borba** v. **Thomas** (1977) 70 CA3d 144]; or
- an opinion given to a buyer by a seller's agent who could not honestly hold or reasonably believe the truth of their opinion due to facts known or readily available to them. [**Cooper** v. **Jevne** (1976) 56 CA3d 860]

An opinion based on facts and conditional opinions

Consider a prospective buyer interested in acquiring a lot within a subdivision and constructing a home on it.

The subdivider's agent, based on subdivision maps and discussions with the subdivider, advises the buyer all the lots are going to be the same size and subject to the same use restrictions. Further, all homes built on the lots are to be worth at least $400,000.

The buyer purchases the lot and builds their home in accordance with the use restrictions.

Due to an economic downturn at the end of the current business cycle, the subdivider resubdivides the remaining unsold lots and removes the use restrictions. The resubdividing is intended to increase the marketability of the unsold lots in the tract.

The buyer now seeks to rescind the purchase and recover their entire investment, claiming the subdivider's agent made false representations about the subdivision on which the buyer relied.

The subdivider's agent claims they honestly believed their representations that the subdivider will not alter the lots remaining to be sold.

Here, the agent's representations about the lot size were made truthfully. There was no intent to deceive the buyer. Both the agent and the subdivider had a reasonable basis for believing changes were

not necessary at the time of the purchase. However, a later shift in the economy warranted the changes as necessary to prevent the tract from deteriorating in its marketability.

The seller's agent's statements about the future were honest at the time they were made. Thus, their statements qualify as an expression of their opinion.

Further, the buyer did not require the deed from the seller to include a grant of the promised rights that all the lots will be the same size with the same restrictions on minimum value. Thus, the buyer did not take proper action in reliance on the seller's agent's opinion when they agreed to purchase the property. [**Meehan** v. **Huntington Land & Improvement Co.** (1940) 39 CA2d 349]

Conditional opinions

Consider a developer of a residential duplex subdivision who provides their seller's agent with a schedule of **projected rents**. The agent is instructed to inform prospective buyers these rents are estimates of the amounts obtainable from the duplexes should they buy one.

The developer has not developed properties in the area prior to this project. Also, they have no actual knowledge of the rents a comparable duplex might obtain in the area.

A buyer with minimal investment property experience contacts the agent asking for more information.

The buyer is advised by the agent that "if you receive the rents we contemplate, it will be a good investment."

The buyer purchases a duplex, but is unable to locate tenants willing to pay the rental amounts represented in the agent's opinion. Ultimately, the buyer loses the property to foreclosure.

The buyer makes a demand on the agent for the loss of their invested funds. The buyer claims the agent's statements about the property's future rental income were misrepresentations since the buyer relied on their *superior knowledge* about rental conditions in the area when purchasing the duplex.

The agent claims the statement was a mere opinion since it conditioned the investor's success on collecting the represented rent amounts.

Here, the agent's statement was only an estimate or opinion held about future anticipated rental income. As no operating history existed to draw on when making the projections, the agent's opinion was based on all *readily available information*.

Further, the developer's lack of prior rental experience in the area or knowledge of rents actually attainable by the duplexes made the statement an opinion. Thus, the buyer may not rely on the rent projections given by the adversarial seller's agent as a fact which might reasonably motivate their decision to buy. [Pacesetter Homes, Inc., supra]

Conclusions drawn from opinions

An opinion given by a seller's agent predicting the future occurrence of an event does not impose liability on the seller's agent for erroneous conclusions if the buyer is aware of the relevant facts on which the agent's opinion is based.

A buyer who has *knowledge of and equal access to the same information* relied on by the seller's agent cannot later claim they acted in reliance on the seller's agent's opinion. This is especially true when the buyer has sufficient time to conduct their own independent investigation to ascertain the accuracy of the agent's opinion.

Thus, the buyer cannot ignore their own knowledge of the same facts used by the seller's agent to develop an opinion, and then claim they relied on the seller's agent's opinion as an assurance the prediction will occur.

Consider a leasing agent acting on behalf of a prospective commercial tenant in percentage rent lease negotiations. The commercial landlord is experienced and has not retained the services of a real estate agent.

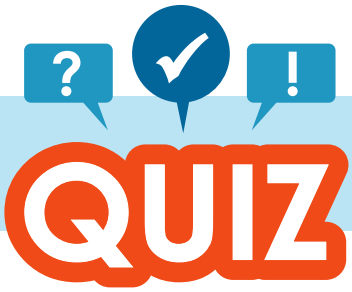
The leasing agent tells the landlord that "*in my opinion*" the tenant's annual gross sales receipts will be in excess of $5,000,000. A lease agreement is entered into. The lease rent is a base monthly amount plus a percentage of annual gross sales receipts over $5,000,000. The landlord pays the leasing agent's fee.

A dispute erupts between the landlord and the tenant. The landlord wants to recover the fee paid to the tenant's agent, claiming the agent represented the potential gross sales receipts as exceeding $5,000,000, an amount much higher than the sales the tenant might ever experience during the leasing period.

Here, the tenant's agent prefaced their statements with the words "in my opinion." Also, a landlord cannot reasonably rely on the representation of future gross sales as a condition which will actually occur.

Thus, the landlord should have known the gross receipts prediction was just an estimate honestly made by the agent who represented the tenant. They cannot treat the estimates of the adversarial agent as fact.

Further, the landlord had ample time and the means to make their own inquiries and analyze their findings. Since the landlord was not represented by an agent, they needed to conduct their own due diligence investigation if they intended to eliminate the uncertainties of estimates made on behalf of the tenant by the tenant's agent. [**Foreman & Clark Corporation** v. **Fallon** (1971) 3 C3d 875]



1. Statements couched in words such as "anticipation," "estimation," "prediction" or "projection," denote the statement is a(n) _____ about an uncertain future event.

   a. assurance
   b. guarantee
   c. opinion

2. Statements worded as an assurance that events and conditions will occur as presented reach the level of a(n):

   a. guarantee.
   b. prediction.
   c. projection.

Opinions of the Buyer's Broker and Agent

Special fiduciary duty owed

A seller's broker and seller's agent have only a *general non-agency duty* to deal honestly and in good faith with a prospective buyer. As for a buyer, the seller's agent's opinions are those of an adversary.

Thus, a seller's agent's opinion cannot be reasonably relied upon by a prospective buyer as having a high probability of occurring, unless **special circumstances** exist.

In contrast, a buyer's broker and their agent have a special fiduciary duty to handle a buyer with the same level of care and protection a trustee exercises on behalf of their beneficiary.

This special **fiduciary duty** raises an opinion given to a buyer by the buyer's broker or their agent to a higher level of reliability than had the same opinion been expressed by a seller's agent acting solely on behalf of a seller. As a fiduciary, the opinion of the buyer's agent becomes an assurance the condition or event will occur, unless the buyer's agent conditionalizes their opinion.

fiduciary duty
The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

For the buyer's agent to give their opinion to their buyer and keep it from rising to an *actionable assurance* when the predicted event fails to occur, the opinion will include a recommendation to investigate and expertly analyze relevant information to confirm the agent's opinion. Further, to mitigate risks, a *further-approval contingency* provision covering the condition or event that is the subject of the opinion needs to be included in any offer made by the buyer. [**Borba** v. **Thomas** (1977) 70 CA3d 144]

Assurance of suitability without a contingency

Consider a buyer's agent who represents a prospective buyer looking for rental income property.

The buyer's agent is aware the buyer's primary purpose for acquiring property is to receive spendable income from the investment.

The agent locates a multi-unit apartment complex. The agent assures the buyer:

- monthly vacancies will only be three or four units since the apartment complex is the only complex in the area which allows children and pets;
- the complex will require very little expense to maintain; and
- the buyer will receive the amount of spendable income sought from the investment.

Even though the seller's books and records are **readily available** for inspection on request, the buyer's agent does not verify the accuracy of the seller's projected income and expense statements, or confirm the maintenance costs. The agent fills out and hands their buyer an **Annual Property Operating Data (APOD**) sheet restating the representations already made to the buyer about the agent's projections of future income. [See **RPI** Form 352]

The buyer, in reliance on their agent's predictions about the property's future operations, enters into a purchase agreement with the seller. No contingency provisions are included to confirm the integrity of the improvements or to investigate the income and expenses experienced by the seller.

After the buyer acquires the property, the buyer encounters higher maintenance costs and significantly lower rental income than

represented by their agent. Also, the property has a high turnover rate and a large number of tenants are constantly delinquent in the payment of rent.

The buyer does not receive the sought-after spendable income projected by their agent. Soon, the property is lost to foreclosure.

The buyer makes a demand on their agent for their lost investment, claiming the agent misrepresented the operations of the property. The buyer's agent rejects the demand, claiming their comments on the property's performance were opinions, not guarantees.

Here, the buyer had the right to rely on their agent's unconditional statements of facts about the property. The buyer was further correct to treat the representations as true without concern for their verification as a fiduciary relationship existed between the buyer and their agent. Thus, the buyer's agent's predictions were **misrepresentations** since they did not come to be, and the basis for the buyer's recovery of the value of the lost investment. [**Ford** v. **Cournale** (1973) 36 CA3d 172]

Expertise of the broker or agent

Agents often hold themselves out as experts with **superior knowledge** about a particular type of transaction, such as high-end residential properties, apartment projects, industrial buildings or land. Agents often claim special knowledge for reason of an alphabet-soup-type certification attached to their name. Prospective buyers, aware of a seller's agent's specialty, often ask the agent for their opinion about some anticipated future use or operation of the property.

Due to an agent's experience, special training and education, seller's agents may find their opinion is given extra weight by a buyer. An agent's **special qualifications** suddenly become reasonable justification for the buyer to rely on their opinion as an **assurance** the predicted event, activity or condition will be experienced as stated. Thus, a risk averse agent will express their opinion as only a *belief* or *thought*.

Consider a developer who controls a homeowners' association (HOA) which governs a countryside subdivision of homes.

The developer and seller's agent hold themselves out as HOA experts when questions about HOA operations and the Covenants, Conditions and Restrictions (CC&Rs) are received from prospective buyers.

The seller's agent assures prospective buyers that the subdivision's CC&Rs protect the view from each lot, and that the architectural committee will not approve fences interfering with the view. The recorded CC&Rs contain provisions confirming the agent's statements.

However, an architectural committee is never setup. Further, all proposals for fences are reviewed and approved by the developer themselves. This fact is known to the agent, but not prospective buyers.

A prospective buyer pays a premium for a home with a view.

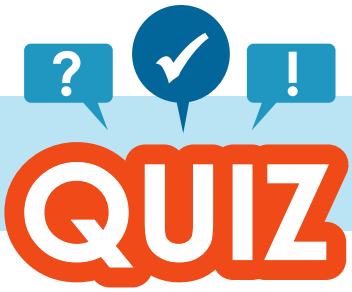
After acquiring the property, a neighbor erects a fence as approved by the developer. The fence blocks the buyer's view. The buyer makes a demand on the agent for their money losses brought about by a loss in value suffered by their property since the agent's statement on view rights failed to come true.

The seller's agent claims their statement about the view rights was their opinion which cannot be reasonably relied on by the buyer when making a decision to purchase the property.

In this instance, the agent held himself out as an expert on HOA and CC&Rs enforcement. The agent then stated the CC&Rs and architectural committee will maintain the view provided by the development. Further, the seller's agent knew the architectural committee had not been created and that the developer had full control.

Thus, the buyer may pursue the agent to recover their lost value, i.e., the view, due to the agent's false opinion about the HOA's ability to protect the buyer's view rights in the future, which was a misrepresentation.

When an agent holds themselves out to be *specially qualified* in the subject matter expressed in opinion, it becomes a *positive statement of truth* on which a buyer or seller of lesser knowledge can rely. [**Cohen** v. **S & S Construction Co.** (1983) 151 CA3d 941]



1. A buyer's broker and their agent have a(n) _____ to handle a buyer with the same level of care and protection a trustee exercises on behalf of their beneficiary.

   a. limited general duty
   b. special fiduciary duty
   c. specialized binary duty

Inducing Reliance by Assurances

Inducing reliance by assurances

All agents give opinions to buyers. However, when the opinion is coupled with advice expressing no further need for the buyer or others to investigate and confirm the prediction, the opinion is elevated to the level of a **guarantee**.

guarantee
An assurance that events and conditions will occur as presented by the agent.

The level of assurance equivalent to a *guarantee* also arises when the buyer indicates they are relying on the agent:

- to analyze a qualifying property to determine the property's ability to be used or operated as the buyer has indicated; and
- to advise on whether the property is suitable and will meet the buyer's expectations.

Further, any affirmative activities or statements of any agent designed to suppress the buyer's **inspection** of the property are considered assurances which make the conclusion drawn in the opinion the equivalent of a fact.

Facts not supporting the conclusion

An agent's opinion is to be **honestly held** by the agent if the agent is to avoid liability when the predicted event or condition does not occur.

For an agent to hold an honest belief, the opinion is to be based on a due diligence investigation and knowledge of all readily available facts which have a bearing on the probability of the event or condition occurring.

When facts affecting the conclusion drawn by the agent are known or readily available to the agent, the test of an *honestly held opinion* is whether the agent giving the opinion *should have known better* than to give such an opinion.

An agent who fails to conduct a due diligence investigation to determine the facts before expressing an opinion, which the investigation might have influenced, is liable for their opinion when the event fails to occur. The agent is liable no matter their wording to limit the prediction to a mere speculative opinion.

Without first having the facts on which to base an opinion, the agent's opinion is either an *unfounded guess* or an *unreasonable assumption*.

Consider a seller's agent for a condominium project who advertises "luxury" condos for sale. The agent knows the condos are poorly constructed and the defects are unobservable to someone not knowledgeable in the field of construction.

A buyer contacts the agent for more information.

The agent tells the buyer that the condos are an "outstanding" investment opportunity. Unaware of the defects, the buyer purchases a condo. The buyer soon discovers the condo is in danger of falling down.

Here, the seller's agent and their broker are guilty of both *affirmative* and *negative fraud*.

The agent could not have honestly believed the condo was an "outstanding" investment opportunity in light of their knowledge of the construction defects. Thus, the agent's representation is an **affirmative fraud**, also called an **intentional misrepresentation**.

affirmative fraud
Intentionally and knowingly misrepresenting information to someone.

Also, the significant defects in the "luxury" project were material facts since they adversely affected the present value and desirability of the condos. Accordingly,

the agent is liable for damages caused by their nondisclosure (omission) of the defects which were known to him, an example of **negative fraud**, also called deceit. [**Cooper** v. **Jevne** (1976) 56 CA3d 860]

negative fraud
Deceitfully withholding or failing to disclose information to someone.

Predicting the conduct of others

The transfer of real estate to a buyer typically involves **third parties** who are not principals or agents in the transaction. Some transactions require approval, consent, administrative review or similar conduct by others regarding some event or condition to occur before or after closing. This causes buyers to be concerned about whether the third party will respond favorably or act timely.

Thus, buyers frequently ask agents what they believe will be the reaction of others.

These third parties include an:

- HOA;
- water authority;
- landlord;
- contractor;
- lender;
- attorney;
- accountant;
- planning agency; or
- redevelopment agency.

Consider agricultural land listed for sale. For a buyer to receive water from the Bureau of Reclamation, the buyer is to first obtain approval of the purchase price from the Bureau.

The seller's agent locates a buyer.

A purchase agreement is drawn up contingent on the Bureau's

approval of the purchase price. The agent estimates the approval process will take 30 to 60 days.

The buyer, concerned with meeting the planting deadline for the season, asks the agent about the probability of the Bureau's approval.

The seller's agent consults with the seller as to whether the transaction will be approved by the Bureau since the seller has dealt with the Bureau over water issues before.

The seller says "he believes" it will be approved.

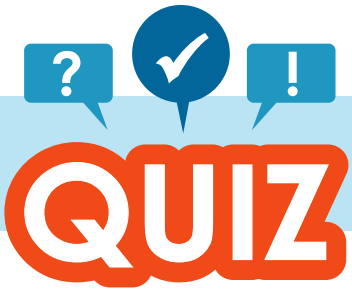
The agent tells the buyer of the seller's opinion. The buyer waives the Bureau-approval contingency, stating they will get the approval later. Escrow is closed.

The buyer files for Bureau approval. During the approval process period, the property's natural well caves in. The Bureau refuses to approve the transaction and will not provide water.

The buyer seeks to recover their losses from the seller, claiming the seller's prediction of a future event (approval by the Bureau) was a fact they relied on when they purchased the property.

However, nothing suggests the seller or their agent held themselves out to be *specially qualified* on the subject of Bureau approval. Thus, the seller's erroneous prediction about the approval was not a misrepresentation of fact. Instead, it was an expression of opinion.

The seller's access to facts about the Bureau's approval process was equally available to the buyer. Furthermore, unless a *special prior relationship* exists between the seller and buyer, the buyer is not entitled to rely on the opinion of the seller (or the seller's agent) concerning the future decisions of a public body. [**Borba** v. **Thomas** (1977) 70 CA3d 144]



1. Any affirmative activities or statements of any agent designed to suppress the buyer's inspection of the property are considered _____ which make the conclusion drawn in the opinion the equivalent of a fact.

   a. assurances
   b. predictions
   c. estimations

Estimates as Projections or Forecasts

Nearly every transaction offers agents the opportunity to provide **estimates** for their clients or the other principals involved. Estimates include:

estimate
Prediction of future amounts which have not yet actually occurred.

- approximations;
- predictions;
- pro-forma statements;
- anticipated expenditures; and
- contemplated charges.

Estimates relate to income and/or expenditures, such as exist in:

- seller's net sheets [See **RPI** Form 310];
- buyer's cost sheets [See **RPI** Form 311];
- operating cost sheets for owner-occupied properties;
- APODs on income properties [See **RPI** Form 352];
- mortgage origination or assumption charges;

- lender impounds;
- rent schedules (rolls) [See **RPI** Form 352-1];
- repair costs for clearances; and
- any other like-type predictions of costs or charges.

Estimates by their nature are not facts. The amounts estimated have not yet actually occurred. The amount estimated will become certain only by its *occurrence in the future*. The amount actually experienced may or may not equal the amount estimated.

A document entitled an "estimate" is typically based on the actual amount currently experienced. Thus, estimates are expected to be fairly accurate in amount, not just guesswork. Words used in titles such as "contemplated," "pro-forma," "anticipated" or "predicted" indicate something less than an accurate estimate, and provide less basis for a buyer to rely.

Distinguish projection from forecasts

Opinions voiced by agents about an income property's future performance are either **projections** or **forecasts**.

projection
An opinion about an income property's future performance based on its performance during the preceding 12-month period, adjusted for presently known trends.

forecast
Analysis of anticipated changes in circumstances influencing the future income, expenses and use of a property.

A *projection* is prepared by a seller's agent on an income property to represent its annual operations. The data is set out in an APOD sheet handed to prospective buyers to induce them to purchase the property. The data entered on the APOD is a projection based exclusively on the income and expenses actually incurred by the owner/seller of the property during the preceding 12-month period. [See **RPI** Form 352]

The amounts experienced by the seller during the past year are *projected to occur* again over the next year. However these amounts are *adjusted* by the agent for any trends in income and expenses reflected by information currently available or known to the agent.

No estimations, contemplations or use of figures other than those experienced by

the owner are used as a basis to prepare the projection, except for adjustments to reflect changed conditions known (or should be known due to readily available facts).

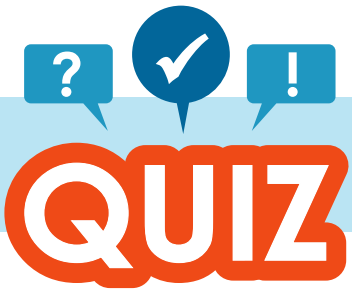
A *forecast* requires the knowledge and analysis of an anticipated change in circumstances which will influence the future income, expenses and operations of a property. These anticipated changes are distinct from trend factors used for projections. Forecasts anticipate *future changes* in income and expense the preparer of the forecast believes will probably occur under new or developing circumstances.

Changes in circumstances

Changes in circumstances considered in a forecast include:

- new management;
- rent increases up to current market rates;
- elimination of deferred maintenance and replacement of obsolete fixtures/appliances;
- changes in rent control ordinances;
- new construction adding to the supply of competing income properties;
- foreclosures adding properties to an illiquid market;
- commodity market prices (natural gas, water, fuel oil, electricity, etc.);
- local and state government fiscal demands for revenue and services;
- federal monetary policy effects on short- and long-term rates;
- demographics of increasing/decreasing population density in the area immediately surrounding the property;
- traffic count changes anticipated;
- zoning changes reducing, altering or increasing the availability of comparable competitive properties;
- government condemnation, relocation or redevelopment actions;
- changes in the local employment base of employed individuals;

- on-site security measures to prevent crime;
- the age and condition of the major components of the structure;
- local socio-economic trends; and
- municipal improvement programs affecting the location of the property.



1. Opinions voiced by agents about an income property's future performance are:

   a. projections.
   b. forecasts.
   c. Either a. or b.

Agency: Glossary

A

affirmative fraud 49

Intentionally and knowingly misrepresenting information to someone.

agency confirmation provision 11, 24

A provision in all purchase agreements and counteroffers disclosing the agency of each broker in the transaction.

Agency Law Disclosure 11

Restatement of agency codes and cases which establish the conduct of real estate licensees. It is delivered to all parties in targeted sales and leasing transactions.

agent 1

One who is authorized to represent another, such as a broker and client, or sales agent and their broker.

associate licensee 25

A sales agent employed by a broker.

B

buyer's agent 14

An agent representing the buyer. Also known as a selling agent.

C

conflict of interest 29

When a broker or agent has a positive or negative bias toward a party in a transaction which is incompatible with the duties owed to their client.

D

Department of Real Estate (DRE) 1

A government agency which oversees, regulates, administers and enforces California real estate law as practiced by licensees.

dual agency 28

The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction.

E

estimate 53

Prediction of future amounts which have not yet actually occurred.

exclusive agent 14

An agent who is acting exclusively on behalf of only one party in a transaction.

F

fact 38

An existing condition which is presently known or readily knowable by the agent.

fiduciary duty 16, 43

The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

forecast 54

Analysis of anticipated changes in circumstances influencing the future income, expenses and use of a property.

G

guarantee 48

An assurance that events and conditions will occur as presented by the agent.

M

multiple listing service (MLS) 35

An association of real estate agents pooling and publishing the availability of their listing properties.

N

negative fraud 50

Deceitfully withholding or failing to disclose information to someone.

O

opinion 37

A statement by an agent concerning an event or condition which has not yet occurred based on readily available facts.

P

principal 2

A person, individual or entity acting as a buyer or seller, and represented by a broker and their agents.

projection 54

An opinion about an income property's future performance based on its performance during the preceding 12-month period, adjusted for presently known trends.

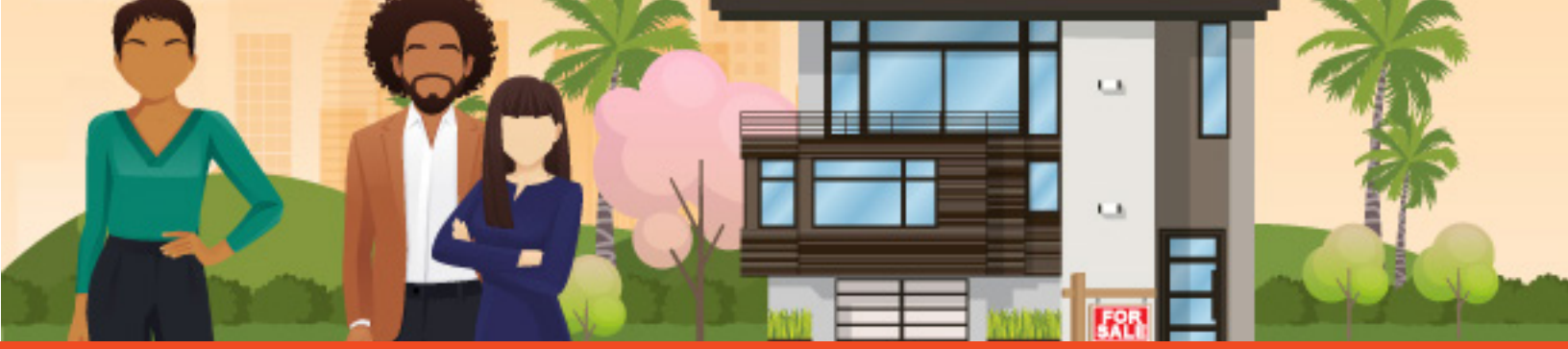
S

seller's agent..... **14**

An agent representing the seller. Also known as a listing agent.

subagent.....**34**

An individual who has been delegated agency duties by the primary agent of the client, not the client themselves.



Fair Housing: Video™

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HUD advertising guidelines for sales and rentals 42

Marketing Real Estate For Sale of Rent
Avoiding a wrongful discriminatory preference 44

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Property Rights Cannot be Based on Status

The Civil Rights Acts of 1866 and 1870

All citizens of the United States have the right to acquire, lease, sell, hold and encumber real estate and personal property, regardless of race. [42 United States Code §1982]

Further, all persons within the United States, legally or illegally, have the same rights to make and enforce contracts, sue, be sued, enjoy the full benefits of the law and be subject to the same punishments, penalties, taxes and licenses, regardless of race. [42 USC §1981(a)]

The protection against race discrimination given under **The Civil Rights Acts of 1866 and 1870** applies to discrimination generally. It is much broader than the protection given under the **Federal Fair Housing Act (FFHA)**, which is covered in later sections.

Civil Rights Acts
Federal prohibitions against racial discrimination on all types of real estate.

The Civil Rights Acts of 1866 and 1870 apply to race discrimination on *all types of real estate*, not just residential real estate.

Further, the right to acquire, lease, sell, hold and encumber real estate is additionally protected by giving all persons the right to make and enforce contracts regardless

of race. Contracts in real estate transactions include:

- purchase agreements;
- leases;
- trust deeds;
- grant deeds; and
- quitclaim deeds.

Racially motivated opposition

For example, a city housing authority is to construct low-income **public housing**.

public housing
Subsidized housing typically reserved for low-income families, the elderly and persons with disabilities.

The city housing authority acquires an area which is considered integrated through **inverse condemnation**, also known as **eminent domain**. The city levels the existing structures to build high-rise public housing.

The surrounding community opposes the construction of high-rise public housing. In response, the city housing authority decides to construct single family residences (SFRs) as public housing.

In pursuit of this goal, the city condemns additional property on which to build the SFRs. As a result, the area surrounding the proposed development becomes all White.

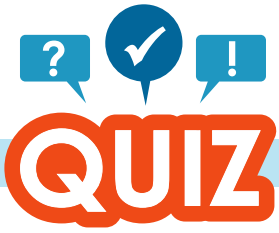
The SFR housing project is approved by local community representatives. Later, as construction begins, the community representatives oppose the project, blocking access to the construction site and the equipment so the development cannot be completed.

The city's mayor then actively and vocally opposes the construction of the public housing. The mayor implies the public housing will be for Black housing which does not belong in the White neighborhood. In response, the city terminates the housing project.

Does the city violate an individual's right to real estate due to their race?

Yes! The city's opposition to the project is racially motivated. The city was originally passive in support of the project, then it actively sought to prevent the development after the citizens of the area initiated biased demonstrations.

As a result, the city is prohibited from interfering with the completion of the public housing project. The city, with discriminatory intent, delayed and frustrated the public housing. [**Resident Advisory Board** v. **Rizzo** (1977) 564 F2d 126]



1. The protection against race discrimination given under the _____ applies to discrimination generally.

   a. Federal Fair Housing Act (FFHA)
   b. Civil Rights Acts of 1866 and 1870
   c. Unruh Civil Rights Act

2. The Civil Rights Acts of 1866 and 1870 apply to race discrimination on:

   a. just residential real estate.
   b. just commercial real estate.
   c. all types of real estate.

The Federal Fair Housing Act

Introduction to fair housing

Discrimination against an individual is prohibited by the **Federal Fair Housing Act (FFHA)** in:

- the sale, rental or advertisement of a *residence*;
- offering and performing *broker services*;
- *making mortgages* to buy, build, repair or improve a residence;
- the *purchase* of real estate mortgages; and
- *appraising* real estate. [42 United States Code §§3601 et seq.]

Federal Fair Housing Act (FFHA)
A collection of policies designed to prevent discrimination in the access to housing based on an occupant's inclusion in a protected class.

A **dwelling** for sale, lease or mortgage activities is defined to include:

- any building or structure occupied or designed to be occupied as a residence by one or more families; and
- any vacant land offered for sale or lease for the construction of a residential building or structure. [42 USC §3602(b)]

dwelling
Any building designed to be occupied as a residence by one or more families, or vacant land offered for the construction of a residential building.

Discriminatory actions of a broker or sales agent covered under the FFHA are actions taken against individuals based on that individual's:

- race or color;
- national origin;
- religion;
- sex;
- familial status; or
- handicap. [42 USC §3605]

Familial status in discrimination refers to one or more individuals who are under the age of 18 and live with:

- a parent or person having legal custody; or
- a person having written permission of the parent or legal custodian as the designee of the parent or custodian. [42 USC §3602(k)]

Handicap refers to an individual who:

- has a physical or mental impairment that limits one or more of a person's major life activities;
- has a record of such an impairment; or
- is regarded as having such an impairment. [42 USC §3602(h)]

The term *handicap* does not include the current illegal use of a controlled substance. However, individuals who are considered "recovering or recovered addicts" are protected as handicapped. [**United States** v. **Southern Management Corporation** (4th Cir. 1992) 955 F2d 914]

Individuals with the Human Immunodeficiency Virus (HIV) are also protected as handicapped. [24 Code of Federal Regulations §100.201]

Federal guidance for the FFHA also prohibits landlords and their agents from enforcing *blanket bans* against all prospective tenants with any criminal history when such a policy results in a disparate impact on a protected class of people (e.g., individuals of a particular race or ethnicity). [U.S Department of Housing and Urban Development. (2016). *Office of General Counsel Guidance on Application of Fair Housing Act Standards to the Use of Criminal Records by Providers of Housing and Real Estate-Related Transactions*. Washington, DC.]

Americans with Disabilities Act (ADA)

Under the **Americans with Disabilities Act (ADA)**, an employer may not discriminate against a *qualified person with a disability* who seeks employment based on that person's disability. [42 United States Code §12112]

Americans with Disabilities Act (ADA)
Federal regulations prohibiting an employer from discriminating against a qualified person based on a disability.

An employer may not discriminate in regards to:

- job application procedures and hiring;
- advancement or termination of employees;
- compensation or job training; and
- other terms, conditions and privileges of employment. [42 USC §12112(a)]

A real estate broker is classified as an **employer** if they employ 15 or more employees each working day. These individuals need to be employed during a period of 20 or more calendar weeks occurring in either the current or the preceding calendar year. [42 USC §12111(5)(A)]

A disabled person is considered a *qualified person with a disability* if they can perform a job with or without reasonable accommodation by the employer.

Examples of *mental disabilities* protected under the ADA include:

- mental retardation;
- emotional illness; or
- specific learning disabilities, such as dyslexia.

Examples of *physical disabilities* protected under the ADA include:

- a visual or speech impairment;
- cerebral palsy; or
- epilepsy.

A business may not discriminate against a person with a *disability* when **offering services** to the public. Discrimination is also prohibited in places of **public accommodation** or **commercial facilities**. [42 USC §§12132; 12182(a)]

public accommodation
Property owned, leased, or operated by a private entity whose services are made fully available to individuals and the general public.

Further, real estate used to provide *public accommodation* and *commercial facilities* need to be designed, constructed and altered in compliance with the ADA. [28 Code of Federal Regulations §36.101]

Real estate is considered a place of public accommodation if it is owned, leased or operated by a private entity and the operation affects commerce. Thus, a place of public accommodation includes:

- an inn, motel, hotel, etc., unless it contains five or fewer rooms for rent and is occupied by a resident manager;
- establishments serving food or drink (restaurants or bars);
- places of exhibition, entertainment or public gathering (theaters, stadiums or convention facilities);
- sales or other service establishments (grocery stores, clothing stores, dry cleaners, brokerage offices, insurance offices or doctors' offices);
- public transportation depots;
- a place of public display or collection (museums or libraries);
- places of recreation (zoos or parks);
- places of education (schools);
- social service center establishments (day care centers or senior citizen centers); and
- places of exercise or recreation (gymnasiums, health spas or golf courses).

A **commercial facility**:

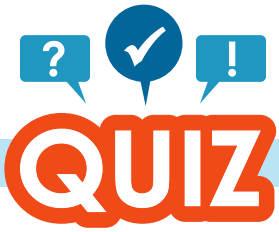
- is intended for *commercial use*, such as factories, office buildings, warehouses and other buildings in which employment may

occur; and

- affects *commerce* through its operation. [42 USC §12181(2)]

commercial facility
Property owned, leased or operated by a private entity whose operation affects commerce.

Any person who owns or operates a place of public accommodation or a commercial facility may not *discriminate* on the basis of a disability. [42 USC §12182(a)]



1. The _____ refers to a broad collection of policies designed to prevent discrimination in the access to housing based on an occupant's inclusion in a protected class.

   a. Truth-in-Lending Act (TILA)
   b. Real Estate Settlement Procedures Act (RESPA)
   c. Federal Fair Housing Act (FFHA)

2. Familial status in discrimination refers to one or more individuals who are under the age of:

   a. 16.
   b. 18.
   c. 21.

Steering

The Federal Fair Housing Act and the Refusal to Rent

Qualifying and processing tenants

The FFHA prohibits a seller, landlord or property manager from unlawfully discriminating against individuals during solicitations and negotiations for the sale or rental of a dwelling. [42 United States Code§3604(a)]

Thus, in the context of leasing, a landlord or property manager may not:

- refuse to rent a dwelling or to negotiate the rental of a dwelling for prohibited discriminatory reasons;
- impose different rental charges on a dwelling for prohibited discriminatory reasons;
- use discriminatory qualification criteria or different procedures for processing applications in the rental of a dwelling; or
- evict tenants or tenants' guests for prohibited discriminatory reasons. [24 Code of Federal Regulations §100.60(b)]

Different terms, different privileges

Consider a broker who is hired by a residential apartment landlord to perform property management activities. One of the broker's duties as a property manager is to locate tenants to fill vacancies.

A tenant from a religious minority group contacts the broker about the availability of an apartment.

The broker (or their agent) informs the prospective tenant of the monthly rent. However, the rate the broker communicates to the prospective tenant is higher than the rent nonminority tenants are asked to pay for similar apartments.

When the prospective minority tenant asks the broker for an application, the broker informs the tenant a nonrefundable screening fee is charged to process the application. The creditworthy minority tenant fills out the application, pays the fee and is told the processing will take several days.

In the meantime, a nonminority tenant inquires about the rental of the same or similar apartment. The monthly rent rate the broker quotes the nonminority is lower than the rent rate the minority tenant was quoted, even though the nonminority tenant is not as creditworthy as the minority tenant. Further, the nonminority tenant is not charged a screening fee with their application. The apartment is immediately rented to the nonminority tenant.

Here, the broker's actions were racially or religiously motivated, a violation of the FFHA. The broker misrepresented the availability of the apartment based on the tenant's religion by using different procedures and qualification standards in accepting and processing the tenant's application. [**United States** v. **Balistrieri** (7th Cir. 1992) 981 F2d 916]

Selective reduction

Selective reduction of buyer or tenant privileges, conditions, services and facilities offered to protected individuals is prohibited. *Selective reduction* can take the form of:

- using less favorable provisions in lease or purchase agreements, such as in rental charges and closing requirements;
- delaying or failing to perform maintenance;

- limiting use of privileges, services or facilities to different classes of individuals; or
- refusing or failing to provide services or facilities due to an individual's refusal to provide sexual favors. [24 CFR §100.65(b)]

Further, the landlord or property manager may not discriminate based on an individual's status by representing that a dwelling is not available for rent in order to direct the individual to a particular Section 8 project or neighborhood, when the dwelling is available. This practice is called **steering**.

Steering
An unlawful housing practice that includes words or actions by a real estate sales licensee intended to influence the choice of a prospective buyer or tenant.

Steering involves the restriction of an individual seeking to rent or purchase a dwelling in a community, neighborhood or development, when the guidance perpetuates segregated housing patterns. [42 USC §3604(d); 24 CFR §100.70]

Discrimination in advertising

A broker or their agent making a notice, statement or advertisement when handling the sale or rental of a dwelling unit is barred from using any wording that indicates a discriminatory preference or limitation against individuals of protected classes of people. [42 USC §3604(c)]

The prohibition against prohibited discriminatory advertisements applies to all oral and written statements.

Notices and statements include any applications, flyers, brochures, deeds, signs, banners, posters and billboards used to advertise the availability of a dwelling for rent.

1. A landlord or property manager may not:

   a. impose different rental charges on a dwelling for prohibited discriminatory reasons;

   b. use discriminatory qualification criteria or different procedures for processing applications in the rental of a dwelling.

   c. Both a. and b.

2. _____ refers to an unlawful housing practice that includes words or actions by a real estate sales licensee intended to influence the choice of a prospective buyer or tenant.

   a. Steering

   b. Redlining

   c. Endorsing

Blockbusting for Exploitation

Exploiting the prejudices of property owners

An attempt to influence sales or rentals of real estate by exploiting the prejudices of property owners in a neighborhood is known as **blockbusting**.

blockbusting
The prohibited practice of a real estate licensee inducing a property owner to list their property for sale in response to a change taking place in the neighborhood demographics.

Blockbusting occurs when agents make negative representations about a change in the ethnic makeup of a neighborhood and the economic consequences resulting from the change. [42 United States Code §3604(e)]

Examples of blockbusting activities include:

- actions which portray the neighborhood as undergoing, or as about to undergo, a change in the race, color, religion, sex, handicap, familial status or national origin of its residents in order to encourage an owner to offer a dwelling for sale or rent; or
- encouraging an owner to sell or rent a dwelling by making the assertion the entry of persons of a particular race, color, religion, sex, familial status, handicap or national origin will result in undesirable consequences for the neighborhood or community such as a lowering of property values, an

increase in criminal activity or a decline in the schools and other facilities. [24 Code of Federal Regulations 100.85(c)]

Blockbusting is also known as **panic selling** when the agent is attempting to induce a seller to list and sell their property due changes in the ethnic makeup of an area.

Exemptions from the FFHA

FFHA protections for individuals do not apply to an owner of a single family residence (SFR) sold or rented by an owner without the use of third-party services. Services include that of a real estate broker or agent or any other person in the business of selling or renting residential properties.

An owner, broker or sales agent is considered in the business of selling or renting residential property if the individual:

- has participated within the past 12 months as a principal in three or more transactions involving the sale or rental of any residence;
- has participated within the past 12 months as an agent, by providing sales or rental services in two or more transactions involving the sale or rental of any residence or interest in a residence, excluding their own personal residence; or
- is the owner of a residence property intended to be occupied by five or more families. [42 USC §3603(c)]

Thus, if a broker is the agent for any of the parties to a sale or rental transaction, the FFHA applies.

To be exempt from the FFHA, the owner cannot be represented by a broker and cannot:

- own or own an interest in more than three SFRs;
- within a 24-month period, sell more than one residence in which the owner does not live at the time of the sale or for which the owner was not the most recent resident; and
- publish or mail any discriminatory advertisements. [42 USC §3603(b)(1)]

Also exempt from FFHA discrimination rules is the sale or rental of a residence in a one-to-four unit residential rental property which is occupied in part by the owner. [42 USC §3603(b)(2)]

Certain exceptions also apply to **religious organizations**. *Religious organizations* may limit the sale, rental or occupancy of dwellings, provided the dwelling is owned for noncommercial reasons, to individuals of the same religion, unless the religion is restricted to persons of a particular race, color or national origin. [42 USC §3607(a)]

Also, a **private club** which is not open to the public and that operates residences for noncommercial purposes may limit rental or occupancy of the dwellings to its members.

Finally, housing limited to occupancy of senior citizens is not considered discrimination based on familial status. [42 USC §3607(b)]

Failure to comply with the FFHA

Any **aggrieved person** may file a complaint alleging a discriminatory housing practice with the Secretary of Housing and Urban Development (HUD). The complaint needs to be filed within one year of the alleged discriminatory housing practice. [42 USC §3610(a)]

aggrieved person
Any person who claims to have been injured by a discriminatory housing practice.

After an investigation and informal negotiations, the Secretary will have the parties mediate an agreement to resolve the dispute. [42 USC §3610(b)]

However, if mediation fails, the dispute will be resolved:

- by an administrative law judge; or
- in a civil action filed in a court of law, at the election of any of the parties. [42 USC §§3612(a), 3612(b)]

If neither party elects to have the dispute resolved in a civil action, the *administrative law judge* will hear the complaint. If the administrative law judge finds a discriminatory housing practice has taken place, the judge may enter a money award for losses caused by the discriminatory housing practice, an injunction or other equitable relief against the discriminatory housing practice, plus civil penalties in the amount of:

- no more than $10,000 if the person has not been previously adjudged to have participated in discriminatory housing practices;

- no more than $25,000 if the person has been adjudged as participating in discriminatory housing practices within five years of the current complaint being filed; or
- no more than $50,000 if the person has been adjudged to have participated in two or more discriminatory housing practices within seven years of the current complaint being filed.

However, if an individual is judged to have committed *prior acts* of housing discrimination, then the penalties may be assessed without regard to the time limits of prior adjudication. [42 USC §3612(g)(3)]

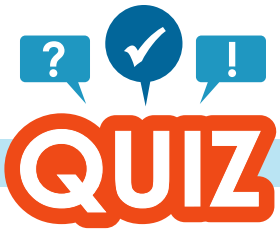
Further, if a real estate broker is found to have committed discriminatory housing practices, the Secretary will recommend disciplinary action to the **California Department of Real Estate (DRE)**. [42 USC §3612(g)(5)]

Civil action

When in a *civil action* the court determines discriminatory housing practices occurred, the court may enter a money award for *actual losses* and a *punitive award*. Additionally, the court may issue an injunction, temporary restraining order or other order preventing the person from engaging in any discriminatory housing practice. [42 USC §3613(c)(1)]

Further, if the **Attorney General** commences a civil action against a person for discriminatory housing practices, the court may award:

- relief preventing further discriminatory housing practices, such as an injunction or restraining order;
- money damages; and
- civil penalties of no more than $50,000 for the first violation and no more than $100,000 for any subsequent violation. [42 USC §3614(d)]



1. An attempt to influence sales or rentals of real estate by exploiting the prejudices of property owners in a neighborhood is known as:

   a. redlining.
   b. slandering.
   c. blockbusting.

2. A person who claims to have been injured by a discriminatory housing practice may file a complaint with:

   a. the Secretary of Housing and Urban Development (HUD).
   b. the California Secretary of State.
   c. Fannie Mae.

Unruh Civil Rights Act =
business
establishments

California Prohibitions Against Discrimination

The Unruh Civil Rights Act

A business establishment operating in California is specifically prohibited by the **Unruh Civil Rights Act** from discriminating based on an individual's:

- sex;
- race;
- color;
- religion;
- ancestry;
- national origin;
- disability;
- medical condition;
- marital status; or
- sexual orientation or gender identity.

Unruh Civil Rights Act
A California law which prohibits discrimination by a business establishment based on sex, race, color, religion, ancestry, national origin, disability or medical condition.

Anyone in the business of providing housing or any commercial real estate facility is subject to the *Unruh Civil Rights Act*. Brokers, housing developers, apartment owners, condominium owners and single family residence (SFR) owners are considered to be in the business of providing housing.

Age restrictions are enforceable only when a project qualifies as a **senior citizen housing** development. [Calif. Civil Code §§51, 51.2, 51.3]

senior citizen housing
Housing intended for persons 55 or 62 years of age or older.

Consider an owner of a unit in a *common interest development (CID)*. The project does not qualify as *senior citizen housing*, but its covenants, conditions and restrictions (CC&Rs) limit residency to persons over the age of 18. The owner brings a child into the unit.

The homeowners' association (HOA) of the CID notifies the owner of the CC&R violation and demands the child be removed. The owner refuses. The HOA seeks to have the owner ejected for failure to remove the child.

The owner seeks to remain in the project with the child, claiming the *age restriction* in the CC&Rs is unenforceable since age limitations are a violation of California's anti-discrimination law.

Is enforcement of the age restrictions in the CC&Rs by a nonprofit HOA a violation of California's anti-discrimination law?

Yes! The HOA is barred by California statutes from discriminating against a person due to age since it is a business establishment. Since the HOA performs all the customary business functions *typical of a landlord* in a landlord/tenant relationship, the HOA is considered a business establishment. [**O'Connor** v. **Village Green Owners Association** (1983) 33 C3d 790]

Further, a business establishment may not **boycott**, **blacklist**, refuse to buy from or sell to or enter into contracts because of the race, creed, religion, color, national origin, sex, disability, medical condition, marital status or sexual orientation of a person or the person's partners, members, stockholders, directors, officers, managers, agents, employees, business associates or customers.

Thus, no person or organization may be blacklisted or boycotted for these discriminatory reasons. [CC §51.5]

Housing for older persons

A provision in a written instrument which refers to qualified senior citizen housing is enforceable as allowable age discrimination.

A **senior citizen housing** project is housing:

- intended for and *solely occupied* by persons 62 years of age or older; or
- intended and operated for *occupancy* by persons of 55 years of age or older. [42 United States Code §3607(b)]

Landlords and owners of retirement communities or senior citizen apartment complexes may exclude children to meet the particular needs of older persons.

To qualify as senior citizen housing project under the *Unruh Civil Rights Act*, a project will:

- be developed, substantially renovated or rehabilitated for senior citizens; and
- consist of at least 35 dwelling units. [CC §51.3(b)(4)]

California legislation recognizes the special design requirements for senior housing may be difficult to determine for developments constructed before 1982. Thus, any housing development *constructed before February 8, 1982* may be considered a senior citizen housing development if the development meets all the requirements of a senior citizen housing development, except the requirement the housing be specially designed to meet the physical and social needs of senior citizens. [CC §§51.2(a); 51.4]

Qualifying for senior citizen housing federally

A "62-or-older" senior housing exemption from anti-discrimination law is contained in the *Federal Fair Housing Act (FFHA)*. A housing project qualifies as senior housing if it is occupied only by persons who are 62 years of age or older. The 62-or-older restriction excludes all persons under the age of 62, even if one spouse is 62 or older and the other is not. [24 Code of Federal Regulations §100.303] [See *Fair Housing* Chapter 1]

Further, the housing project still qualifies under the 62-or-older exemption even when project employees and their families living on the premises are under 62 years of age. To qualify as employees, they are to perform *substantial duties* directly related to the management or maintenance of the housing. [24 CFR §100.303(a)(3)]

If a project owner elects not to qualify or cannot qualify for the 62-or-older exemption, the project might qualify under the broader alternative **55-or-older** exemption.

The 80% rule for 55-or-older

As an alternative to the 62-or-older exemption, a senior citizen housing project may qualify under the *55-or-older* exemption. This exemption requires at least 80% of the rented units to be occupied by at least one person 55 or older.

For newly constructed projects, the 80% occupancy requirement does not apply until the real estate is 25% occupied. [24 CFR §100.305(d)]

The 55-or-older rule does not apply to residents who occupied the project on or before September 13, 1988. However, at least 80% of new vacancies are to be occupied by an individual who is 55 or older. [24 CFR §100.305(e)(1)]

Spouses may live with their 55-or-older spouse in apartment and condominium projects under *California's Unruh Civil Rights Act*. The FFHA leaves age restrictions regarding those under 55 to the individual states.

For example, under California law, a person may occupy a residential unit, but not a mobilehome, with a person 55-or-older if the younger person:

- resides with the 55-or-older person prior to the senior's death, hospitalization or dissolution of marriage; and
- is 45 years old, a spouse, or a person offering primary economic or physical support for the 55-or-older occupant; or
- is a child or grandchild of the 55-or-older occupant with a disability, illness or injury. [CC §§51.3(b)(2), 51.3(b)(3)]

Mobilehomes in California are to comply with age discrimination rules set by the FFHA. Thus, the mobilehome park cannot discriminate against a younger co-tenant since federal law does not allow any discrimination in mobilehome parks when one occupant is at least 55 years of age. [CC §798.76]

1. The _____ is a California law which prohibits discrimination by a business establishment, and applies to anyone in the business of providing housing.
   a. Federal Fair Housing Act (FFHA)
   b. Holden Act
   c. Unruh Civil Rights Act
2. Housing intended for persons 55 or 62 years of age or older is referred to as:
   a. aprotected housing.
   b. senior citizen housing.
   c. silver communities.

Prohibited Discriminatory Practices

Discriminatory practices, exemptions and remedies

California law prohibits discrimination in the sale or rental of housing accommodations based on the distinguishing factors of:

- race;
- color;
- religion;
- sex;
- gender;
- gender identity;
- gender expression;
- sexual orientation;
- familial status;
- marital status;
- disability;
- genetic information;
- national origin;
- source of income;
- veteran or military status;

- ancestry;
- citizenship;
- primary language;
- or immigration status. [CC §§51 et. seq.; Calif. Government Code §12955; DRE Reg. §2780 and §278]

Discriminatory practices include:

- *making an inquiry*, written or oral, into the race, sex, disability, etc., of any individual seeking to rent or purchase housing;
- publishing ads or notices for the sale or rental of housing which *indicate a preference* or limitation based on any of the prohibited factors;
- use of prohibited discrimination when providing or arranging *real estate mortgages and financing;*
- refusal based on a prohibited factor by a broker to *represent* an individual in a real estate transaction; and
- any other practice that *denies housing or residential financing to a member of a protected class. [Calif. Government Code §12955]*

The Civil Rights Department (Department) and the **Civil Rights Council (Council)** are the California government agencies which enforce anti-discrimination law. [Gov C §§12901, 12903, 12930, 12935]

Any individual who feels they have been discriminated against may file a complaint with the *Department*. The Department investigates the complaint to

Civil Rights Department
A state agency designated with protecting Californians from housing, employment, and public accommodation discrimination.

determine any wrongful conduct. If grounds exist, the Department seeks to resolve the situation through discussions with the individual against whom the complaint is made. [Gov C §12980]

If the Department believes a discriminatory practice has occurred, it will first attempt to reach a resolution through the Department's mandatory dispute resolution division. The dispute resolution is provided without charge to either party. If the dispute cannot be effectively resolved, the Department will file a civil action on behalf of the individual who was discriminated against in the county where the discriminatory conduct is alleged to have occurred. [Gov C §12981]

Religious exemption

An exemption from anti-discrimination laws exist for **religious organizations**. Religious organizations may give preference to members of the same religious group when providing residential property for noncommercial purposes. However, membership in that religion may not be restricted on account of race, color or national origin. [Gov C §12955.4]

Further, a landlord may not use *religious beliefs*, such as those regarding marital status, to shield their discriminatory conduct.

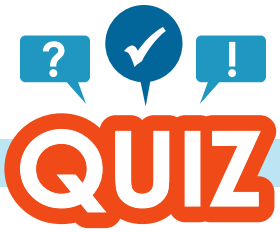
Consider, a landlord who refuses to rent an apartment to an unmarried couple for religious reasons.

The couple files a complaint with the Council. The Council rules the landlord violated fair housing laws prohibiting discrimination based on marital status.

The landlord claims refusing to rent to an unmarried couple is not discriminatory since renting to them would violate the landlord's religious beliefs regarding cohabitation of unmarried couples.

Can the landlord refuse to rent to the couple based on their marital status?

No! The landlord's refusal to rent to unmarried couples violates fair housing laws. The landlord's religious beliefs regarding marriage do not require them to participate in the business of renting property. The fair housing law prohibiting discrimination based on marital beliefs does not interfere with the practice of the landlord's religion. [**Smith** v. **Fair Employment and Housing Commission** (1996) 12 C4th 1143]



1. An individual in California who feels they have been discriminated against may file a complaint with the:

   a. Department of Equity and Inclusion.
   b. Department of Equal Credit Opportunity.
   c. Civil Rights Department.

Broker

DRE Regulation of Discrimination

Guidelines for broker conduct

The California Department of Real Estate (DRE) enforces numerous regulations prohibiting discriminatory practices by real estate brokers and agents. A broker or agent found guilty of engaging in **discriminatory business practices** may be disciplined by the DRE. [Department of Real Estate Regulation §2780]

discriminatory business practices
Unequal treatment given to members of a protected class of individuals.

DRE prohibited *discriminatory practices* include situations in which a broker or agent discriminates against anyone based on race, color, sex, religion, ancestry, disability, marital status or national origin.

Discriminatory practices include:

- refusing to negotiate the purchase, sale or rental of real estate;
- refusing to show property or provide information, or steering clients away from specific properties;
- discriminating in the terms and conditions of a sale, such as charging minority buyers higher prices;
- refusing to accept a rental or sales listing or an application for financing;

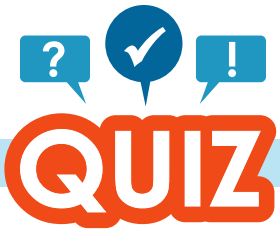
- publishing or distributing advertisements which indicate a discriminatory preference;
- limiting access to Multiple Listing Services (MLS);
- any discrimination in the course of providing property management services;
- agreeing with a client to discriminate when selling or leasing the client's property, such as agreeing not to show the property to members of particular minority groups;
- attempting to discourage the purchase or rental of real estate based on representations of the race, sex, disability, etc., of other inhabitants in an area; and
- encouraging or permitting employees to engage in discriminatory practices. [DRE Reg. §§2780 et seq.]

For example, a broker is aware a licensed care facility for disabled people is located in a single family residence (SFR) near a residence their client is interested in buying.

The presence of the facility might influence the client's decision to purchase the property. However, to *volunteer information* to the client about the facility — rather than on direct inquiry from the client — would be **unlawful discrimination**. The broker may not attempt to influence the buyer's decision based on advice and disclosures about the disability of other inhabitants in the area. [73 Ops. Cal. Atty. Gen. 58 (1990)]

Broker's duty to employees

A broker has a duty to advise their agents and employees of anti-discrimination rules. This includes DRE regulations, the Unruh Civil Rights Act, the Fair Employment and Housing Act administered by the Civil Rights Department, and federal fair housing law. Thus, the broker is not only responsible for their own conduct, but needs to also ensure their employees follow anti-discrimination regulations when acting as agents on their behalf.



1. A broker has a duty to:

   a. advise their agents and employees of all federal and state anti-discrimination rules.

   b. instruct their agents and employees on best health practices concerning diet and exercise.

   c. provide health insurance coverage to all administrative and managerial staff.

Federal Fair Lending Rules

The Equal Credit Opportunity Act

Consider an unmarried couple who submit an offer to purchase a home. The sale is contingent on the couple obtaining financing. The couple applies for a mortgage to be evidenced by a note and trust deed signed by both. The couple fills out a mortgage application stating their separate incomes which, when combined, are sufficient to qualify for the mortgage.

The lender denies the mortgage application since the couple is not married and their separate incomes are not sufficient to allow each of them to independently qualify for the mortgage. The couple is unable to locate another lender before their purchase agreement is cancelled by the seller.

The couple seeks to recover their losses from the lender under the federal **Equal Credit Opportunity Act (ECOA)**, claiming the lender unlawfully discriminated against them based on their *marital status*.

Equal Credit Opportunity Act
A federal law which prohibits discriminatory and unfair lending practices.

The lender claims the denial of the mortgage to the unmarried couple is motivated by a legitimate business consideration. The lender states the couple presents a greater risk of default since the couple's separate incomes are not sufficient to cover the mortgage, and unmarried couples are not liable for each other's debts,

as are married couples.

Was the lender's denial of the couple's mortgage unlawful discrimination?

Yes! The lender had no valid reason not to consider the couple's combined income in determining whether their income is sufficient to qualify for the mortgage. As both will sign the note, both will be liable for the mortgage. Thus, the lender's denial of the couple's mortgage application is based on their marital status. This is a form of **unlawful discrimination**. **[Markham v. Colonial Mortgage Service Co. Associates, Inc. (1979) 605 F2d 566]**

Fairness in lending

The *ECOA* prohibits discrimination in lending based on race, color, religion, national origin, sex, marital status or age (provided an individual is of legal age).

The anti-discrimination rules apply to institutional lenders, loan brokers, and others who *make* or *arrange loans*. [15 United States Code §1691a(e)]

Discriminatory practices take many forms, including:

- treating minority loan applicants less favorably than non-minority applicants;
- placing additional burdens on minority applicants;
- requiring a spouse's signature on a loan application when an applicant qualifies for a loan individually [**Anderson v. United Finance Company (1982) 666 F2d 1274] ;**
- discouraging loan applicants based on their race, color, sex, etc. [12 Code of Federal Regulations §1002.5(b)] ; and
- making inquiries into the marital status of loan applicants. [12 CFR §1002.5(d)]

The lender may not make any inquiries into whether a loan applicant's income is derived from *alimony* or *child support*. The lender may not inquire whether the applicant intends to bear children. [12 CFR §1002.5(d)]

Further, to deny a loan based on an applicant's receipt of income from a public assistance program, such as *welfare* or *social security*, is unlawful discrimination. [15 USC §1691(a)(2)]

However, discrimination is rarely practiced overtly. Most lenders are not transparent enough for the consumer to see the discrimination. Most often, discrimination takes the form of a lender denying a loan to a minority borrower without a valid reason, or applying different standards to minority and non-minority borrowers.

Different treatment is discrimination

Lenders need to be careful not to provide more assistance to non-minority borrowers than to minority borrowers when preparing applications and working out problems which arise. The *different treatment* of minority and non-minority applicants is another form of unlawful discrimination.

For example, consider a Black couple who applies for a mortgage to be insured by the **Federal Housing Administration (FHA)**, which will fund the purchase of a residence. The home the couple seeks to purchase is 75 miles from their place of work. The couple intends to occupy the home as their principal residence and commute to work.

The lender suspects the couple wants to purchase the home as an investment, and not to occupy it themselves. Since the type of FHA insurance sought may only be used to purchase homes which the buyer will occupy, the lender denies the mortgage application.

The lender does not discuss with the couple whether they intend to occupy the home. Also, the lender never suggests the couple can apply for a non-FHA mortgage. Due to a mortgage contingency, the couple loses their right to buy the home and incurs expenses in the process.

The couple seeks to recover their money losses from the lender under the *ECOA*, claiming the lender's denial of their mortgage application was due to unlawful discrimination.

The lender claims the denial of the mortgage application was proper since it believed the couple did not intend to occupy the home, and thus did not qualify for an FHA-insured mortgage.

Here, the lender is practicing unlawful discrimination. Lenders need to provide the same level of assistance to non-minority borrowers as minority borrowers. Thus, the lender may not unilaterally decide the couple did not intend to occupy the home without first discussing the couple's intentions with them. Also, even if the couple did not qualify for an FHA-insured mortgage, as a matter of professional practice, the lender needs to refer them to other forms of financing.

The lender discriminated against the Black couple by denying their mortgage application without a valid reason. Further, there was a failure to use diligence in assisting the couple to obtain other financing. [**Barber v. Rancho Mortgage & Investment Corp. (1994) 26 CA4th 1819]**

Denial of credit and notification

After the lender's receipt of a loan application, the lender has 30 days to notify the

applicant as to whether the loan is approved or denied. If the lender denies the loan, the lender needs to deliver a statement to the applicant listing the specific reasons for the denial. [15 USC §1691(d)] [See **RPI** Form 219]

Alternatively, if the lender does not give the applicant a statement of the specific reasons for the denial, the lender needs to deliver a notice to the applicant stating the applicant has the right, upon request, to obtain a statement listing the reasons for denial.

In addition to the *ECOA*, California law controls **credit reporting agencies**. Consumers may request a free copy of their credit report once every year to review it for errors. [Calif. Civil Code §1785.10]

credit reporting agency
A private agency which collects and reports information regarding an individual's credit history.

Penalties for discrimination in lending include actual money losses sustained by a person who has been discriminated against and punitive money awards of up to $10,000, plus attorney fees. [15 USC §1691e]

1. The _____ is a federal law designed to prohibit discriminatory and unfair lending practices.
   a. Real Estate Settlement Procedures Act (RESPA)
   b. Federal Fair Housing Act (FFHA)
   c. Equal Credit Opportunity Act (ECOA)
2. After the lender's receipt of a loan application, the lender has _____ to notify the applicant as to whether the loan is approved or denied.
   a. five days
   b. two weeks
   c. 30 days

California's Fair Lending Laws

An efficient real estate market

To achieve a healthy state economy, all residential housing for sale needs to be available to any homebuyer who is creditworthy and qualifies for **purchase-assist financing**. [Calif. Health and Safety Code §35801(b)]

An efficient real estate market requires the value of housing to be immune from fluctuations caused by lenders who arbitrarily deny financing to qualified homeowners. Thus, state law prohibits discriminatory lending practices. The goal of anti-discrimination law in home financing is to:

- increase the availability of housing to creditworthy buyers; and
- increase lending in communities where lenders have made conventional mortgages unavailable. [Health & S C §35802]

Lenders need to make financing available to *qualified creditworthy mortgage applicants* to:

- buy, build, repair, improve or refinance an existing mortgage on a one-to-four unit, owner-occupied residence; or
- improve one-to-four unit residences which are not owner-occupied. [Health & S C §35805(d)]

Lenders violate public policy when they indicate a **discriminatory preference** by

denying or approving financing to creditworthy mortgage applicants based on the applicant's:

- race;
- color;
- religion;
- sex;
- marital status;
- sexual orientation,
- source of income;
- genetic information;
- disability;
- national origin; or
- ancestry. [Health & S C §35811]

Discrimination in certain communities

In a community which is composed mainly of residents of a certain race, color, religion or other protected class, a lender may not:

- refuse to fund a mortgage based on the **demographics** of that community; or
- appraise real estate in that community at a lower value than comparable real estate in communities predominantly composed of non-minority residents. [Health & S C §§35810, 35812]

Failure to provide financing in certain communities is called **redlining.** *Redlining* is specifically targeted for correction by the law since it adversely affects the health, welfare and safety of California residents. [Health & S C §35801(e)(4)]

redlining
The practice of denying mortgages and under-appraising properties in minority communities based on demographics, outlawed in California by Housing Financial Discrimination Act of 1977.

Lenders who deny mortgage applications based on the characteristics of the community discourages homeownership in that community. Thus, redlining leads to a decline in the quality and quantity of housing in areas where financing is generally unavailable. [Health & S C §3580]

However, a lender can consider neighborhood conditions when making a

mortgage under certain circumstances. When doing so, the lender needs to demonstrate a mortgage denial is based on neighborhood conditions which render the mortgage unsafe and unsound as a matter of good business practice. [Health & S C §35810(a)]

For example, a lender is not precluded from considering the **fair market value** of real estate intended to secure a mortgage. A property *appraisal,* however, cannot be based in any part on the demographic makeup of the area where the real estate is located.

Further, if the property's topography, structure or location is unsafe or unhealthy, the lender is not required to provide purchase-assist financing. [Health & S C §35813]

Notice of a mortgage applicant's rights

Lenders are required to post in a conspicuous public location at their place of business a written notice informing applicants for mortgages to be secured by an owner-occupied, one-to-four unit residential property of:

- their right to file a lending discrimination claim; and
- the name and address of the Secretary of the California Business, Consumer Services and Housing Agency (Agency). [Health & S C §35830]

Lenders subject to this posting requirement include **state regulated**:

- banks;
- thrifts;
- public agencies; or
- other institutions which make, arrange or buy mortgages to buy, build, repair, improve or refinance one-to-four unit, owner-occupied housing. [Health & S C §35805]

Administrative remedies

A mortgage applicant may file a discrimination claim with the Agency against a state regulated lender if the applicant believes their mortgage application was denied due to:

- their race, color, religion, sex, marital status, national origin, ancestry or any of the other protected classifications described above; or

- trends, conditions or characteristics of the community where the real estate is located. [Health & S C §§35800 et seq.]

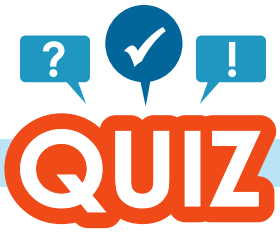
A mortgage applicant who believes they have been unfairly discriminated against by a state lending institution needs to exhaust the Agency administrative remedies before suing the lender for money losses.

Federally regulated banks and thrifts are not subject to state regulation and discipline. [**Conference of Federal Savings and Loans Associations** v. **Stein** (1979) 604 F2d 1256]

Once the claim is received, the Agency will attempt to work with the lender to end any unlawful discriminatory lending practices. [Health & S C §35821]

The Agency will determine if the lender has engaged in an unlawful discriminatory practice within 30 days of receiving the complaint. The Agency will then serve the lender with its written decision and an order requiring the lender to end the unlawful discriminatory practice. [Health & S C §35822]

The order will also require the lender to review the mortgage application under nondiscriminatory terms and provide the denied financing, if feasible. The lender may also be required to pay the borrower's money losses in an amount no greater than $1,000. [Health & S C §§35822(a), 35822(b)]



1. Failure to provide financing in certain communities is called:

   a. blockbusting.
   b. steering.
   c. redlining.

2. Lenders are required to post in a conspicuous public location at their place of business a written notice informing applicants for mortgages to be secured by an owner-occupied, one-to-four unit residential property of:

   a. their right to file a lending discrimination claim.
   b. the name and address of the Secretary of the California Business, Consumer Services and Housing Agency (Agency).
   c. Both a. and b.

Lenders Release Home Mortgage Data

Home Mortgage Disclosure Act (HMDA)

The federal **Home Mortgage Disclosure Act (HMDA)** seeks to prevent lending discrimination and unlawful redlining practices. The HMDA requires lenders to disclose mortgage origination information to the public when the borrower is seeking a residential or home improvement mortgage. [Department of Housing and Urban Development Mortgagee Letter 94-22]

Home Mortgage Disclosure Act
A federal law mandating data collection on mortgage originations and applications of lenders who meet threshold requirements.

State and federally regulated banks and mortgage brokers are required by the HMDA to compile mortgage origination data. This data is submitted to their respective supervisory agencies. [12 United States Code §§2802, 2803; Calif. Health and Safety Code §35816]

Mortgage originations include:

- purchase-assist financing;
- construction for a new home;
- improvement of the borrower's home; or
- the refinance of an existing mortgage.

The data includes:

- the type and purpose of the mortgage;
- the owner-occupancy status of the real estate securing the mortgage;
- the amount and interest rate of the mortgage;
- the value and type of property securing the mortgage;
- the action taken by the lender on the application;
- points and fees paid;
- discount points and lender credits;
- the mortgage term and any prepayment period;
- the sex, race, age and national origin of the mortgage applicant; and
- the income and credit score of the mortgage applicant. [12 Code of Federal Regulations §1003.4(a)]

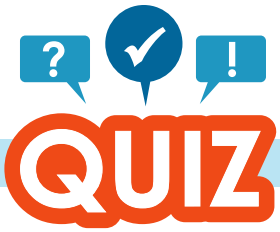
The data is grouped according to census tracts to determine the lender's activity within the tract. [12 USC §2803(j)(2)(C)]

All lenders approved by the *Department of Housing and Urban Development (HUD)* need to report to HUD and disclose the census tract information on all *Federal Housing Administration (FHA)* mortgages they originate. [HUD Mortgagee Letter 94-22]

The data is compiled by the **Federal Financial Institutions Examination Council** into a *disclosure statement* sent to the lender. [12 CFR §1003.5(b)]

The disclosure statement needs to be posted in a conspicuous location in the lender's office where it is readily accessible to the public. The disclosure is posted for a minimum of five years. [12 USC §§2803(a)(2), 2803(c)]

On request from any member of the public, the lender needs to make available a copy of the disclosure statement data. [12 USC §2803(a)(1)]



1. The _____ is a federal law mandating data collection on mortgage originations and applications of lenders who meet threshold requirements.

   a. Home Mortgage Disclosure Act (HMDA)
   b. Real Estate Settlement Procedures Act (RESPA)
   c. Dodd-Frank Act

Avoiding Discrimination in Advertising

HUD advertising guidelines for sales and rentals

The printing or publishing of an advertisement for the sale or rental of residential property that indicates a wrongful discriminatory preference is a violation of the **Federal Fair Housing Act (FFHA)**. [42 United States Code §3604(c)]

Federal Fair Housing Act (FFHA)
A collection of policies designed to prevent discrimination in the access to housing based on an occupant's inclusion in a protected class.

A property sold or leased for residential occupancy is referred to as a **dwelling**. The discriminatory preference rule applies to all brokers, developers and landlords in the business of selling or renting a *dwelling*. [42 USC §§3603, 3604]

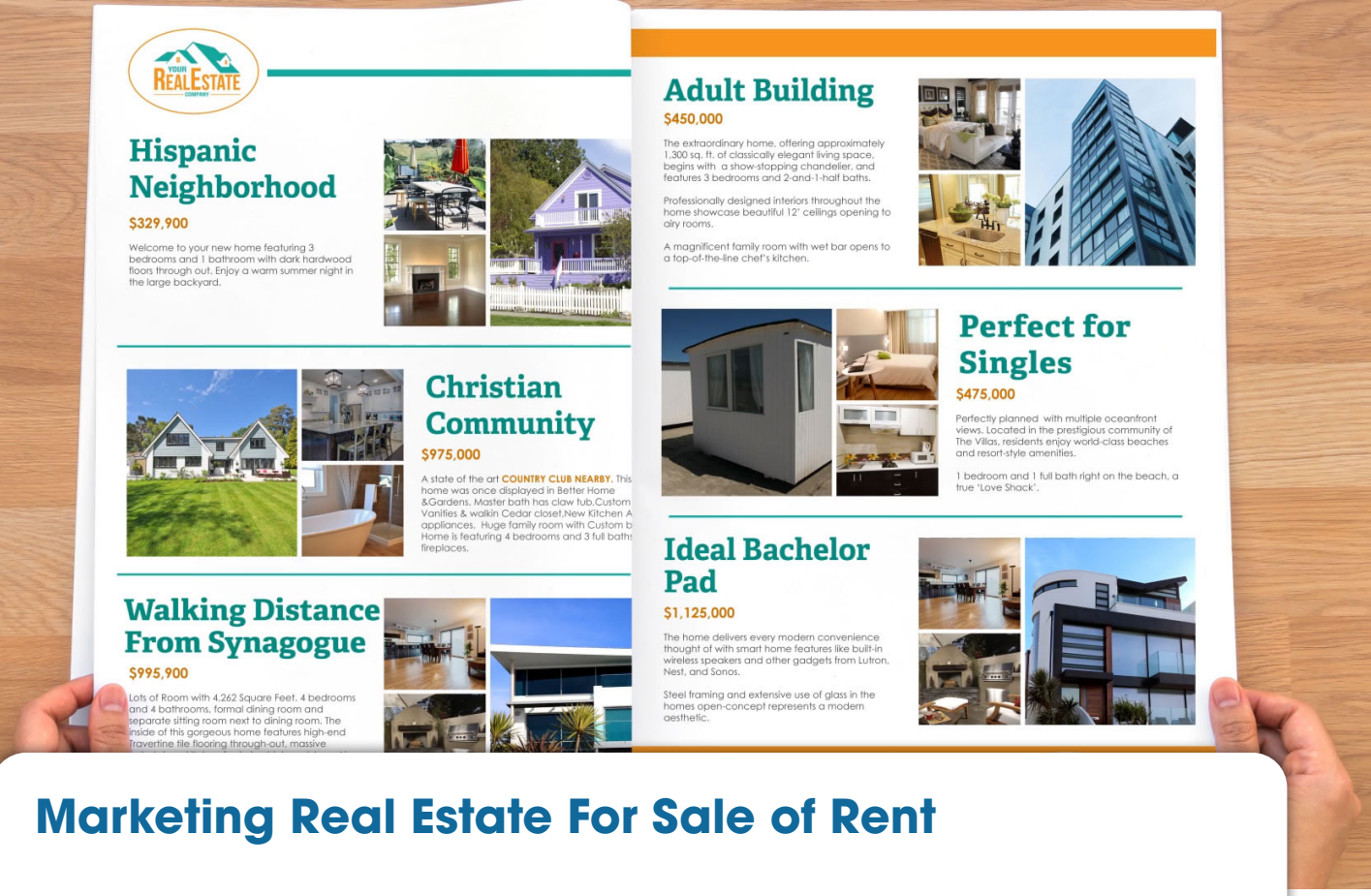
dwelling
Any building designed to be occupied as a residence by one or more families, or vacant land offered for the construction of a residential building.

Real estate advertising guidelines are issued by the **Department of Housing and Urban Development (HUD)**. The guidelines are the criteria by which *HUD* determines whether a broker has practiced or will practice wrongful discriminatory preferences in their advertising and availability of real estate services.

HUD guidelines also help the broker, developer, and landlord avoid signaling preferences or limitations for any group of persons when marketing real estate for sale or rent.

1. The printing or publishing of an advertisement for the sale or rental of residential property that indicates a wrongful discriminatory preference is a violation of the:

   a. Civil Rights Act.
   b. Home Mortgage Disclosure Act (HMDA).
   c. Federal Fair Housing Act (FFHA).



Marketing Real Estate For Sale of Rent

Avoiding a wrongful discriminatory preference

The selective use of words, phrases, symbols, visual aids and media in the advertising of real estate may indicate a wrongful *discriminatory preference* held by the advertiser. When published, the preference can lead to a claim of discriminatory housing practices by a member of the protected class.

Words in a broker's real estate advertisement that indicate a particular race, color, sex, sexual orientation, handicap, familial status or national origin are considered violations of the FFHA.

To best protect themselves, a broker refuses to use phrases indicating a wrongful preference, even if requested by a seller or landlord.

Words or phrases indicating a preference in violation of the rights of persons from protected classes include:

- "perfect for newlyweds"
- "country club nearby"
- "Christian community"
- "ideal bachelor pad"
- "walking distance from the synagogue"

- "Hispanic neighborhood" or
- "adult building."

Preferences are often voiced in prejudicial colloquialisms and otherwise seemingly harmless terms such as *restricted, exclusive, private, integrated or membership approval.* Encourage inclusivity by reexamining other problematic terms such as "master bedroom," an antiquated reference to slavery and plantation life.

Indicating a preference by age is an **exclusion** from unlawful age discrimination and permitted when marketing qualified 55-or-over residences or communities.

Selectively using *media* or *human models* in an advertising campaign can also lead to discrimination against minority groups. Examples of these include:

- sexuality pride flags;
- religious images, such as a cross;
- gender symbols;
- handicap signs; and
- national flags.

Practice in an enclave

Consider a broker who works in a metropolitan enclave area and markets single family residences (SFRs). A significant number of people residing in the general area speak a language other than English.

Although several non-English publications are printed in the area, the broker advertises the residences only in publications printed in English. Also, the broker distributes fliers only in neighborhoods where the residents speak English.

Since the residence is advertised exclusively in English and the broker has limited their advertising to English speaking communities, the broker may be construed as indicating a discriminatory preference for English speaking buyers.

1. Words or phrases indicating a preference in violation of the rights of persons from protected classes include:

   a. "perfect for newlyweds"

   b. "walking distance from the synagogue"

   c. Both a. and b.

The HUD Fair Housing Poster

The HUD fair housing poster

HUD issues guidelines that require real estate brokers selling or renting single family residences (SFRs) to display a *fair housing poster.* [24 CFR §§110.1, 110.10]

The fair housing poster is available at any HUD office. [24 CFR §110.20]

The broker marketing dwellings for sale or rent needs to display the fair housing poster:

- in the broker's place of business; and
- at any dwelling offered for sale, other than SFRs. [24 CFR §110.10(a)]

Thus, a broker holding an open house at an SFR listed for resale is not required to display the fair housing poster at the residence.

However, if a dwelling is marketed as part of a residential development, the fair housing poster needs to be displayed by the developer during construction of the development. Later, the poster is to be displayed in the model dwellings whether or not the dwellings are sold through a broker. [24 CFR §§110.10(a)(2)(ii), 110.10(a)(3)]

The fair housing poster needs to be placed where they can be easily seen by any persons seeking to:

- engage the services of the broker to list or locate a dwelling; or
- purchase a dwelling in a residential development. [24 CFR §110.15]

Failure to follow HUD guidelines

Even though it is required, a broker will not be subject to any penalties for failing to display the **fair housing poster.** However, failure to display the fair housing poster is initially considered sufficient evidence in a lawsuit to show that a broker practiced discriminatory housing practices. [24 CFR §110.30]

Also, a real estate broker and their agents who follow HUD advertisement guidelines and display the fair housing poster are less likely to practice a discriminatory activity.

The fair housing poster openly assures potential sellers/landlords and buyers/tenants the broker does not unlawfully discriminate in the services offered.

Also, the broker following HUD advertising and poster guidelines is in a better position to defend themselves against a fair housing lawsuit. Use of the fair housing poster indicates to the public the broker's invitation to work with all individuals.

1. A broker marketing dwellings for sale or rent needs to display the fair housing poster:
   a. in the broker's place of business and at any dwelling offered for sale, other than single family residences (SFRs).
   b. in all single family residences (SFRs) listed by the broker and all automobiles used by the brokerage office in the course of conducting real estate-related activities.
   c. Both a. and b.

Fair Housing: Glossary

A

aggrieved person 15

Any person who claims to have been injured by a discriminatory housing practice.

Americans with Disabilities Act (ADA) 6

Federal regulations prohibiting an employer from discriminating against a qualified person based on a disability.

B

blockbusting 13

The prohibited practice of a real estate licensee inducing a property owner to list their property for sale in response to a change taking place in the neighborhood demographics.

C

Civil Rights Acts 1

Federal prohibitions against racial discrimination on all types of real estate.

Civil Rights Department 24

A state agency designated with protecting Californians from housing, employment, and public accommodation discrimination.

commercial facility 8

Property owned, leased or operated by a private entity whose operation affects commerce.

credit reporting agency 33

A private agency which collects and reports information regarding an individual's credit history.

D

discriminatory business practices 27

Unequal treatment given to members of a protected class of individuals.

dwelling 5, 42

Any building designed to be occupied as a residence by one or more families, or vacant land offered for the construction of a residential building.

E

Equal Credit Opportunity Act 30

A federal law which prohibits discriminatory and unfair lending practices.

F

Federal Fair Housing Act (FFHA) 4, 42

A collection of policies designed to prevent discrimination in the access to housing based on an occupant's inclusion in a protected class.

H

Home Mortgage Disclosure Act 39

A federal law mandating data collection on mortgage originations and applications of lenders who meet threshold requirements.

P

public accommodation 7

Property owned, leased, or operated by a private entity whose services are made fully available to individuals and the general public.

public housing 2

Subsidized housing typically reserved for low-income families, the elderly and persons with disabilities.

R

redlining 35

The practice of denying mortgages and under-appraising properties in minority communities based on demographics, outlawed in California by Housing Financial Discrimination Act of 1977.

S

senior citizen housing 19

Housing intended for persons 55 or 62 years of age or older.

steering 11

An unlawful housing practice that includes words or actions by a real estate sales licensee intended to influence the choice of a prospective buyer or tenant.

U

Unruh Civil Rights Act 18

A California law which prohibits discrimination by a business establishment based on sex, race, color, religion, ancestry, national origin, disability or medical condition.

Trust Funds: Video™

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Introduction to Trust Funds

Trust funds overview

Real estate licensees often handle other people's items which have or evidence monetary value, called **funds**. *Funds* belonging to others which a broker and their agents handle when acting as agents in a transaction are called **trust funds**.

trust funds
Items which have or evidence monetary value held by a broker for a client when acting in a real estate transaction.

Trust funds generally include:

- rents and security deposits collected under a property management agreement [See **RPI** Form 550];
- good faith deposits tendered by a buyer with an offer to purchase;
- fees and costs handed to the broker in advance of their performance of agreed-to services;
- mortgage payments and funds on contract collection and mortgage brokerage; and
- any other personal property of value.

Trust funds are held by brokers for safekeeping and may not be treated casually. **Recordkeeping** and accounting requirements are imposed on brokers when they receive, transfer or disburse trust funds.

This chapter familiarizes brokers and their agents with the requirements and procedures for the handling of trust funds.

Identification of trust funds

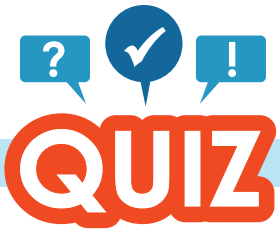
Brokers, while acting on behalf of others in their capacity as agents in real estate transactions, receive funds which are not theirs and are *held in trust* for the owner of the funds. These trust funds include:

- deposits on offers to purchase and applications to rent or borrow;
- fees advanced for any brokerage services to be provided in the future, called *advance fees;*
- funds advanced for future costs;
- funds from sellers, borrowers and landlords as reserves to cover future costs;
- rental income and tenant security deposits;
- funding for a mortgage or the purchase of real estate; and
- proceeds from a sale or financing.

Trust funds are received by a broker, or by an employee acting on behalf of the broker.

Employees acting on behalf of a broker include:

- sales agents;
- broker-associates;
- resident property managers; and
- office personnel.



1. Items which have or evidence monetary value held by a broker for a client when acting in a real estate transaction are referred to as:

   a. monetary funds.
   b. trust funds.
   c. mutual funds.

2. Trust funds may be received by:

   a. a broker.
   b. an employee acting on behalf of the broker.
   c. Either a. or b.

Managing Trust Funds

Item or evidence of value

Trust funds include any *item or evidence of value* handed to the broker or the broker's employee while acting as an agent in a real estate transaction.

For example, a buyer enters into a purchase agreement. The buyer's **good faith deposit** is in the form of a bag of gems handed to the broker. The dollar value of the gems will apply toward the purchase price on closing.

Is the broker required to handle the bag of gems as trust funds?

Yes! All items of value received by the broker as part of a transaction, regardless of form, are trust funds subject to special handling — safekeeping and recordkeeping.

Trust funds come in many forms, including:

- checks;
- precious metals/stones;
- stocks/bonds;
- collectibles;
- promissory notes; and
- any other item or evidence of value. [Calif. Business and Professions Code §10145]

Trust funds in practice

Consider a broker who enters into a *property management agreement* with an owner of income-producing real estate. Management services to be performed by the broker under their license include locating tenants, collecting rent and deposits, and disbursing funds for payment of operating expenses and installments on a trust deed mortgage encumbering the real estate.

The broker is further authorized to withdraw their fee and send any funds remaining to the owner.

The broker takes possession of the property under the property management agreement. The broker locates several new tenants and collects monthly rent and deposits.

The broker deposits the rent and security deposits received into their **general account.** The broker then enters the amount of each transaction as trust funds on the client's **subaccount ledger.**

general account
A broker or agent's personal or business account, not to be commingled with trust funds.

subaccount ledger
An accounting document or file identifying the owner of trust funds and the amount held for the owner.

Although sufficient funds are held in the client's subaccount to meet operating expenses and make the mortgage payment, the broker first withdraws their fee before making the mortgage payment authorized by the owner. The disbursement of the brokerage fee reduces the balance on the client's ledger below the amount needed to make the mortgage payment.

The broker then issues a check to the lender for the mortgage payment. The check bounces due to insufficient funds remaining in the broker's general account. The owner is notified by the lender and contacts the broker who provides funds to cover the mortgage payment.

In this instance, the broker *illegally commingled* the owner's funds with their funds when the rent and security deposits were deposited into the broker's general account rather than a trust account. Even though a subaccount ledger for the client's trust funds was maintained, the funds were improperly commingled with funds belonging to the broker.

Further, the broker breached their agency duty owed the client by withdrawing the brokerage fee before paying all other obligations the broker agreed to disburse on behalf of the owner, including payment on the mortgage, known as a **conversion.** The brokerage/management fee is to be paid last, after agreed-to services have been performed, including all authorized disbursements.

conversion
The unlawful appropriation of another's property, as in the conversion of trust funds.

Lastly, by writing a check for the mortgage payment when the broker knew insufficient funds existed in the account to cover the check, the broker misrepresented the availability of immediate funds. This is considered fraud and is grounds for the revocation or suspension of the broker's license. [**Apollo Estates, Inc.** v. **Department of Real Estate** (1985) 174 CA3d 625]

Handling cash and checks

Funds received in the form of cash or checks made payable to the broker while acting as an agent need to be:

- deposited into the broker's trust account;
- held undeposited as instructed; or
- endorsed and handed to others entitled to the funds.

Further, the broker has a duty to *secure trust funds* that are not in the form of cash or checks, such as gems, coins, notes or other personal property, from loss or damage after they are received. These nonnegotiable types of trust funds cannot be deposited in a bank account. Thus, the broker is to place the nonnegotiable items in a safe or safe-deposit box for safekeeping until they are delivered to others.

Trust funds received in the form of checks or cash may only be used for expenditures authorized and incurred for the benefit of the owner of the funds.

Further, the broker needs to regularly account to the owner on the status, expenditure and location of the negotiable trust funds, called an owner's statement.

owner's statement
An accounting on the status, expenditure and location of negotiable trust funds provided to the owner of those funds.

Identifying the owner

A broker needs to know who owns and controls the funds held in their trust account at all times. Trust funds can only be disbursed on the authorization of the owner of the funds. Subaccount ledgers are set up to identify the owner of funds and the amount held for the owner.

However, persons other than the owner of the trust funds may have an interest in the funds. If so, their authorization is also required to withdraw the funds.

For example, a buyer, as a good faith deposit on an offer to purchase, issues a check payable to the broker with instructions in the purchase agreement to hold the check undeposited until acceptance of the offer.

The seller accepts the buyer's offer and the broker deposits the check in their trust account as funds held on behalf of and owned by the buyer.

The buyer is unable to obtain a purchase-assist mortgage to fund the purchase. The buyer cancels the transaction, consistent with the mortgage contingency provision in the purchase agreement. However, the seller does not sign *mutual cancellation* instructions or other instructions to authorize the return of the buyer's deposit. [See **RPI** Form 183]

The buyer makes an offer to purchase real estate owned by another seller, which is accepted.

To obtain the funds to close escrow on the second transaction, the buyer makes a demand on the broker to transfer the buyer's good faith deposit on the first transaction from the trust account to the escrow handling the second transaction. The broker refuses to withdraw the buyer's good faith deposit from their trust account without further instructions from the seller under the purchase agreement cancelled by the buyer.

Did the broker act correctly when retaining the buyer's good faith deposit?

Yes! When a buyer's offer, which includes receipt of a good faith deposit, is accepted by a seller and the buyer's good faith deposit is placed in the broker's trust fund account (or the purchase escrow),

the buyer's funds may not be withdrawn without written authorization signed by both the buyer and seller. If the funds are disbursed without mutual instructions, the broker is liable to the seller for losses due to an improper release of the funds. [**Mullen** v. **Department of Real Estate** (1988) 204 CA3d 295]

Prior to the end of the **third business day** following the day the broker receives negotiable trust funds, the broker needs to deposit the funds:

- with the *person or escrow* depository entitled to the funds (as payee or by endorsement); or
- in a *trust account* maintained by the broker at a bank or other state-recognized depository. [Bus & P C §10145; Department of Real Estate Regulation §2832(a)]

Also, when an agent of the broker accepts trust funds on behalf of the broker, the agent needs to immediately deliver the funds to the broker, unless directed by the broker to:

- deliver the trust funds to the person or the escrow entitled to the funds; or
- deposit the trust funds into the broker's trust account. [Bus & P C §10145(c)]

1. Prior to the end of the third business day after the broker receives negotiable trust funds, the broker must _____ the funds.

   a. invest
   b. deposit
   c. embezzle

2. A(n) _____ is an accounting document or file used to identify the owner of trust funds and the amount held for the owner.

   a. owner's statement
   b. take sheet
   c. subaccount ledger

Holding Checks Undeposited

Held until occurrence of an event

Generally, when a broker negotiates the purchase or lease of real estate, they receive a check as a good faith deposit.

The broker may hold the check undeposited until an event occurs, such as the offer is accepted or escrow is opened, when:

- the check is made payable to someone other than the broker; or
  - the check is made payable to the broker with written instructions, typically from the buyer or tenant, to hold the check undeposited until acceptance of the offer or escrow is opened; and
  - the person to whom the offer is submitted, usually the seller or landlord, is informed the check for the good faith deposit is being held by the broker when the offer is submitted. [DRE Reg. §2832(c)]

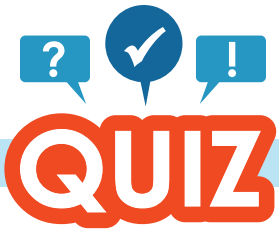
The instructions to hold the check undeposited until acceptance are included in the terms for receipt of the deposit contained in the offer to purchase or lease.

After a buyer's offer is accepted, the broker may continue to hold the buyer's check for the good faith money undeposited when the seller has given the broker written instructions to continue to hold the check undeposited.

However, without instructions to further retain the check undeposited, the broker needs to deposit or deliver the funds no later than *three business days* after

acceptance:

- to the payee entitled to the funds, such as a title company or escrow;
- into the broker's trust account at a bank or other state-recognized depository, such as a thrift; or
- to an escrow depository on the broker's endorsement, when the broker is the payee and does not want to deposit and disburse the funds from their trust account to escrow. [DRE Reg. §2832]

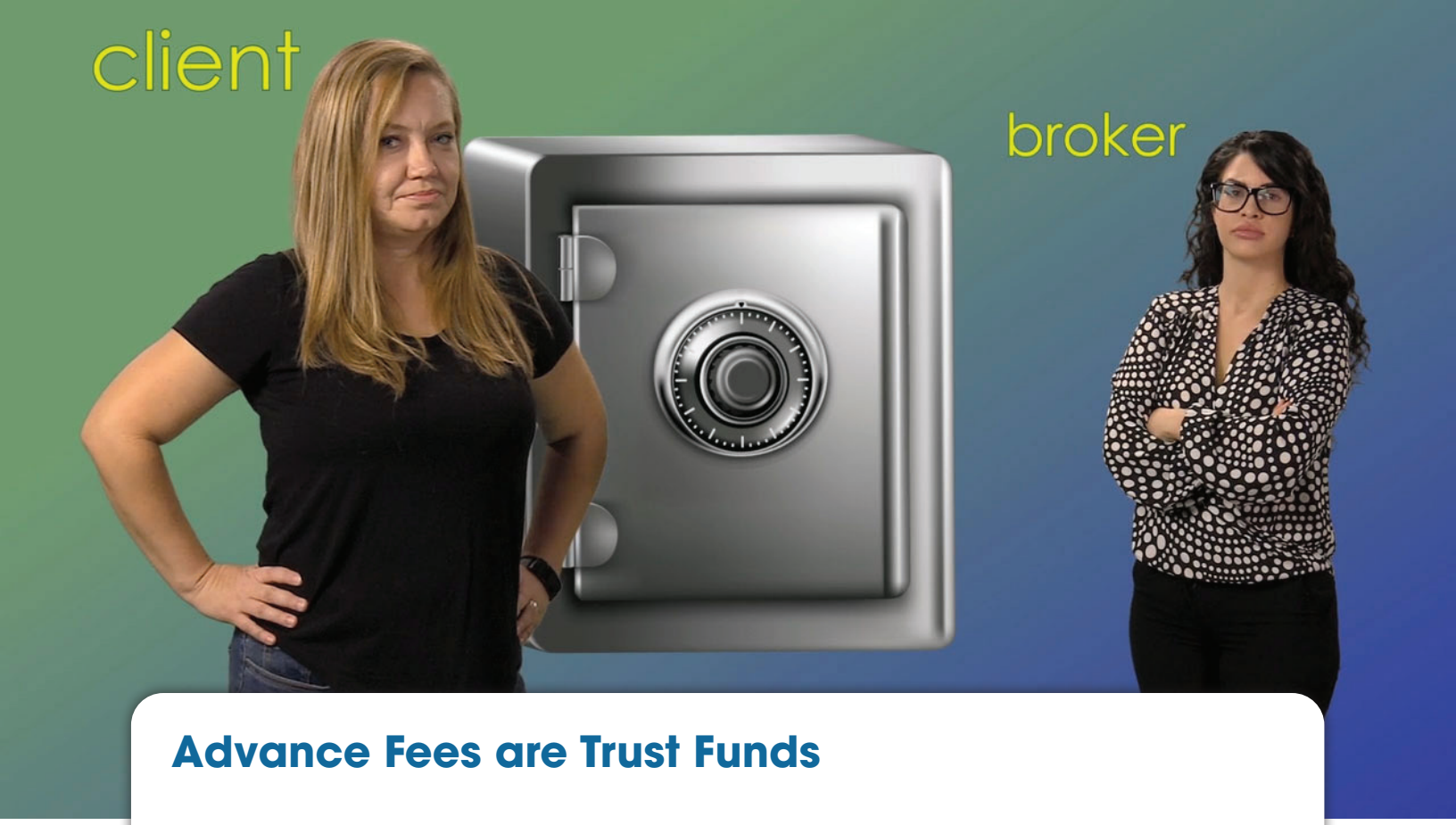


1. When a broker negotiates the purchase or lease of real estate, they generally receive a check as a(n):

   a. kickback.
   b. advance on their broker fee.
   c. good faith deposit.

2. After a buyer's offer is accepted, the broker may continue to hold the buyer's check for the good faith money undeposited when the seller has given the broker _____ to continue to hold the check undeposited.

   a. verbal instructions
   b. written instructions
   c. Either a. or b.



Advance Fees are Trust Funds

Advance fee trust fund accounting

Broker fees deposited with the broker before they are earned are called **advance fees**. *Advance fees* will be deposited in the broker's trust account. The funds belong to the client of the broker, not the broker, and cannot be withdrawn by the broker before they are earned and a statement is sent to the client.

advance fee
A fee paid in advance of any services rendered.

In addition to trust fund *accounting requirements*, a broker will send the client a verified accounting for the advance fees:

- no later than at the end of each calendar quarter, and
- at the time the contract between the broker and client is fully performed.

The verified accounting for the advance fees will include:

- the name of the broker;
- the name of the client;
- a description of the services rendered or to be rendered;
- an identification of the trust fund account and where the advance fee is deposited; and

- the amount of the advance fee collected (Department of Real Estate Regulation §2972).

In addition, the verified accounting will include the amount disbursed for each of the following:

- costs for *agreed-to services*;
- *fees* paid to field agents and representatives; and
- *overhead costs* and *profits. [*DRE Reg. §2972(f)]

If an agreed-to service disbursed from the account is made for advertisement, the verified accounting will include:

- a copy of the advertisement;
- the name of the publication in which the advertisement appeared; and
- the number of ads published and the dates they appeared. [DRE Reg. §2972(g)]

Further, if the advance fee is for the arrangement of a mortgage, the verified accounting will include a list of the names and addresses of the persons to whom the information pertaining to the mortgage requirements was submitted, and the dates the information was submitted. [DRE Reg. §2972(h)]

The amounts placed in the trust account may be withdrawn:

- when expended for the *benefit of the client*; or
- on the *fifth day* after the verified accounting is mailed to the client. [Calif. Business and Professions Code §10146]

Approval of advance fee agreements

Before a broker may solicit, advertise for and agree to receive an advance fee, the paperwork material is to be submitted to the Commissioner of the **California Department of Real Estate (DRE)** for approval at least **10 calendar days** prior to use. [DRE Reg. §2970]

If the Commissioner, within 10 calendar days of receipt, determines the material might mislead clients, the Commissioner may order the broker to refrain from using the material. [Bus & P C §10085]

To be approved by the Commissioner, the *advance fee agreement* and any materials to be used with the agreement will:

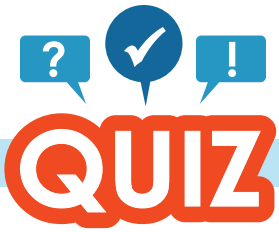
- contain the total amount of the advance fee and the date or event the fees will become due and payable;
- list a specific and complete description of the services to be rendered to

earn the advance fee;

- give a definite date for full performance of the services described in the advance fee agreement; and
- contain no false, misleading or deceptive representations. [DRE Reg. §2970(b)]

Further, the advance fee agreement may not contain:

- a provision relieving the broker from an obligation to perform verbal agreements made by their employees or agents; or
- a guarantee the transaction involved will be completed. [DRE Reg. §§2970(b)(4), 2970(b)(5)]

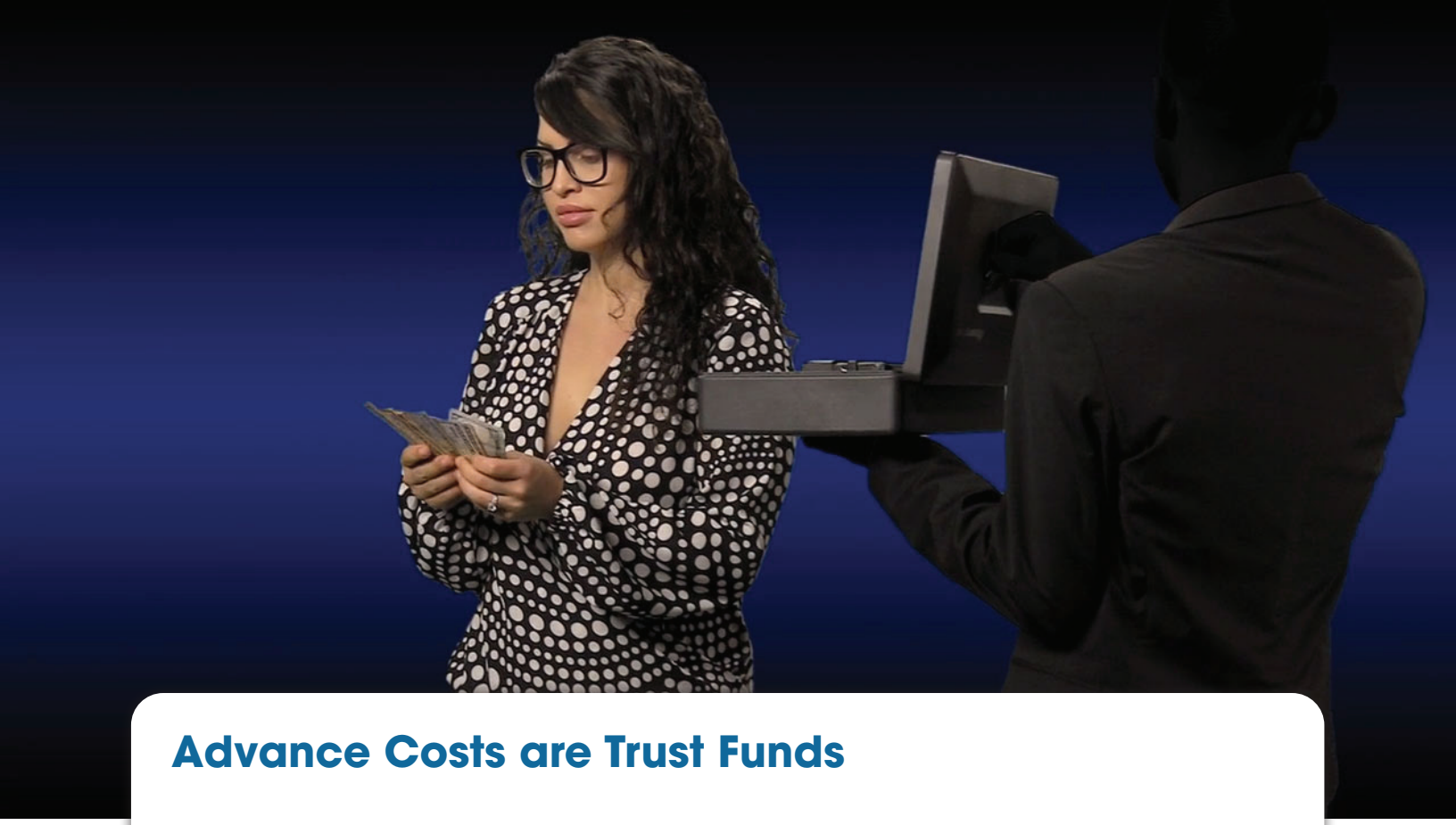


1. Broker fees deposited with the broker before they are earned are called:

   a. advance fees.
   b. kickbacks.
   c. referral fees.

2. Before a broker may solicit for an advance fee, the paperwork needs to be submitted to the California Department of Real Estate (DRE) for approval at least _____ prior to use.

   a. 5 days
   b. 10 days
   c. three months



Advance Costs are Trust Funds

Funds handed to the broker for marketing costs

Funds advanced by the client directly to the broker for costs the client agrees to pay belong to the client. Typically, the seller will incur costs for acquiring property reports and marketing the property to prospective buyers.

On receipt of an **advance deposit** from the client for the payment of costs, the broker will place the funds in their trust account since they are trust funds. [Calif. Business and Professions Code §10146]

An **advance cost sheet**, also referred to as a *marketing package cost sheet*, acknowledges the broker's receipt of any deposit towards marketing costs. Further, it authorizes the broker to make disbursement from the funds as the itemized costs are incurred. The *advance cost sheet* is best included as part of the marketing package as an attachment to the listing agreement.

advance cost sheet
An itemization of the costs incurred to properly market a property for sale which are to be paid by the owner.

When the listing terminates, the broker is to return all remaining trust funds to the client. The broker may not use trust funds to offset any fees the client may owe them, unless instructed to do so.

An accounting of all funds held in trust will be handed to the client every calendar quarter. However, a monthly accounting by way of a print out of the client's *trust account ledger* creates a better business relationship.

Accounting of funds

A *final accounting* of the funds will be made when the listing agreement expires. When any funds remain, they will be returned to the client with the final accounting. [Bus & P C §10146]

The **statement of account** for the trust funds will include the following information:

- the amount of the deposit toward advance costs;
- the amount of each disbursement of funds from the trust account;
- an itemized description of the cost obligation paid on each disbursement;
- the current remaining balance of the advance cost deposit; and
- an attached copy of any advertisements paid from the advance cost deposit.

Lastly, the broker is to keep all accounting records for at least *three years*. Further, the records will be made available to the California Department of Real Estate (DRE) upon request. [Bus & P C §10148]

A broker who fails to place advance cost deposits in their trust account, or who later fails to deliver proper trust account statements, is presumed guilty of **embezzlement**. [**Burch** v. **Argus Properties, Inc.** (1979) 92 CA3d 128]

embezzlement
The dishonest act of converting a client's assets for personal use.

For example, a borrower retains a mortgage broker to locate a lender to make a mortgage to fund the acquisition of real estate. The borrower and mortgage broker enter into an *exclusive right-to-borrow listing agreement*.

The listing agreement states the broker will receive a broker fee when the mortgage is funded by the lender the broker locates. [See **RPI** Form 104]

The broker includes an *advance cost sheet* as an attachment to the listing. The advance cost sheet calls for the borrower to advance funds to cover itemized costs which will be incurred by the broker while arranging a mortgage. These costs cover such items as the appraisal of the property securing the mortgage and credit reports. The advance costs are separate and unrelated to the payment of

the broker fee.

The borrower issues a check payable to the broker for the amount of the costs to be incurred by the broker while arranging the mortgage.

Can the broker deposit part or all of the funds advanced by the borrower into the broker's *general business account* to cover the costs the broker is to pay on behalf of the borrower?

No! Funds received by the broker to hold and use to pay costs to be incurred in the future on behalf of the borrower are *trust funds*.

Trust funds are deposited by the broker in a *trust account* in the name of the broker as trustee. They are separate from general accounts established to hold the broker's personal or business funds. [Bus & P C §10145]

1. A(n) _____ refers to an itemization of the costs incurred to properly market a property for sale which are to be paid by the owner.

   a. advance cost sheet
   b. advance fee sheet
   c. balance sheet

2. A broker who fails to place advance cost deposits in their trust account is presumed guilty of:

   a. blockbusting.
   b. embezzlement.
   c. eminent domain

Analyzing the Marketing Package Cost Sheet

Itemized costs the seller can expect to incur

The items listed on the *marketing package cost sheet* are not costs of the broker's overhead incurred to maintain their brokerage office.

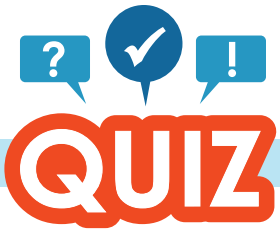
The costs listed, when incurred, relate primarily to the condition of the property listed, marketed and sold. The costs are incurred to document the integrity of the client's property, not to pay for services of the broker.

Thus, the costs rightly are to be paid by the client who owns the property, not borne by the broker. [See **RPI** Form 107]

When filling out the sheet, the client is given choices as to *when* and *how* they will pay the stated costs.

The client may agree to pay the charges directly to third-party vendors when billed. In this case, the broker coordinates the arrangements for payment with the vendors as an agent of the client. When the client's check is payable to the vendor, not the broker, it is handed to a seller's agent for delivery to the vendor. The check still constitutes trust funds received by the broker, and requires an entry in the trust fund ledger maintained by the broker.

Alternatively, the client may deposit the estimated costs with the broker, making the check payable to the broker, thus classifying the payment as **advance costs.** The broker will then pay the charges from the funds held on deposit when billed by the vendor.



1. Costs listed on a marketing package cost sheet which relate to the condition of the property listed, marketed and sold are paid:

   a. by the client who owns the property.

   b. by the broker.

   c. by the buyer.

non-interest bearing trust account

Trust Account Management

The withdrawal of trust funds

Checks or cash are frequently made payable and handed to a real estate broker during a transaction. These items are *trust funds* since they do not belong to the broker. Rather, checks payable to the broker and cash are received "in trust" by the broker and held on behalf of the client. These funds will be deposited by the broker into a **non-interest bearing trust account**, unless endorsed and handed to others as instructed by the client.

trust account
An account separate and physically segregated from a broker's own funds, in which the broker is required by law to deposit all funds received for clients.

The *trust account* opened for the deposit of cash and items payable to the broker will be in the name of the broker, as **trustee**, at a bank or a state-recognized depository, such as a *thrift*. [Calif. Business and Professions Code §10145]

Once deposited, the trust funds may only be withdrawn or disbursed as authorized and instructed by the owner of the trust funds. A third party who has an interest in the funds may also be necessary to authorize disbursement, such as a seller who acquires an interest in the buyer's good faith deposit on acceptance of a purchase agreement offer. [Bus & P C §10145(a)(1)]

Withdrawals or disbursements from the trust account in the name of an individual

broker will be made under the signature of:

- the broker named as *trustee* on the account;
- a licensed broker or sales agent employed by the named broker under a broker-agent employment agreement [See **RPI** Form 505]; or
- an unlicensed employee of the named broker, provided the unlicensed employee is **bonded or insured** for the total amount of the trust funds the employee can access, and the bond or insurance protects the broker from intentional wrongful acts committed by the employee. [Department of Real Estate Regulation §2834(a); Bus & P C §10145(a)(2)(c)]

A **signer** is an employee other than the broker who has written authorization from the broker to withdraw or disburse funds from the trust account. This authority is either included in an addendum to the employment agreement or is provided in the agreement itself.

signer
An employee who has written authorization from the broker to withdraw or disburse funds from the trust account.

When the trust account is in the name of a **corporate broker** as trustee, withdrawals are made by:

- the **designated officer (DO)** who qualified the corporation as a licensed broker; or
- a licensed or unlicensed employee with the written authorization of the designated officer. [DRE Reg. §2834(b)]

The authorization from the corporation is made as part of the employment agreement with each signatory. [See **RPI** Form 505, 510 or 511]

However, a broker's written delegation to others who are signers on the trust account does not relieve the individual broker or the designated officer of a corporate broker from liability for any loss or misuse of trust funds. [DRE Reg. §2834(c)]

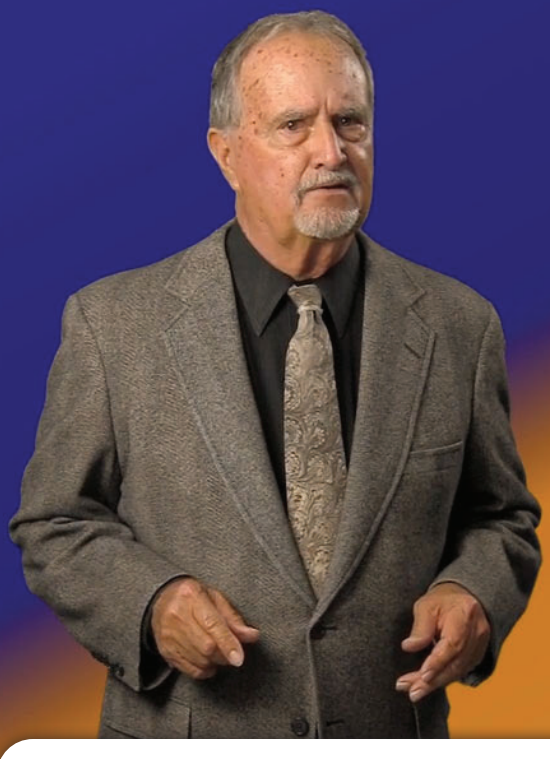
To help prevent an improper withdrawal by an individual signer, the broker may require two signatures on trust account withdrawals. An *insurance policy* for the brokerage business needs to include coverage for theft by employees who have direct or indirect access to trust funds.

1. A trust account opened for the deposit of cash and valuable items payable to the broker will be in the name of the broker as the:

   a. signer.
   b. trustor.
   c. trustee.

2. A _____ is an employee other than the broker who has written authorization to disburse funds from a trust account.

   a. signer
   b. substitute
   c. dual agent



interest bearing account

Interest-Bearing Accounts

A broker's proper handling of interest-bearing trust accounts

Trust funds may be placed in an **interest-bearing account** if requested by the owner of the funds and agreed to by the broker. [See RPI Form 535]

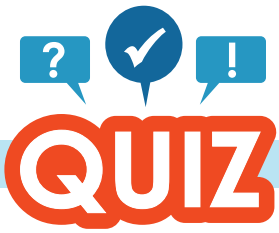
However, the broker is under no obligation to comply with the owner's request if they notify the owner they will not place the trust funds in an interest-bearing account. [Bus & P C §10145(e)]

If the broker agrees to place the owner's trust funds in an interest-bearing trust account:

- a separate trust account will be established solely to hold the owner's trust funds;
- the trust account will be in the name of the broker as trustee, with the owner named as the specified *beneficiary*;
- the trust account will be insured by the Federal Deposit Insurance Corporation (FDIC); and
- the broker and their agents may not receive any interest earned by the trust account, even if agreed to by the owner of the trust funds. [Bus & P C §10145(d)]

Also, if trust funds are to be placed in an interest-bearing account, the broker is to first disclose:

- how interest is calculated on the account;
- who will receive the interest;
- who will pay bank service charges; and
- any penalties or notice requirements for withdrawal. [Bus & P C §10145(d)(4); see **RPI** Form 535]



1. Trust funds are generally kept in a(n):

   a. interest-bearing account.
   b. non-interesting-bearing account.
   c. off-shore account.

Maintaining Trust Account Integrity

Improper commingling

If a broker deposits trust funds into an account used to receive and disburse personal or business funds, the broker has **improperly commingled** the funds. Similarly, *improper commingling* occurs when the broker places or leaves personal funds in a trust account. [**Stillman Pond, Inc.** v. **Watson** (1953) 115 CA2d 440]

commingling
The mixing of personal funds with client or third-party funds held in trust.

Except to the limited extent authorized by the California Department of Real Estate (DRE), commingling is always improper.

A broker is only permitted to commingle personal or business funds with trust funds in the following two authorized situations:

1. The broker may maintain a deposit of up to *$200 of their own funds* in the trust account to cover bank service charges on the account; and
2. Fees or reimbursement for costs *due the broker* from the trust funds may remain in the trust account for up to 25 days before being disbursed to the broker. [DRE Reg. §2835]

The improper commingling of trust funds exposes the broker to a complaint and

revocation or suspension of their license. [Bus & P C §10176(e)]

For example, a broker prepares a purchase agreement for a buyer. The offer includes the broker's receipt of a check for the buyer's *good faith deposit*. Instructions are not included in the purchase agreement authorizing the broker to hold the check undeposited until acceptance of the offer. [See **RPI** Form 150 through 159]

The buyer signs the offer and issues a check payable to the broker for the good faith deposit. The broker deposits the buyer's check into their trust account.

The offer is not accepted by the seller. The broker then withdraws the buyer's good faith deposit from the trust account and deposits the funds in their personal account. From their personal account, the broker writes checks using the buyer's funds to pay personal expenses.

Is the broker's personal use of the buyer's funds cause for revocation or suspension of their license?

Yes! Not only has the broker violated the rule against commingling trust funds and personal funds, the broker also *converted* the buyer's funds to their own use. Both violations are separate grounds for revocation or suspension of the broker's license. [**Brown** v. **Gordon** (1966) 240 CA2d 659]

Proper recordkeeping

Records maintained by the broker for their trust accounts document and track the broker's **receipt and disbursement** of trust funds. However, recordkeeping alone will not protect the broker against dishonest employees.

The assurance all trust funds are correctly deposited, credited and disbursed is best accomplished by maintaining a *written journal* or *digital accounting system*. However, even the best of accounting procedures do not protect against deliberate diversion of trust funds by others.

The broker named as trustee on a trust fund account is responsible for funds held in the account. The broker is liable even if others sign on the account with authorization to make withdrawals from the account. [DRE Reg. §2834(c)]

Occasionally, it is unfeasible for the broker to personally enter and maintain each accounting transaction and conduct the reconciliation required by the DRE. Banks and other depositories send a monthly statement of the account to each account holder for the purpose of verifying the validity of the deposits, withdrawals and charges on the account. The broker can best protect the trust funds from unauthorized withdrawals by personally receiving and reviewing bank statements before anyone else.

The broker, to maintain the integrity of the trust account, is to make sure the statement is:

- mailed to the broker's office and handed to them unopened;
- held by the bank and personally picked up by the broker; or
- sent to the broker's residence instead of the office.

If unauthorized withdrawals occur, the broker will discover them by reviewing the bank statement and the accompanying deposit tickets and paid checks before anyone else has access to the statement.

In the event the broker discovers an unauthorized withdrawal due to forgeries or improper endorsements, the broker is to notify the bank within 30 days of receiving the statement. The notice of improper payment of checks by the bank will enable the broker to recover the amount of the unauthorized payment. [Calif. Commercial Code §4406]

Any loss from the trust account not covered by the bank will be covered by the broker. Thus, to protect the broker from unrecoverable losses, business insurance is to include coverage for *employee theft*.

Trust account bookkeeping and monthly reconciliation

The broker's bookkeeping for each trust account maintained at a bank or thrift includes entries regarding:

- the amount, date of receipt and source of all trust funds received;
- the date the trust funds were deposited in the broker's trust account;
- the date and check number for each disbursement of trust funds previously deposited in the trust account; and
- the daily balance of the trust account. [Department of Real Estate Regulation §2831(a)]

Entries in the **general ledger** for the overall trust account are to be in chronological order of occurrences and formatted in columns. The ledgers may be maintained in either a computer program or a written journal. [DRE Reg. §2831(c)]

Editor's note – Computer programs have been developed that allow the broker to make a single entry for the receipt and disbursement of

trust funds from the trust account under an account number given to the owner of the funds, called a beneficiary. On completing the entry, the program automatically generates reports for the overall trust account, each owner's subaccount, and the statements to be sent to each owner of trust funds.

In addition to the *general ledger* of the entire trust account, the broker also maintains a separate **subaccount ledger** for each owner of the trust funds. The *subaccount ledger* lists each deposit and disbursement from the broker's trust account on behalf of each owner of the trust funds.

The subaccount ledger identifies:

- the date and amount of trust funds *deposited;*
- the date, check number and amount of each *disbursement* from the trust account;
- the date and amount of any *interest earned* on funds in the trust fund account; and
- the total amount of trust *funds remaining* after each deposit or disbursement from the trust account. [DRE Reg. §2831.1]

Brokers maintaining bank trust accounts are to **reconcile** the general ledger for the entire trust account against the separate subaccount ledger of each person and each transaction in the subaccounts. Brokers are to reconcile these accounts at least once each calendar month deposits or withdrawals occur.

The monthly reconciliation of the bank trust account contains:

- the name of the bank or thrift where the trust account is located and the account number;
- the date of the reconciliation;
- the account number of each subaccount in the trust account documenting the deposits, withdrawals and disbursement for each person; and
- the amount of funds remaining held in trust on behalf of each (DRE Reg. §2831.2).

1. _____ occurs when a broker deposits trust funds into an account used to receive and disburse personal or business funds.

   a. Dual agency
   b. Improper commingling
   c. A kickback

2. A broker is permitted to keep up to _____ of their own funds in a client's trust account.

   a. $200
   b. $1,000
   c. $5,000

Penalties for Misuse of Trust Funds

Commingling, conversion and restitution

Real estate brokers who handle trust funds need to deposit the funds as instructed by their owner.

Trust fund handling is regulated by a variety of *penalties and consequences*. A broker who misuses trust funds is subject to:

- *civil liability* for money wrongfully converted;
- *disciplinary action* by the California Department of Real Estate (DRE);
- *income tax liability*; and
- *criminal sanctions* for embezzlement.

The penalty depends on the nature of the funds which the broker misuses. For example, penalties for a broker's misuse of **advance fees** held in trust accounts are specifically fixed by statute.

If the broker misuses advance fees, the owner of the funds may recover treble damages plus attorney fees from the broker. A broker who fails to account for advance fees is presumed to be guilty of **embezzlement**. [Calif. Business and Professions Code §10146)]

embezzlement
The dishonest act of converting a client's assets for personal use.

However, the existence of specific statutory provisions relating to the misuse of advance fees does not mean the misuse of other types of trust funds will go unpunished. Penalties for the misuse of trust funds for other purposes fall under more general statutory schemes.

Violations subject to DRE discipline

If the DRE Commissioner determines a broker violated trust fund accounting rules, the Commissioner may obtain an injunction against the broker to stop or prevent the violation. [Bus & P C §10081.5]

The Commissioner may also include a claim for **restitution** on behalf of clients injured by the broker's misuse of trust funds. [Bus & P C §10081(b)]

restitution
Money award given to restore an injured party to the condition they held before being damaged.

If the DRE conducts an audit of the broker's trust account and discovers the broker has **commingled** or **converted** more than $10,000 of trust funds, the broker's license may be suspended pending a formal hearing.

After the hearing, a receiver may be appointed to oversee the broker's business. The receiver is allowed to exercise any power of the broker and may file for bankruptcy on behalf of the broker. [Bus & P C §10081.5]

Commingling of trust funds is grounds for suspension or revocation of the broker's license. [Bus & P C §10176(e)]

Civil liability

A broker who misuses trust funds needs to **reimburse** the owner of the funds the amount wrongfully used. [Calif. Civil Code §3281]

However, a client's right to recover money from a broker is not limited to the amount or value of the funds the broker wrongfully converted. In addition to money losses, the client may be awarded *punitive penalties* based on a breach of the broker's agency relationship with the client.

Also, when a broker uses the client's money for their own benefit, any profits earned by the broker's misuse belong to the client.

Thus, the client is entitled to recover the funds wrongfully converted, *plus any gain* the broker derived from their use. [**Savage** v. **Mayer** (1949) 33 C2d 548]

For example, a seller's broker presents the listed property to a buyer at a price exceeding the seller's listing price. The buyer signs an offer to purchase at the price solicited by the broker and gives the broker a **good faith deposit**.

The broker never communicates the buyer's offer to the seller. Instead, the broker purchases the property from the seller at the seller's lower listed price, then deeds the property to the buyer. The broker keeps the difference between the listed price and the purchase price as a profit.

The buyer seeks to recover from the broker the difference between the prices paid for the property. The broker claims the buyer is not entitled to recover the difference since the property acquired was worth at least what the buyer paid for it.

Is the buyer entitled to the difference in price?

Yes! Further, the buyer's recovery is not limited to actual money losses for overpayment on the price. Since the broker used the buyer's deposit to secretly profit, the buyer is also entitled to recover the profits and fees received by the broker. [**Ward** v. **Taggart** (1959) 51 C2d 736]

Punitive damages

A broker who wrongfully converts trust funds may be liable for **punitive damages**. *Punitive damages*, also called **exemplary damages**, is a money award given to a client when the broker wrongfully obtained assets, such as trust funds, from the client by fraud or with malice. [CC §3294]

punitive damages
Monies awarded in excess of actual money losses in order to deter unlawful actions.

Any wrongful use of trust funds is automatically considered *fraudulent*. The broker's breach of their agency duty is defined by statute as *constructive fraud*. [CC §1573]

Thus, any broker misusing trust funds is potentially liable to the principal for punitive damages as well as reimbursement of the trust funds taken or misused. Whether punitive damages will be awarded depends on:

- the severity of the broker's misconduct; and
- the agency relationship undertaken by the broker.

For example, a seller and broker enter into a *listing agreement*. Under the terms of the listing, the broker's fee will be any amount paid by a buyer in excess of the net sales price sought by the seller.

After the seller signs the listing agreement, the broker alters the fee provision to provide for a brokerage fee of one third of the sales proceeds.

The broker accepts cash from a buyer for the full sales price of the property. The broker handles the closing and retains one third of the sales proceeds as their brokerage fee. The balance handed to the seller is an amount less than the net amount agreed to in the listing agreement.

Here, the seller is entitled to *punitive damages*. The punitive damages are based not only on the wrongful conversion of gross sales proceeds held in trust for the seller, but also on the broker's fraudulent conduct. The broker could not have honestly believed they were entitled to a fee equal to one third of the sales proceeds. [**Haigler** v. **Donnelly** (1941) 18 C2d 674]

In instances where actual money losses are small, punitive money awards are occasionally awarded as a *deterrent* against future fraudulent activity. [**Esparza** v. **Specht** (1976) 55 CA3d 1]

Income tax

Income taxes to the extent due are paid on all income, from whatever source. This includes income derived from illegal activities such as *embezzlement.* [**James** v. **United States** (1961) 366 US 213]

Thus, brokers who convert trust funds expose themselves to tax penalties when they fail to report the converted funds as income and pay the appropriate taxes on the *illegal income*. [Calif. Revenue and Taxation Code §19701]

Further, embezzled money needs to be reported as income even when it is paid back. Thus, a broker embezzling trust funds cannot escape income tax liability by returning the funds and characterizing the embezzlement as an *unauthorized loan*. [**Buff** v. **Commissioner of Internal Revenue** (1974) 496 F2d 847]

In addition, no deductions of any kind are allowed to offset income derived from illegal activities. The broker is responsible for reporting the full amount of the income they have derived from converting trust funds, undiminished by their related expenses, costs and reimbursements. [Rev & T C §17282]

Embezzlement

A broker who uses funds in any way not authorized by the owner is guilty of **embezzlement**. [Calif. Penal Code §506]

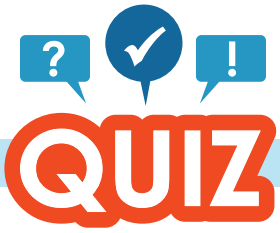
Whether the broker is merely "borrowing" the funds and intends to return them is of no import. The broker is still guilty of embezzlement. [Pen C §513]

For instance, a developer accepts down payments from buyers for homes in a subdivision. The purchase agreements state the down payments will be held in escrow until title to the homes is conveyed to the buyers.

The developer fails to deposit any of the funds received into an escrow or trust account. Instead, the developer uses the funds for their own business expenses.

The developer gives the buyers credit for the down payments and later conveys title to the buyers. Thus, the buyers are not harmed by the developer's conversion of the down payments funds.

Even though the down payments would ultimately go to the developer and the buyers received what they paid for, the developer is guilty of embezzlement. The developer had no right under the purchase agreements to use the funds until title was conveyed to the buyers. [**People** v. **Parker** (1965) 235 CA2d 100]



1. Money damages awarded in excess of actual money losses that are levied in order to deter unlawful actions are known as:

   a. legal fees.
   b. reimbursement.
   c. punitive damages.

2. _____ refers to the dishonest act of converting a client's assets for personal use.

   a. Embezzlement
   b. Civil liability
   c. Restitution

The Real Estate Recovery Account

Recovery from an insolvent broker

If a client sues a broker for trust account violations and receives a money judgment, the client may satisfy the judgment through the state **Real Estate Recovery Account** if:

Real Estate Recovery Account
Funds available to individuals who have obtained a final-court judgment against a licensee and are unable to recover the judgment from the licensee. This account is also referred to as the Real Estate Recovery Fund and Consumer Recovery Account. All refer to the same thing.

- the broker is *insolvent*; and
- the losses are *directly related* to the broker's conduct.

This account is also referred to as the *Real Estate Recovery Fund* and *Consumer Recovery Account*. All refer to the same thing.

The client's recovery is limited to:

- **$50,000** for one transaction; or
- **$250,000** for any one licensee.

The recovery is further limited to the actual losses on the transaction which resulted

from the *broker's fraud. [Bus & P C §§10471 et seq.]*

For example, an owner of income-producing real estate enters into a property management agreement with a broker. Under the property management agreement, the broker collects rents from tenants and arranges for maintenance of the real estate.

The owner gives the broker a cash advance to cover maintenance expenses. The broker deposits the cash advance into their **personal account**.

Tenants pay their rents to the broker in cash, which the broker deposits into their personal checking account. The broker then issues a check from their personal account payable to the owner for all funds due the owner.

The check is rejected by the broker's bank due to insufficient funds. The owner demands the broker to either pay the rents collected and return the cash advanced for maintenance, or account for the funds when they have been disbursed. The broker refuses to account to the owner.

The owner sues the broker and is awarded a judgment for:

- three times the amount of *rents collected* by the broker and not paid to the owner;
- three times the amount of the *cash advanced* for maintenance, as no evidence exists showing the broker expended the funds for the benefit of the owner;
- *pre-judgment interest* at the legal rate of 10% on the rents and cash advanced from the date they were received by the broker;
- *post-judgment interest* at 10% until the judgment is satisfied;
- costs; and
- attorney fees.

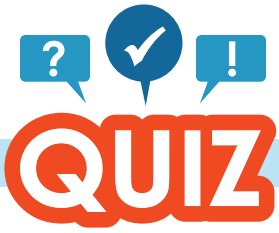
The owner attempts to collect on the judgment but the broker is insolvent.

Can the owner collect all of their money judgment amounts due from the broker for the misuse of trust funds from the *Real Estate Recovery Account*?

No! The owner can only recover their *actual and direct losses* on the transaction from the Recovery Account, up to the sum of $50,000. Thus, the owner's recovery is limited both by the $50,000 ceiling and the actual amount of their lost rents and the cash advanced for maintenance. The tripled amount cannot be recovered from the Recovery Account since the amount exceeds the actual loss inflicted by the broker. [**Circle Oaks Sales Co.** v. **Real Estate Commissioner** (1971) 16 CA3d 682]

Also, no attorney fees award can be recovered from the Recovery Account since attorney fees are not direct losses. [**Acebo** v. **Real Estate Education, Research and Recovery Fund** (1984) 155 CA3d 907]

However, the owner can recover the interest and court costs awarded in the judgment from the Recovery Account as part of the $50,000 maximum recovery. [**Nordahl** v. **Franzalia** (1975) 48 CA3d 657]



1. When an individual obtains a final-court judgment against a licensee and is unable to recover the judgment from the licensee, the individual may be able to recover the funds through the:

   a. broker's errors and omissions (E&O) insurance policy.
   b. real estate recovery account.
   c. Department of Housing and Urban Development (HUD) embezzlement fund.

2. An individual seeking funds from the real estate recovery account is limited to:

   a. $50,000 for one transaction.
   b. $250,000 for any one licensee.
   c. Both a. and b.

Trust Funds: Glossary

A

advance cost sheet 15

An itemization of the costs incurred to properly market a property for sale which are to be paid by the owner.

advance fee 12

A fee paid in advance of any services rendered.

C

commingling 25

The mixing of personal funds with client or third-party funds held in trust.

conversion 6

The unlawful appropriation of another's property, as in the conversion of trust funds.

E

embezzlement 16, 30

The dishonest act of converting a client's assets for personal use.

G

general account 5

A broker or agent's personal or business account, not to be commingled with trust funds.

O

owner's statement 6

An accounting on the status, expenditure and location of negotiable trust funds provided to the owner of those funds.

P

punitive damages **32**

Monies awarded in excess of actual money losses in order to deter unlawful actions.

R

Real Estate Recovery Account **35**

Funds available to individuals who have obtained a final-court judgment against a licensee and are unable to recover the judgment from the licensee. This account is also referred to as the Real Estate Recovery Fund and Consumer Recovery Account. All refer to the same thing.

restitution **31**

Money award given to restore an injured party to the condition they held before being damaged.

S

signer **21**

An employee who has written authorization from the broker to withdraw or disburse funds from the trust account.

subaccount ledger **5**

An accounting document or file identifying the owner of trust funds and the amount held for the owner.

T

trust account **20**

An account separate and physically segregated from a broker's

own funds, in which the broker is required by law to deposit all funds received for clients.

trust funds 1

Items which have or evidence monetary value held by a broker for a client when acting in a real estate transaction.

Ethics: Video™

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Conflict of interest 1

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Professional Relationships Compromised

Conflict of interest

A **conflict of interest** arises when a broker or their agent, acting on behalf of a client, has a competing professional or personal bias which hinders their ability to fulfill the fiduciary duties they have undertaken on behalf of their client.

conflict of interest
When a broker or agent has a positive or negative bias toward a party in a transaction which is incompatible with the duties owed to their client.

In a professional relationship, a broker's financial objective of compensation for *services rendered* is not a conflict of interest.

However, fees and benefits derived from conflicting sources need to be **disclosed** to the client. This includes compensation in the form of:

- professional courtesies;
- familial favors; and
- preferential treatment by others toward the broker or their agents. [See **RPI** Form 119]

Similarly, the referral of a client to a financially controlled business, owned or co-owned by the broker needs to be disclosed by use of an **affiliated business arrangement (ABA)** disclosure. [See **RPI** Form 519]

affiliated business arrangement
A business arrangement in which a broker may lawfully profit from referring a client to a service provider the broker owns. Here, the broker is required to make a disclosure of their ownership interest to the client.

A conflict of interest addresses the broker's personal relationships potentially at odds with the agency duty of care and protection owed the client.

Thus, a conflict of interest creates a fundamental **agency dilemma** for brokers; it is not a compensation or business referral issue.

Unless disclosed and the client consents, the conflict is a breach of the broker's fiduciary duty of good faith, fair dealing, and trust owed to the client when the broker continue to act on the client's behalf.

1. A(n) _____ occurs when a broker or agent has a positive or negative bias toward a party in a transaction which is incompatible with the duties owed to their client.

   a. fiduciary breach
   b. unlawful detainer
   c. conflict of interest

2. A conflict of interest creates a fundamental _____ for brokers.

   a. existential crisis
   b. agency dilemma
   c. moral hazard

Situations Involving a Conflict of Interest

To disclose or not to disclose?

A **conflict of interest**, whether patent or potential, is disclosed by the broker at the time it occurs or as soon as possible after the conflict arises. Typically, the conflict arises prior to providing a buyer with property information or taking a listing from a seller.

The disclosure creates transparency in the transaction. It reveals to the client the bias held by the broker which, when disclosed, allows the client to take the bias into consideration in negotiations. The disclosure and consent does not neutralize the inherent bias itself. However, it does neutralize the *element of deceit* which would breach the broker's fiduciary duty if left undisclosed.

Potential overlaps of allegiance or prejudice which cause a conflict that a broker or their agent need to disclose include:

- the broker or their agent holds a direct or indirect *ownership interest* in the real estate, including a partial ownership interest in a limited liability company (LLC) or other entity which owns or is buying, leasing, or lending on the property;
- an individual related to the broker or one of their agents by *blood or marriage* holds a direct or indirect ownership interest in the property or is the buyer;
- an individual with whom the broker or a family member has a *special pre-*

existing relationship, such as prior employment, significant past or present business dealings, or deep-rooted social ties, holds a direct or indirect ownership, leasehold, or security interest in the property or is the buyer;

- the broker's or their agent's concurrent representation of the opposing party, a *dual agency situation*; or
- an *unwillingness* of the broker or their agent to work with the opposing party, or others, or their brokers or agents in a transaction.

Simply, a **conflict of interest** arises and is disclosed to the client when the broker:

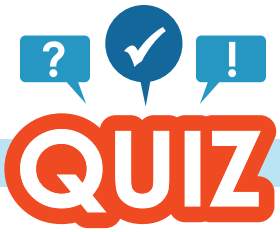
- has a *pre-existing relationship* with another person due to kinship, employment, partnership, common membership, religious affiliation, civic ties, or any other socio-economic context; and
- that relationship might hinder their *ability to fully represent* the needs of their client.

Unfortunately, comprehensive rules do not yet exist which establish those instances where a conflict of interest arises and needs to be disclosed. [See **RPI** Form 527]

Thus, brokers are left to draw their own conclusions when situations regarding a property or a transaction with or involving third-parties arise. In practice, brokers, and especially agents, all too often err on the side of nondisclosure, putting their brokerage fee, if not their license itself, at risk. [Calif. Business and Professions Code §10177(o)]

Generally, if a broker even questions whether it is appropriate to disclose a potential conflict of interest to a client, they should disclose it. The existence of any concern is reason enough for a prudent broker to be prompt in seeking their client's consent to the potential conflict. By timely disclosing a conflict of interest and obtaining consent, the broker immediately creates an honest working relationship with their client.

Fundamentally, a broker who becomes aware they have a conflict of interest, but is reluctant to disclose it and seek the client's consent, is advised to consider rejecting or terminating the employment with that individual.



1. Timely disclosure of a conflict of interest:
   a. neutralizes the inherent bias itself.
   b. neutralizes the element of deceit which would breach the broker's fiduciary duty if left undisclosed.
   c. invalidates the purchase, sale or lease.

2. Pre-existing relationships which may present a conflict of interest include:
   a. kinship, employment or partnership.
   b. common membership, religious affiliation or civic ties.
   c. Both a. and b.

Relative's Participation in a Transaction

A relative owns the property sold

A seller's broker needs to disclose their acquisition of any direct or indirect interest in the seller's property. Likewise, the broker also needs to disclose whether a family member, a business owned by the broker, or any other person holding a special relationship with the broker will acquire an interest in the seller's property. [See **RPI** Form 527]

For example, consider a broker's brother-in-law who makes an offer to buy property the broker listed. The purchase agreement states the broker is to receive a fee and that they represent the seller exclusively.

The broker does not disclose to the seller that the buyer is their brother-in-law.

The broker opens two escrows to handle the transaction. The first escrow facilitates the sale and transfers the property from the seller to the broker's brother-in-law.

The second escrow is for the sole purpose of transferring title to the property from the brother-in-law to a limited liability company (LLC) in which the broker holds an ownership interest. Both escrows close and the broker receives their fee.

The seller discovers the buyer was their broker's brother-in-law and the true buyer was an entity partially owned by the broker. The seller demands a return of the brokerage fee, claiming the broker had a conflict of interest which breached the fiduciary duty they owed to the seller since it was not disclosed and the seller did not consent.

In this instance, the broker is not entitled to retain the brokerage fee they received from the seller. Further, the seller is entitled to recover any property value at the time of the sale in excess of the price they received. Alternatively, the seller may set the sale aside due to the failure of the broker's agency with the seller and the conflict of interest with the buyer.

A broker cannot act for more than one party in a transaction, including themselves, without disclosing their **dual agency** and obtaining the **client's consent** at the time the conflict arises. [Bus & P C §10176(d); see **RPI** Form 117]

dual agency
The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction.

Also, a seller's broker has an affirmative duty to disclose to the seller their agency or other conflicting relationship they might have with the buyer. The duty to disclose exists even if the seller fails to inquire into whether the broker has a relationship with the buyer.

Further, failure to disclose a broker's personal interest as a buyer in a transaction when they are also *acting as a broker* on behalf of the seller constitutes grounds for discipline by the Real Estate Commissioner. [**Whitehead** v. **Gordon** (1970) 2 CA3d 659]

Disclosure of a direct or indirect interest

A buyer's broker needs to disclose to the buyer the nature and extent of any direct or indirect interest the broker or the broker's agents hold in any property presented to the buyer.

For example, a buyer's broker shows the buyer several properties, one of which is owned by the broker and others, vested in the name of an LLC. The broker does not inform the buyer of their indirect ownership interest in the property.

The buyer later decides to purchase the property owned by the LLC. An offer is prepared on a purchase agreement with an agency confirmation provision stating the broker is the agent for both the buyer and seller. The offer is submitted to the LLC. [See **RPI** Form 159]

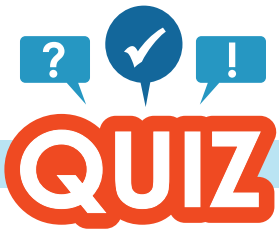
The broker, aware the buyer will pay a higher price for the property than the initial price offered by the buyer, presents the buyer with a

counteroffer from the LLC at a higher selling price. The buyer accepts the counteroffer.

Here, the broker has a duty to promptly disclose their ownership interest in the property to the buyer the moment the conflict arises. The conflict of interest in the broker's ownership is a **material fact** requiring disclosure since the buyer's decisions concerning acquisition of the property might be affected.

As a result of the nondisclosure, the buyer can recover the fee received by the broker and the increase in price under the counteroffer.

Had the buyer known the broker held an ownership interest in the property when it was first presented, the buyer might have negotiated differently when setting the price and terms for payment. Alternatively, the buyer may have retained a different broker who was not compromised by a conflict of interest.



1. An agent or broker representing a seller needs to disclose whether a family member or a(n) _____will acquire an interest in the seller's property.

   a. a business owned by the broker
   b. any person holding a special relationship with the broker
   c. Both a. and b.

2. Failure to disclose a broker's personal interest as a buyer in a transaction when they are also acting as a broker on behalf of the seller:

   a. is acceptable so long as the broker timely discloses the conflict of interest after the close of escrow.
   b. constitutes grounds for discipline by the Department of Real Estate (DRE).
   c. is an example of implicit bias.

Conflicts of Interest when Acting as a Principal

Taking a fee when acting as a principal

A broker acting solely as a **principal** in the sale of their own property is not restricted in their conduct by compliance with agency obligations. The broker selling or buying property for their own account acts solely as the *seller* or *buyer*. The licensee has no conflict due to the existence of their license since they are not holding themselves out as a broker or agent acting on behalf of another person in the transaction. [**Robinson** v. **Murphy** (1979) 96 CA3d 763]

However, when a *broker-seller* receives a brokerage fee on the sale of their own property, or on the purchase of their own property, the broker subjects themselves to real estate agency requirements.

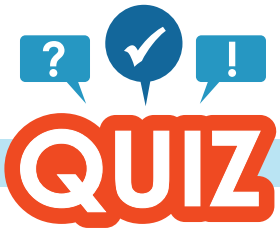
For example, a broker sells their residence. The residence is in violation of safety requirements for occupancy due to known defects in the foundation. The broker does not tell the buyer about the foundation defects.

Out of the proceeds the broker receives on closing the sale of the property, the broker-seller pays themselves a brokerage fee, claiming to *exclusively represent themselves* (which is not an agency and does not require a license).

The buyer later discovers they have to demolish the residence and rebuild it with an adequate foundation. The buyer obtains a money judgment against the broker for breach of their general agency duty owed to all parties in a real estate transaction to disclose known property defects.

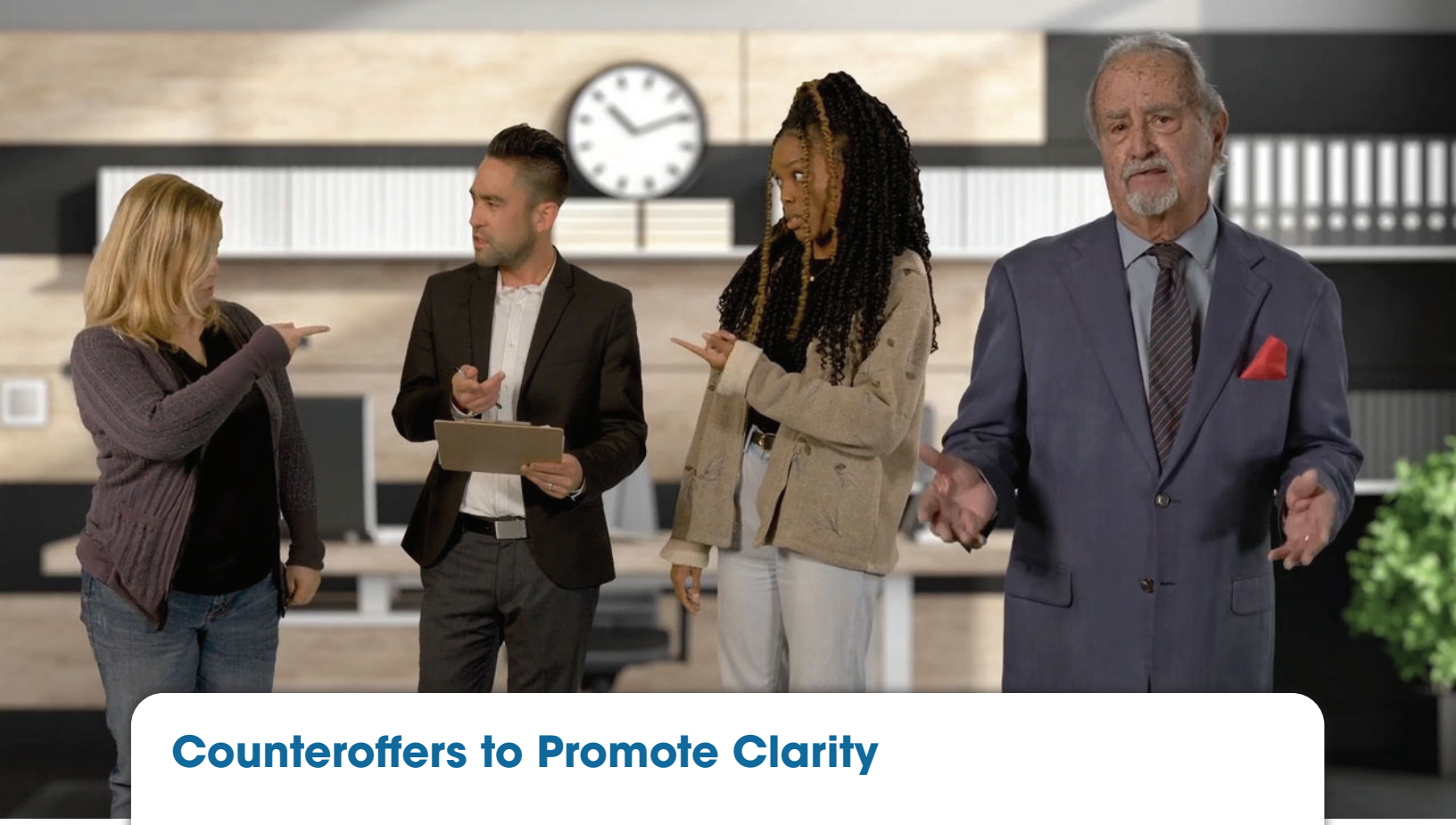
The broker is unable to pay the money judgment. The buyer seeks payment from the **Real Estate Recovery Account**.

Recovery is received from the *Real Estate Recovery Account* since the broker held themselves out as *acting as a real estate* broker in the transaction by receiving a fee. The broker's license is then suspended. Before the broker can reactivate their license, they need to reimburse the Recovery Account. [**Prichard** v. **Reitz** (1986) 178 CA3d 465]



1. When a broker sells their own property and receives a brokerage fee on the sale, the broker:

   a. is acting solely as a principal.
   b. immediately subjects themselves to real estate agency requirements.
   c. Neither a. nor b.



Counteroffers to Promote Clarity

Defacing a previously signed document

A broker or agent may not alter a document once it is signed without that party's prior consent.

Consider a broker who submits an offer to the seller which has been signed by a buyer. The seller is unwilling to accept all the terms contained in the offer. However, the seller will agree to sell if the buyer concedes to a larger down payment, a greater interest rate on the carryback note and a shorter escrow period.

The buyer's broker strikes out the down payment amount, the interest rate and the escrow period entries on the purchase agreement form signed by the buyer. The seller's changes are then entered by *interlineation* to replace the original entries. This activity is called **defacing**.

defacing
When a document is modified on its face, usually by striking copy and interlineation, after it is signed by one or both parties.

The seller signs the form where it provides for the seller's signature, and initials and dates all the changes, an improper technique referred to as *change and initial*.

The original offer as altered on its face is then presented to the buyer for their approval. The buyer is to indicate approval by also initialing and dating the changes to form a binding agreement.

Counteroffers: prepared for clarity

This altering of a signed document is *improper practice*. The broker needs to prepare, and have the seller sign, a separate **counteroffer** form containing the changes. The *counteroffer* is then presented to the buyer for consideration and acceptance. [See **RPI** Form 180]

counteroffer
An alternative response to an offer received consisting of terms different from those of the offer rejected.

Here, "acceptance" by the seller of the buyer's offer by signing and altering a purchase agreement offer submitted by a buyer was not an acceptance at all. The alterations written on the buyer's offer constituted a *rejection* of the buyer's offer.

Any counteroffer arrangement constitutes a *new offer*. Good brokerage practice requires a new offer be presented on a separate form. By using a separate counteroffer form, the broker promotes clarity for interpreting just what has been agreed upon in the event of a dispute. More importantly, *defacing* of a signed document is avoided. [See **RPI** Form 180]

The change-and-initial method of preparing a counteroffer often creates uncertainty as to when and who placed which terms in the agreement. Further, the agreement is interpreted against the individual creating the uncertainty, typically the seller who countered by defacing and initialing a signed original document. [Calif. Civil Code §1654]

A counteroffer may be made when the original offer submitted is not acceptable and is either:

- rejected; or
- allowed to expire unaccepted.

A *rejection* can occur by a written rejection stating no counteroffer is forthcoming. It may also be rejected by submitting a *counteroffer* which is an alternative set of terms to the original offer. After a rejection has been communicated, the original offer can no longer be accepted to form a binding agreement. [See **RPI** Form 184]

The rejection on receipt of a purchase agreement offer by preparing and submitting a counteroffer takes place in one of two circumstances:

- by incorporating the terms in the offer into a new offer which is then modified with alternative or additional provisions on the counteroffer form; or

- by preparing an entirely *new offer* on a newly prepared purchase agreement form which is submitted as a counteroffer. [See **RPI** Form 150]

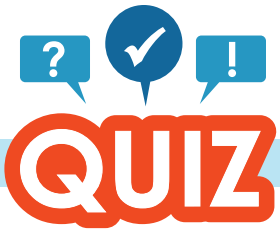
Analyzing the counteroffer form

The counteroffer form has four sections, each with a separate purpose explained as follows:

- *Reference to prior offer*: The purpose of a counteroffer is to reference a prior written offer and state the terms and conditions contrary or in addition to those in the original offer which are agreeable to the party countering.
- *The agreement offered*: The offer submitted and rejected by a counteroffer has all its terms and conditions "incorporated" into the counteroffer. Terms which are additional to or in conflict with those of the prior offer are then entered on the counteroffer to create the terms and conditions of the new offer. Any terms in conflict with the terms of the original offer override and become the terms of the counteroffer.
- *Time for acceptance*: The counteroffer expires at the time and on the date stated for expiration. When no specific date is given, a reasonable time to accept is permitted, unless the counteroffer is first withdrawn.
- *Signatures*: The transaction participant making the counteroffer signs and dates the offer. The brokers sign the counteroffer only to acknowledge their participation in the negotiations. [See **RPI** Form 180]

The rules for preparing and submitting a counteroffer, and those for accepting a counteroffer to buy and sell real estate, are the same rules applied to determine whether an offer made by a seller has been submitted to the buyer or an acceptance by the buyer has occurred to form a *binding agreement*.

Real estate agents instinctively consider submitting written offers from a buyer to a seller to comply with the rule requiring a written agreement, signed by the buyer and seller to form a real estate agreement. Likewise, they need to **automatically submit** written counteroffers from sellers to buyers when the seller will not accept all aspects of the buyer's offer. [See **RPI** Form 180]



1. _____ occurs when a document is modified by striking copy or interlineation after it is signed by one or both parties.

   a. Defacing
   b. Defilement
   c. Constructive fraud

2. An alternative response to an offer received consisting of terms different from those of the offer rejected is referred to as a(n):

   a. aultimatum.
   b. counteroffer.
   c. dual offer.

Property Related Disclosures

General duty to voluntarily disclose

A broker and their sales agents are to disclose the *physical nature* and *condition* of a property when first providing property information to individuals interested in making an offer to purchase. Thus, brokers and agents have a duty to **timely disclose** to all parties involved in a real estate transaction any significant physical aspects of a property that may affect the property's market value or the buyer's decision to purchase.

A broker has a **general duty** to all parties in any type of sales transaction to disclose to buyers at the earliest possible moment their awareness of any property defects. The duty to disclose known conditions on one-to-four unit residential property requires the seller's broker to provide prospective buyers or their agents with the seller's **Transfer Disclosure Statement (TDS)**. [See **RPI** Form 304]

general duty
The duty a licensee owes to non-client individuals to act honestly and in good faith with up-front disclosures of known conditions which adversely affect a property's value.

To be effective, property disclosures including the *TDS* are to be provided to the buyer as soon as practicable – meaning as soon as possible – upon the commencement of negotiations and prior to making an offer. [Calif. Civil Code §§1102 et seq.]

When the disclosures are not timely made, the buyer may:

- *cancel* the offer on discovery of the broker's failure to disclose known defects prior to the buyer entering into a purchase agreement with the seller; or
- close escrow on the purchase and *seek recovery* of the costs to cure the untimely disclosure of known defects.

Any attempt to have the buyer of a one-to-four unit residential property waive their right to the mandated property disclosure statement (TDS) is unenforceable. [CC §1102]

Special fiduciary agency duty

A seller's broker and their agents have a special **fiduciary duty**, owed solely to a seller who has employed the broker, to diligently market the listed property for sale. The objective of this employment is to locate a prospective buyer who is ready, willing and able to acquire the property on the listed terms.

fiduciary duty
The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

On locating a prospective buyer, either directly or through a buyer's agent, the seller's agent owes the prospective buyer, and thus also the buyer's agent, a limited, non-client *general duty* to voluntarily provide critical factual information on the listed property, collectively called disclosures of **material facts**.

material fact
Information about a listed property which may affect the property's value or alter a client's decision to purchase or sell the property. Thus, all material facts need to be timely disclosed.

What is limited about the duty is not the extent or detail to which the seller's agent may go to provide information, but the **minimal quantity of fundamental information** and data about the listed property which the seller's agent will hand to the prospective buyer or the buyer's agent before the seller enters into a purchase agreement.

The information disclosed by the seller's agent need only be sufficient enough in its content to place the buyer on *notice of facts* which may have an adverse effect on the property's value or interfere with the buyer's intended use.

Transparency as public policy objective

In California's public policy pursuit of transparency in property information between sellers and buyers, the disclosure obligations of the seller's agent to voluntarily inform prospective buyers about the fundamentals of the listed property act to eliminate asymmetry and power relationships in sales transactions.

The seller's agent may not:

- deliver up less than the minimum level of information to put the buyer on notice of the property's fundamentals affecting value;
- give unfounded opinions or deceptive responses in response to inquiries; or
- stifle inquiries about the property in a vigorous pursuit of the best financial advantage possible for the seller (or the seller's broker).

1. When property disclosures are not timely made, the buyer may:
   a. cancel the offer on discovery of the broker's failure to disclose known defects prior to the buyer entering into a purchase agreement with the seller.
   b. bclose escrow on the purchase and seek recovery of the costs to cure the untimely disclosure of known defects.
   c. Either a. or b.

2. Information about a listed property which may affect the property's value or alter a client's decision to purchase or sell the property are classified as:
   a. material facts.
   b. cosmetic factors.
   c. opinions.

The Broker's Unlawful "As-Is" Sale

All property conditions disclosed – always

Consider a seller's agent who is aware the seller's residence fails to conform to building regulations. The defect, if known to a buyer, would likely affect the price they are willing to pay. The defect is a material fact.

The broker knows the buyer who is interested in making an offer is not aware of the violations and might reconsider the price they are willing to pay for the property if they learn of the violations. The broker decides not to disclose their knowledge of the defect.

In an attempt to cover the omission, the broker writes an **"as-is" clause** into the purchase agreement. The "as-is" disclaimer states the buyer accepts the property in its current "as-is" condition.

"as-is" clause
An unenforceable provision stating the buyer accepts the property without a full disclosure of known conditions. Properties are sold "as-disclosed," never "as-is."

After the buyer acquires the property, the city refuses to provide utility services to the residence due to the building violations.

The buyer demands their money losses from the broker, claiming the broker breached their general agency duty to disclose conditions of the property known

to the broker before the buyer agreed to purchase.

The broker claims the buyer waived their right to collect money damages when they signed the purchase agreement with the "as- is" disclaimer.

Does an "as-is" disclaimer shield the broker from liability for the buyer's losses caused by the building violations?

No! The seller's broker has a *general duty* owed to all parties to a transaction. The general duty requires the seller's broker to disclose all property conditions known, or ought to have been known, to the seller's broker due to their mandated inspection that affect the value and marketability of the property. The duty is not excused by writing an "as-is" disclaimer into the purchase agreement in lieu of making the factual disclosures before an agreement is entered into with the seller. [**Katz v. Department of Real Estate (1979) 96 CA3d 895]**

A broker and their agents need to advise a prospective buyer or tenant of any known *material facts that may affect the value or desirability of the purchased or rented property*.

Four categories of conditions contribute to or detract from the value of property:

- *physical condition of soil and improvements;*
- *land use and title conditions;*
- *operating income and expenses; and*
- *location hazards and surrounding area impact.*

Marketability disclosure

Consider a buyer who seeks property for investment purposes. The broker recommends an apartment complex as the source of spendable income and equity buildup for the buyer.

The broker analyzes the suitability of an income property which is for sale by preparing an **Annual Property Operating Data Sheet (APOD)** and reviewing it with the buyer. [See **RPI** Form 352]

However, the property's scheduled rental income is represented to be far greater than the actual income. Additionally, the broker represents the property is in excellent physical condition. However, the property requires extensive renovation due to deferred maintenance.

The broker makes these representations based on information received from the seller. The broker does not investigate maintenance, expense, and income records of the property to check the accuracy of the seller's representations. Further, the broker does not advise the buyer the seller is the source of the property information.

At the urging of the seller, the buyer is dissuaded from inspecting the property by the broker.

Relying solely on the broker's representations as to the operating income and condition of the property, the buyer purchases the property.

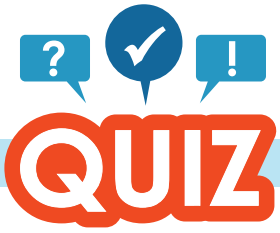
After closing, the buyer realizes the operating income is far less than the scheduled income stated on the property operating statement. The buyer discovers tenants are delinquent in the payment of rent and incurs extensive deferred maintenance expenses. These conditions collectively reduce the projected net spendable income, and in turn the property's *market value*.

Eventually, the buyer defaults and loses the property in foreclosure.

A broker marketing property as an income-producing investment owes a duty to a buyer to research and disclose whether the property produces *adequate income* to meet expenses.

Alternatively, the broker may include a contingency provision in the purchase agreement calling for the buyer to confirm the representations or cancel the agreement prior to closing.

Brokers cannot merely pass on statements made by the seller as to the property's condition and income and expenses generated by the property without first reviewing them for apparent inaccuracies. When property information is passed on to others, the broker needs to advise them about the source of the information and any known need for further investigation into their accuracy. Thus, the broker is liable to the buyer for the buyer's lost property value. [**Ford** v. **Cournale** (1973) 36 CA3d 172]



1. A provision which states the buyer accepts the property without a full disclosure of known conditions is known as a(n):

   a. as-is clause.
   b. liar clause.
   c. conflict of interest disclosure.

2. The seller's agent's general duty to the buyer _____ by writing an "as-is" disclaimer into the purchase agreement in lieu of making the factual disclosures before an agreement is entered into.

   a. is excused
   b. is not excused
   c. is legally avoided

The Borrower and Mortgage Broker Relationship

The accurate representation of mortgage terms

The *essential terms* of a mortgage are to be disclosed to the borrower by a broker soliciting or arranging a mortgage.

For example, consider a real estate broker who advertises they can arrange mortgages with a low monthly payment schedule — a "bait and switch" advertising trick, as mortgages of the type advertised are not really available. A borrower, seeking a mortgage with the low payment schedule advertised by the broker, retains the broker to perform these services.

The borrower asks specific questions of the broker concerning the interest rate, late charges, due date, the final balloon payment and mortgage closing costs.

The broker tells the borrower the balloon payment will be "small." The broker further misrepresents the probable interest rate and the day of the month on which late charges are incurred. The broker provides the borrower with "approximations" of the closing costs that are significantly lower than the actual closing costs. The broker also fails to accurately disclose other important mortgage aspects, such as that the monthly payments are interest only, or that late charges are equal in amount to the monthly interest payment.

Further, the **financial disclosure** statement the broker prepares and hands to the borrower is lengthy and contains complex wording. Rather than reading the

disclosure statement, the borrower relies on the broker's oral representations and signs the mortgage documents.

On closing, the borrower ends up with a mortgage with less favorable terms than verbally represented by the broker. The borrower incurs additional and unexpected expenses, such as high late charges, an early due date and graduated monthly payments. The additional expenses ultimately create an excessive financial burden for the borrower. The borrower defaults on the mortgage and the secured property is sold at a foreclosure sale.

Later, the borrower discovers the broker was aware of the actual mortgage terms and costs for origination before the borrower signed the mortgage documents.

Here, the broker's failure to disclose the actual interest rate, the exact amount of the late charge, the size of the balloon payment and the actual closing costs breached the broker's **agency duty** owed to the borrower.

The borrower can recover all their money losses caused by the broker's misrepresentation and for failing to discuss important provisions in the mortgage documents. [**Wyatt** v. **Union Mortgage Company** (1979) 24 C3d 773]

As the borrower's broker arranging a mortgage, a licensee needs to fully and accurately disclose all **essential facts** of the mortgage transaction which may affect the borrower's decision to participate in the transaction. [Calif. Business and Professions Code §§10130, 10131(d), 10176(a), 10176(i)]

The broker's duty to disclose, and their obligation to deal fairly with borrowers, commences on their first contact with prospective borrowers to solicit employment. Thus, the broker will disclose essential facts before entering into a listing agreement. [**Realty Projects Inc.** v. **Smith** (1973) 32 CA3d 204]

Even after the broker is employed as the agent of the borrower, their duty to disclose and provide accurate representation is not completely fulfilled by merely providing the mortgage documents to the borrower. The provisions in the documents need to be *discussed with the client* to ensure the client has an understanding sufficient to make a well-informed decision regarding the mortgage. [Bus & P C §10241]

Mortgage broker solicitation of a mortgage borrower

Mortgage borrowers and holders of trust deed notes frequently retain the services of a broker to represent them. The service they render is to locate a lender or trust deed investor who will make a mortgage or buy or lend on a trust deed note.

Typically, the mortgage broker solicits these borrowers and note holders seeking to represent them by locating institutional or private money lenders or investors and arranging the financing sought. When soliciting employment as a mortgage

broker, the broker may not represent the existence of a willing lender when one does not exist.

Consider a real estate owner who contacts a broker to arrange a trust deed mortgage.

The owner informs the broker of their desired mortgage terms. The broker is asked if they know of a lender willing to originate such a mortgage. The broker does not now know of a lender who would be willing to make the mortgage sought by the owner, but states they can arrange funding for this type of mortgage.

Based on these representations, the owner enters into a mortgage broker listing with the broker. [See **RPI** Form 104]

The broker's attempts to locate a lender are unsuccessful.

The owner later discovers the broker never knew of a real estate lender who would originate a mortgage on the borrower's terms. The owner files a complaint with the California Department of Real Estate (DRE), claiming the broker had a duty to honestly represent the fact that no lenders were known by the broker who made mortgages on the terms sought at the time the owner employed the broker.

The broker's false claim that a lender existed is cause for the DRE to revoke or suspend the broker's license. [Bus & P C §10177(d)]

Also, the broker may be fined up to $10,000, imprisoned up to six months or both. [Bus & P C §10185]

No "free services" under a listing

"Free" is a word commonly exploited in sales promotions to induce a buyer to believe they will receive something without paying for it, usually an extra portion of the product sought. However, there are rarely "free lunches" as most everything "free" comes with a cost.

A specific service rendered by a broker or agent which contributes to arranging a transaction may not be represented as provided "free" when the broker will be compensated by way of receiving a fee on closing the transaction.

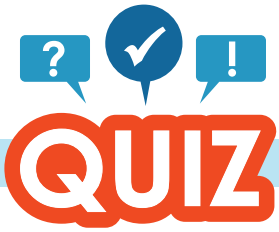
For example, consider a broker who wants to induce a seller to enter into an *exclusive right-to-sell listing* to employ the broker and their agents to market the property and locate a buyer.

The broker offers "free advertising" in the marketing of the seller's real estate, without any charge of the cost to the seller. Believing the advertising incentive is an extra service or a cost normally charged separately from the broker fee, the seller enters into an exclusive listing agreement with the broker. No other broker offers this service for "free," giving this broker a competitive advantage.

However, a seller's broker is duty bound to advertise the seller's property no matter who is to pay the advertising costs, whether the broker or seller. Advertising is part of the *due diligence* imposed on a broker to take all reasonable steps to locate a buyer when employed under an exclusive right-to-sell listing.

Thus, the broker, by use of the "free advertising" gimmick, has represented an activity as free that a diligent broker is *obligated to provide* for a client – again, no matter who agrees to pay for it. The advertised activity is not free, but is offered in expectation of receiving compensation under the listing – when a buyer is located through advertising. [**Coleman** v. **Mora** (1968) 263 CA2d 137]

The broker's bargain under an exclusive listing agreement consists of fulfilling one essential duty — the diligent pursuit of their client's real estate goals. Advertising is a fundamental and integral part of this duty. Thus, the broker cannot represent as "free of charge" a brokerage activity normally performed in a transaction on which they are to be paid a fee.



1. A mortgage broker needs to fully and accurately disclose _____ of a mortgage transaction which may affect the borrower's decision to participate in the transaction.

   a. only minimal details
   b. only the most critical elements
   c. all essential facts

Kickbacks as a RESPA Violation

Duplicate charges for services

When property prices rise, **kickbacks** in real estate sales become infectious.

> **kickback**
> A fee improperly paid to a transaction agent who renders no service beyond the act of referring when the transaction agent is already providing another service in the transaction for a fee.

Although kickbacks, often in the form of **referral fees**, were banned by the *Real Estate Settlement Procedures Act (RESPA)* in 1974, they remain under the radar in many forms and for many reasons. In fact, they continue to be one of the most pervasive RESPA violations.

Referral fees become unlawful kickbacks when received by a broker or agent who negotiated a fee-generating home sale when that broker or agent renders no service to the other provider in exchange for the referral fee beyond the referral. Referral fees of the kickback variety are improper and attack the efficiency of the real estate market. Worse, kickbacks increase the *cost of doing business*, the cost of which is always passed on to buyers and sellers in the sales transactions.

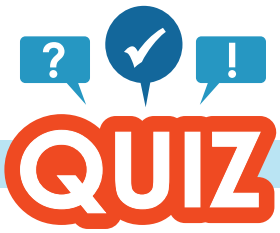
Kickbacks absolutely result in the elimination of better and cheaper competition.

Instead of being directed by agents to legitimate lenders, escrows, title insurers or other types of third-party service providers, buyers are referred to those businesses providing kickbacks to the broker or agent.

Kickbacks to brokers and agents representing sellers and buyers in a home sales transaction are openly undertaken in an unlawful effort by a third-party service provider to garner a larger share of the available business. This is a corrupting business policy. Legitimate operators find it difficult, if not impossible, to compete with fraud without themselves stooping to the same corrupt kickback practices.

Any person who violates RESPA may be fined up to *$10,000 or imprisoned* for up to one year, or both.

RESPA violators are liable, to the person charged for the settlement service, for three times the amount paid for the settlement service. In addition, RESPA violations are often combined with other private lawsuit claims such as antitrust violations, exposing violators to additional civil liability. [12 United States Code §2607(d)]



1. Kickbacks were prohibited in 1974 under the

   a. Real Estate Settlement Procedures Act (RESPA).
   b. Equal Credit Opportunity Act.
   c. The Housing Financial Discrimination Act.

2. A(n) _____ is a fee paid to an agent who renders no service in exchange for a referral fee beyond the referral itself when the agent is already providing another service for a fee.

   a. discount
   b. refund
   c. kickback

RESPA Controls Indirect Kickbacks

Indirect kickbacks from third-party service providers

The mere *referral-steering* of a client is not a **service** rendered in exchange for a kickback, but is already a service owed the client to care for, protect and give them advice in the sales transaction.

Any payment between brokers or agents and third-party service providers, over and above the fee received from the seller on the sales transaction, may only be received in exchange for performing a *significant portion* of the services rendered by the provider paying the agent an additional fee. However, brokers and agents rarely perform services on behalf of service providers beyond the referral (which was done on behalf of the client, not the provider), and therefore cannot receive a referral fee – the **kickback**.

Referral fees are not the only form of kickback which violate RESPA.

Indirect kickbacks commonly provided by third-party services in exchange for referrals from brokers and agents include:

- entry into a "referral contest" drawing for referring a lead;
- paying for sporting events or theater tickets;
- throwing a party for anyone who referred business;
- paying the admission to a real estate seminar/education;

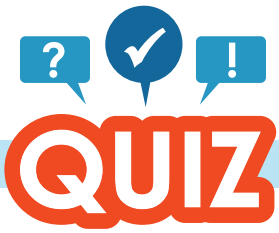
- paying for real estate listing advertising; and
- paying for subscriptions to 800 numbers and call-capture numbers.

However, promotional and educational activities are allowed when:

- they are not conditioned on the referral of business; and
- they do not involve the payment of expenses (rent, IT services, supplies, equipment, etc.) incurred by a broker or agent in a position to refer business. [12 Code of Federal Regulations §1024.14(g)(vi)]

Another classic example of kickbacks is found in so called "*closed offices*," where brokers ban third-party service providers from competing legitimately for business with their one chosen service provider – their "preferred" lender or title insurer.

In addition, lenders may not pay a fee to a real estate broker representing a principal in the sale the lender is to finance, unless the broker has performed a significant service on behalf of the lender. For instance, a broker may receive a second fee, the so-called *referral fee*, if they render significant mortgage origination services.



1. Indirect kickbacks commonly provided by third-party services in exchange for referrals from brokers and agents include:

   a. throwing a party for anyone who referred business.
   b. paying for real estate listing advertising.
   c. Both a. and b.

Referral Fees Between Brokerages

Permitted compensation for a referral

Referral fees are allowed between two brokers when the broker receiving the referral fee is not providing another service in the home sales transaction such as financing, insurance, escrow, etc.

referral fee
A fee paid by one service provider to another for referring a client to them. Referral fees are prohibited by the Real Estate Settlement Procedures Act (RESPA) when consumer financing funds the purchase of one-to-four unit residential property.

Compensation for a referral permitted by or between brokers under RESPA includes:

- payments to the buyer's broker by the seller's broker, and referral arrangements between real estate agents and brokers;
- payment to any person of a bona fide salary or compensation or other payments of goods or facilities actually furnished or for services actually performed; and
- an employer's payment to its own employees for any referral activities. [Calif. Business & Professions Code §10177.4; 12 USC §2607]

However, brokers and agents need to adhere to specific California Department of Real Estate (DRE) rules and codes when paying or accepting referral fees from other brokers or agents.

Agents are prohibited from accepting a fee or other benefit from *any person other than their employing broke*r. Agents are also forbidden from paying a fee to any other broker or agent without first directing the payment through the agent's employing broker. [Bus & P C §10137]

Most importantly, as a *fiduciary* matter, brokers and their agents need to advise their clients of the dollar amount of any compensation received from service providers related to the real estate transaction in which their client is involved. If the compensation (monetary or otherwise) is not disclosed, agents and their employing broker are subject to their client recovering all fees received, as well as license suspension or revocation. [See **RPI** Form 119]

Fees prohibited by RESPA cannot be legalized by disclosure or consent of the client. [Bus & P C §10176(g)]

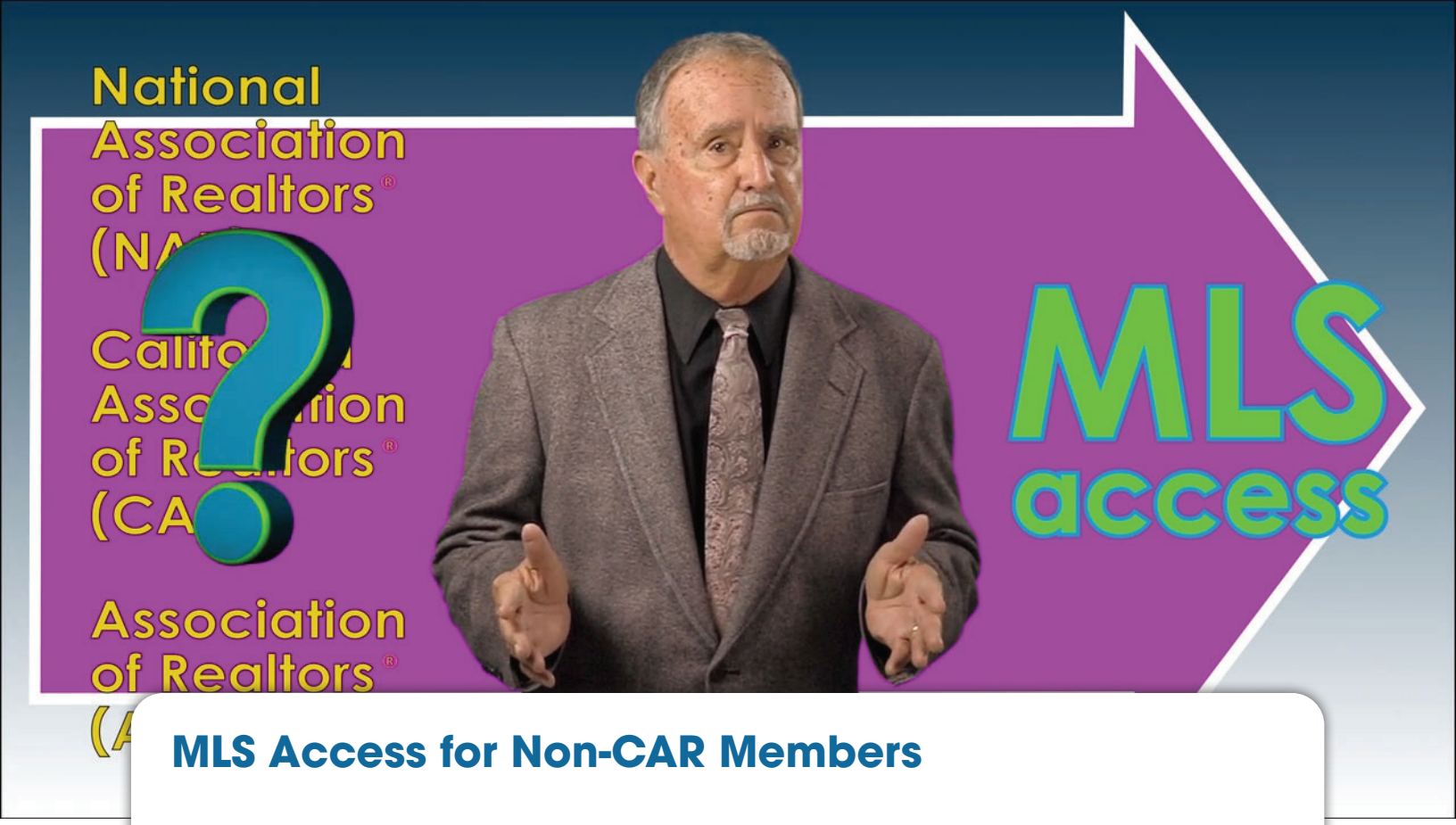
Bottom line: referral fees are prohibited between brokers and third-party providers with one exception. In order for a broker or agent to receive a referral fee when they are receiving a fee on a home sales transaction, a *tangible service besides the referral* needs to be performed for the business paying the referral fee.

1. Agents are prohibited from accepting a fee or other benefit from any person other than:

   a. their employing broker.
   b. their client.
   c. Either a. or b.

2. Fees prohibited by the Real Estate Settlement Procedures Act (RESPA):

   a. cannot be legalized by disclosure or consent of the client.
   b. can be legalized, so long as the client knowingly consents to the fee in writing.
   c. are only collectable if they are not challenged by the client or the agent's employing broker.



MLS Access for Non-CAR Members

Association membership cannot be a prerequisite to MLS access

Many real estate licensees wrongly believe they need to join the *National Association of Realtors® (NAR), the California Association of Realtors® (CAR) or the local Association of Realtors ®(AOR)* branch of CAR to practice real estate in California. Licensees all too often equate these trade union leviathans to the *Department of Real Estate (DRE)* due to their past close liaison via past Real Estate Commissioners.

Other licensees have a slightly better grasp on the implications of membership or non-membership in the real estate trade union versus DRE licensing to protect members of the public. Still, many brokers and agents mistakenly believe that union membership is necessary in order to access their local MLS.

This impression is not unfounded. Before 1976, most real estate trade union boards owned and required all access to the **MLS** to bundle into membership in their association. Such practice was prohibited in 1976. [**Marin County Board of Realtors, Inc.** v. **Palsson** (1976) 16 C3d 920]

Association membership cannot be a prerequisite to MLS access.

However, an association is allowed to exact a "reasonable fee" from nonmembers for MLS access. Yet, the bundling continues with the AORs claiming ownership of data generated by all the published listings, giving access only to their card-

carrying members.

To access an AOR-owned MLS, an individual needs to:

- have a valid California real estate license;
- be a broker, or a sales agent under a broker who is a member of the MLS;
- apply for access to the MLS; and
- pay a fee, which varies by AOR.

If an agent's broker is not a member of an AOR, the agent is not required to be a member of an AOR. However, if a broker is a member of an AOR, their agents need to also be members of the AOR in order to access the broker's MLS.

No other restrictions apply. Real estate agents and brokers can continue to access an MLS without paying unnecessary dues or entangling themselves in a trade union's bureaucracy, codes and arbitration rules.

Unlawful MLS price fixing

Consider a group of local real estate trade associations who each operate their own multiple listing service (MLS). Each association provides their own MLS support services to their subscribers. They also set the price for these support services independently, based on cost.

Some are efficient and very successful at providing these services, incurring less than $10 in total costs per subscriber monthly. Others are inefficient and incur costs of $50 per subscriber monthly to provide their MLS support services.

The associations then form a separate corporation in which they are shareholders in order to create and operate a county-wide MLS. The MLS corporation as the new regional MLS independently contracts with each association to provide MLS support services for the subscribers produced by that association.

To assure the continued viability of those smaller associations with disproportionately higher operating costs for their inefficient service, the associations collaborate to set the minimum fee all associations will charge at $25 per subscriber monthly.

The less efficient associations by agreement are paid a fixed monthly

cash subsidy on top of the support services fee paid by the subscribers they generate since those associations are operating at a loss. With the **fee fixed** for services, the efficient associations agree not to charge less and compete to deprive the less efficient associations of subscribers.

When competitive organizations, such as neighboring associations, *join together* to eliminate their separate MLS database operations in favor of a single county-wide MLS which is more effective and efficient, can they then *collude* to set the fee charged for the MLS services each will provide? Further, can they ban any discounting or rebates by the efficient and more competitively operated associations?

The simple answer is no. **Price fixing** is unlawful!

The fee which reimbursed the associations for the cost of their MLS support services cannot be legally set by agreement between the competing associations. This is particularly the case when the larger, more efficient associations received millions of dollars in excess MLS support services fees over the actual cost they incurred to provide those services.

This arrangement provided the large associations with huge financial rewards at the improper expense of their subscribers. [**Freeman** v. **San Diego Association of Realtors** (9th Cir. 2003) 322 F3d 1133]

It was the likelihood that some of the associations would go out of business under an efficient county-wide MLS which led to the price being fixed at a *supracompetitive* and unlawful level. This led to the banning of competitive pricing by each association for providing the MLS subscriber services the brokers need by agreeing to no discounts or rebates to their broker-subscribers.

However, if competition or **economic darwinism** had been properly allowed to occur, the more efficient associations would have brought about the demise of the less productive associations to the financial benefit of all of the MLS users.

1. _____ cannot be a prerequisite to Multiple Listing Service (MLS) access.
   a. Department of Real Estate (DRE) licensure
   b. Payment of a fee
   c. Association membership in a real estate trade union

Ethics: Glossary

A

affiliated business arrangement 2

A business arrangement in which a broker may lawfully profit from referring a client to a service provider the broker owns. Here, the broker is required to make a disclosure of their ownership interest to the client.

"as-is" clause 18

An unenforceable provision stating the buyer accepts the property without a full disclosure of known conditions. Properties are sold "as-disclosed," never "as-is."

C

conflict of interest 1

When a broker or agent has a positive or negative bias toward a party in a transaction which is incompatible with the duties owed to their client.

counteroffer 12

An alternative response to an offer received consisting of terms different from those of the offer rejected.

D

defacing 11

When a document is modified on its face, usually by striking copy and interlineation, after it is signed by one or both parties.

dual agency 7

The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction.

F

fiduciary duty 16

The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

G

general duty 15

The duty a licensee owes to non-client individuals to act honestly and in good faith with up-front disclosures of known conditions which adversely affect a property's value.

K

kickback 26

A fee improperly paid to a transaction agent who renders no service beyond the act of referring when the transaction agent is already providing another service in the transaction for a fee.

M

material fact 16

Information about a listed property which may affect the property's value or alter a client's decision to purchase or sell the property. Thus, all material facts need to be timely disclosed.

R

referral fee 30

A fee paid by one service provider to another for referring a client to them. Referral fees are prohibited by the Real Estate Settlement Procedures Act (RESPA) when consumer financing funds the purchase of one-to-four unit residential property.

Risk Management: Video™

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The Reduction of Uncertainties for Harm

Mitigating uncertainty and risk

Brokers and agents interact amongst themselves and with members of the public. When acting under their California Department of Real Estate (DRE) licenses, brokers and agents act in the capacity of:

- an *advisor* to an individual who has retained the services of a broker to assist in a real estate related transaction; or
- an *agent* dealing with another broker, their agents or a member of the public in an effort to find a match for the individual they represent regarding ownership, financing or the letting of real estate.

These two relationships contain **risks** as addressed in this section. The risk of causing another person a loss is inherent in all activities conducted in the context of agency relationships.

Agency relationships exist as either:

- **special fiduciary duties** owed to the client; or
- **general duties** which are owed to the other party, called the **customer**.

fiduciary duty
The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

general duty
The duty a licensee owes to non-client individuals to act honestly and in good faith with up-front disclosures of known conditions which adversely affect a property's value.

The risks taken by a broker and their agents expose the broker to liability caused by an:

- error;
- omission; or
- misunderstanding brought about by the activities of the broker or their agents.

All acts carried out by a broker or their agents present the possibility that a client or other party will be *injured financially*. This includes investigations, inspections, negotiations, the giving of advice, and the preparation of disclosures and contracts.

It is the risk of causing these losses which the broker needs to control. Risks are best limited by choosing activities which can be conducted with more certainty of a favorable result when relied on by the client or other person in a real estate transaction. Thus, brokers need to maintain a **risk reduction program** to keep claims from clients and others under control.

The five steps necessary to establish a *risk reduction program* are as follows:

1. All activities exposing the broker to liability are **identified** based on whether the activity runs the risk of causing the client or others to be injured financially.
2. Each identified activity is **broken down** into its component parts, i.e., all of the acts and events that comprise the activity, which need to be properly performed to eliminate the risk of causing a loss to a client, others or the broker.
3. An **evaluation** is undertaken into what sorts of loss the client, others or the broker may experience if the broker or their agents undertake the identified activity, or a modified or alternative version of the activity.
4. Brokerage activities are **chosen** and procedures and limitations **adopted** to control the parameters of the agent's conduct when performing those activities, based on whether they provide the level of exposure to liability acceptable to the broker.
5. Agent **compliance** with activities authorized and limited by the broker's policies and procedures are tracked, and ongoing remedial training and dispute resolution for claims made by clients and others are established.

Identify activities requiring management

To initiate an analysis for managing the risk of loss, a broker needs to *identify and list* all the activities agents perform which could potentially be the source of a claim of liability against the broker.

Also, the nature of the services offered by brokers varies by whether the activities are classified as:

- the *sale* of single family residences (SFRs), income property or land;
- the *financing* of purchases, construction or equity; or
- the *leasing* or *management* of residential or commercial property.

Other categories of broker activity are based on their duty owed to the client for the performance of services sought by the client. This includes the actions of a **seller's broker**, such as:

- advising the seller;
- inspecting the listed property;
- collecting data for disclosures;
- marketing the property; and
- negotiating the terms of a sale.

Likewise included are the actions of a **buyer's broker,** such as:

- selecting qualifying property;
- gathering property information;
- confirming the veracity of seller disclosures;
- evaluating the data collected;
- advising the buyer; and
- negotiating acquisitions.

Mortgage broker and leasing agent activities likewise have categories of duties owed to the participants in their real estate transactions.

Other risks of exposure to liability arise out of losses incurred by clients and others when they rely on information provided by their broker but received by the broker from other sources, such as the property owner or third-party inspectors.

Evaluating the uncertainties in each activity

After identifying the type of broker and agent activities which expose the broker to liability, the next step is to break down each activity into all of its essential parts. This process narrows down the acts containing uncertain results that may lead to the client suffering a loss.

The broker needs to determine what it is about a particular activity that could expose the broker to liability or other adverse consequences. This question is to be considered when defining the handling of an activity, such as a diligent visual inspection of property, the preparation of the *Transfer Disclosure Statement (TDS)* or review of an *Annual Property Operating Data (APOD)* sheet. This break down of the identified activity into its component parts becomes the checklist of proper and improper conduct. [See **RPI** Form 304 and 352]

Thus, a client or other person's risk of loss is mitigated or averted completely.

Having created a list of brokerage activities and actions a broker's agents will be engaged in, an **assessment** is then conducted of the adverse consequences the activities might generate which may cause a loss for the client or others.

If it is determined a loss may occur, the significance of the loss needs to be **evaluated** to determine its financial impact on the client or other person – and whether the broker is exposed to liability for the loss. The evaluation process interprets, in terms of probable losses and liability arising out of an error or omission, the impact of risks taken when representing a client.

This evaluation precedes any decision by the employing broker to authorize an activity. Only after the evaluation can a broker logically undertake the risk of their agents performing the service for clients and others.

E and O insurance mitigates risk

As a buffer against liability, a broker can purchase negligence insurance, called **errors and omissions (E&O) insurance**. With the payment of a premium, *E&O insurance* protects brokers from the full cost of defending against a **negligence claim** made by a client or others. Similarly, *auto insurance* can be purchased to

errors and omissions (E&O) insurance
An insurance policy protecting brokers and agents from negligent conduct when acting as a licensee.

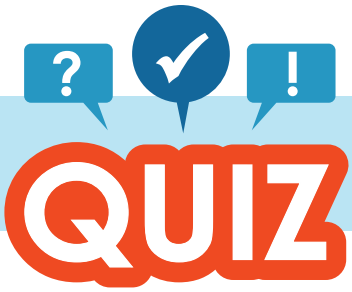
cover liabilities resulting from the agent's use of their vehicle to conduct activities within the scope of the brokerage activities chosen and authorized by the broker for the agent to undertake.

Through both forms of insurance, the liability exposure for professional negligence and the cost of defense are shifted to corporate insurers willing to take on the financial burden of those uncertainties.

Tracking agent compliance with policy

Without an administrative structure to verify the broker's agents are conducting themselves as intended, the broker will be exposed to an unnecessary risk of loss. Thus, continued oversight and policing are put in place to limit unilateral changes, distortions and deviations from agent conduct acceptable to the broker.

Oversight requires the commitment of financial and human resources to report unacceptable conduct, the holding of training meetings, and the maintenance of client files. In a word: *continuing management*.



1. Brokers need to maintain a _____ to keep claims from clients and others under control.

   a. business credit line
   b. risk retention program
   c. risk reduction program

2. As a buffer against liability, a broker can purchase negligence insurance, called:

   a. liability and fraud (L&F) insurance.
   b. theft and auto (T&A) insurance.
   c. errors and omissions (E&O) insurance.

Gathering Facts on Adverse Features

Due diligence by the seller's agent

Consider a broker who enters into an exclusive listing with a seller. The broker's efforts to market the property are limited to placing a "For Sale" sign on the property and publishing property information in the *multiple listing service (MLS)*.

The broker refuses to assist or provide additional information to buyers or their agents, except to make the listed property available for inspection through a lock-box arrangement. Phone calls and emails seeking information about the listed property are not responded to.

The seller's broker does not prepare disclosures or provide a **listing package** regarding the condition of the property and operating costs. The agent also does not obtain a property profile, home inspection report, natural hazard disclosure (NHD) report or pest control report. All these items are left to a buyer's agent to obtain or for a buyer to demand in escrow.

The seller's broker employs a **transaction coordinator (TC)** to prepare documents and obtain the seller's signature as needed — at an extra charge to the seller for the TC's services.

None of these limitations on the marketing services provided by the broker are disclosed to the seller, except for the cost of the TC on closing a sale.

No potential buyers are produced by the agent.

The seller, dissatisfied with the broker's marketing efforts, cancels the listing without the broker's consent. Another broker is employed by the seller to market the property. The property is sold under the new listing, but during the listing period remaining on the cancelled listing.

The original seller's broker makes a demand on the seller for a fee, claiming they are due a fee since the property sold during the original listing period. The seller claims the agent's lack of **due diligence** in marketing the property and locating buyers bars the broker from collecting a brokerage fee.

due diligence
The concerted and continuing efforts of an agent employed to meet the objectives of their client given in exchange for the client's promise to pay a fee.

Is the seller's broker entitled to the fee?

No! The efforts of the seller's broker to market the property and locate buyers were insufficient to entitle the broker to a fee on any sale after the seller canceled the listing for good cause.

When employed under an *exclusive listing agreement*, a broker and their agents are obligated:

- to *inform* the seller about the brokerage services to be rendered; and
- to *diligently perform* the agreed-to services in pursuit of buyers who are ready, willing and able to purchase the listed property.

A concerted, continuing effort to sell

Agents fulfill their **agency duty** owed under an exclusive listing by making a *concerted and continuing effort* to locate a buyer, called a **due diligence effort**. All services are to be performed at a level meeting the owner's *reasonable expectations*. Otherwise, the owner has *good cause* to terminate the agency and cancel the employment under the listing without becoming obligated to pay a fee. [**Coleman** v. **Mora** (1968) 263 CA2d 137]

The *diligent effort* of a broker under an exclusive listing is measured by the conduct and actions taken by the broker and their agents, including:

- *analyzing the property* – a responsibility imposed on the broker or their agent to gather readily **available information** and **adverse facts** about the listed property at the earliest opportunity, before marketing begins. This information is included in a **listing package** handed to prospective buyers [**Jue** v. **Smiser** (1994) 23 CA4th 312]; and

- *marketing the property* – which includes advertising in MLSs or other broker-associated publications, making phone calls, putting up "For Sale" signs, distributing fliers, holding open house, broadcasting the property at pitch sessions, etc.

The agent needs proof they exercised *due diligence* in their analysis and marketing of a property. The best evidence of diligence is provided by keeping detailed records. Records avoid unwarranted cancellation of the listing. Records of all solicitations, contacts, money spent, advertisements placed, buyers contacted, etc., are maintained on worksheets in a physical file separately maintained on the listed property. [See **RPI** Form 520 and 525]

Methods for gathering adverse facts

The methods for gathering *adverse facts* about the property's fundamental characteristics, as required on the sale of a one-to-four unit residential property, include:

- conducting a competent **visual inspection** of the property to observe conditions which may adversely affect its market value. Any observations of adverse conditions are noted on the seller's TDS — if not already noted on the TDS by the seller or inconsistent with the seller's disclosures, regardless of whether a home inspector's report has been obtained by the seller [Calif. Civil Code §2079];
- assuring seller compliance with the **seller's duty** to deliver mandated disclosure statements to prospective buyers as soon as possible. These mandated disclosures cover a variety of routine facts about natural hazards (NHD), the condition of the property (TDS), environment hazards (TDS), Mello-Roos liens, lead-based paint, neighborhood industrial zoning, occupancy and retrofit ordinances, military ordnance locations, condo documents, etc. [See **RPI** Form 304, 314 and 308];
- reviewing and confirming that all the information and data in the disclosure documents received from the seller are consistent with the seller's broker's knowledge, and if not, correct the information and data. Further, if the listing agent has reason to believe information might not be accurate, either investigate and clarify the information, or disclose their uncertainty about the information to the seller and the prospective buyer in the documents;
- advising the seller on **risk avoidance procedures** by recommending the seller obtain third-party inspections of the property's condition and its components (roof, plumbing, septic, water, etc.). Inspections reduce the seller's and their broker's exposure to claims by a buyer who might discover deficiencies in the property, before or after closing, not known to the seller or the seller's broker; and

- **responding to inquiries** by the prospective buyer or buyer's agent into conditions relating to any aspect of the property. Seller's agents are to respond with a full and fair answer of facts known to them which are or might be detrimental to the value of the property. The inquiry itself makes the subject matter a material fact about which the prospective buyer seeks more information before completing negotiations or acquiring the property. Thus, the response of the seller's agent to the inquiry may not suppress further investigation or inquiry by the buyer or the buyer's agent. A contingency provision addressing the subject needs to be included in any purchase agreement or counteroffer entered into by the buyer.

These methods are also used to determine those facts which enhance the property's value.

Information, activities, events and advice

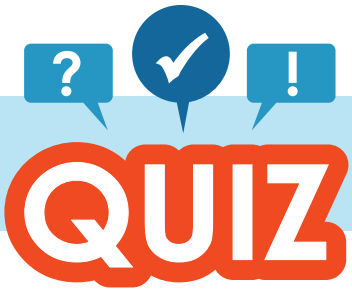
Information to be gathered, activities to be performed, events to be arranged and advice to be given to a seller by a seller's agent when listing and marketing a property for sale include:

1. A **property profile** of the seller's title from a title company reviewed to identify all owners needed to list, sell and convey the property and trust deeds recorded on title.
2. A **condition of property** disclosure sheet, also known as a *Transfer Disclosure Statement*, filled out and signed by the seller and the seller's broker or agent. [See **RPI** Form 304]
3. A **home inspection report** paid for by the seller and attached to the *transfer disclosure statement (TDS)* to shift liability for missed property conditions from the broker to the inspector. [See RPI Form 304]
4. A **natural hazard disclosure (NHD)** on the property from a local agency or a vendor of NHD reports, paid for by the seller, and reviewed and signed by the seller and the seller's broker or agent. [See **RPI** Form 314]
5. An **Annual Property Operating Data sheet (APOD)** sheet covering the expenses of ownership and any income produced by the property, filled out and signed by the seller, together with a **rent roll** and copies of lease forms used by the owner. [See **RPI** Forms 352 and 562]

6. Copies of all the Covenants, Conditions and Restrictions (CC&Rs), disclosures and assessment data from any *homeowners' association (HOA)* involved with the property. [See **RPI** Form 309 and 150 §11.9]
7. A **termite report** and clearance paid for by the seller.
8. Any replacement or repair of defects noted in the home inspection report or on the TDS, as authorized and paid for by the seller.
9. An occupancy **transfer certificate** (including permits or the completion of retrofitting required by local ordinances) paid for by the seller.
10. A statement on the amount and payment schedule for any special district property **improvement bonds** which are liens on the property (these are not property taxes), as shown on the title company's property profile.
11. A **visual inspection** of the property and a survey of the surrounding neighborhood by the seller's broker or agent to become informed about readily available facts affecting the marketability of the property.
12. **Advising** the seller about the marketability of the listed property based on differing prices and terms for payment of the price, and for property other than one-to-four residential units, the financial and tax consequences of various sales arrangements which are available by using alternative purchase agreements, options to buy, exchange agreements and installment sales.
13. A marketing (listing) package on the property compiled by the seller's agent and handed to prospective buyers or buyer's agents before the seller accepts any offer to purchase the property, consisting of copies of all the property disclosures, required or volunteered, to be handed to prospective buyers or the buyer's agent by the seller and seller's broker.
14. A **marketing plan** prepared by the seller's agent and reviewed with the seller for locating prospective buyers, such as by distributing flyers, disseminating property data in the MLS, newspapers and periodicals, broadcasts at trade meetings attended by buyer's agents, press releases to radio or television, internet sites, posting "For Sale" signs on the premises, hosting open house events, posting on bulletin boards, mailing to neighbors and using all other

advertising media available to reach prospective buyers.

15. A **seller's net sheet** prepared by the seller's agent and reviewed with the seller each time pricing of the property is an issue, such as when obtaining a listing, changing the listed price, reviewing the terms of a purchase offer or when substantial changes occur in charges or deductions affecting the net proceeds from a sale. [See **RPI** Form 310]
16. Informing the seller of their agent's **sales activities** through weekly communications, advising what specifically has been done during the past several days and what the seller's agent expects to do in the following days, as well as what the seller can do in response to comments from buyers and their agents, and on any changes in the real estate market.
17. **Keeping records** in a client file of all activities and documents generated due to the listing.



1. _____ refers to the concerted and continuing efforts of an agent employed to meet the objectives of their client in exchange for the client's promise to pay a fee.

   a. Dual agency
   b. Due diligence
   c. General duty

2. Any observations of adverse conditions while conducting a competent visual inspection of the seller's property are to be noted on the:

   a. Transfer Disclosure Statement (TDS).
   b. Agency Law Disclosure.
   c. seller's appraisal report.

Material facts

The Pass-Through of Filtered Information from the Seller

Knowledge and observation

A seller's agent is required to conduct a **visual inspection** of a property upon taking a listing. The seller's agent's statutory duty owed to prospective buyers to disclose facts about the physical condition of a one-to-four unit residential property is limited to:

visual inspection
An inspection of a listed property performed by the seller's agent and undertaken to observe defects to be noted on a condition of property disclosure, called the Transfer Disclosure Statement (TDS).

- their *knowledge* about the property; and
- their *observations* made while conducting the mandatory *visual inspection*.

To complete the disclosure process, the seller's agent *filters property information* provided by the seller before it is provided to the prospective buyer.

Accordingly, all property information received from the seller is reviewed by the seller's agent for inaccuracies or untruthful statements known or suspected to exist by the seller's agent. Corrections or contrary statements by the seller's agent necessary to set the information straight are entered on the disclosure forms

before the information is used to market the property and induce prospective buyers to purchase, collectively referred to as **fair and honest dealings.**

The extent to which disclosures about the physical condition of the property are to be made is best demonstrated by what the seller's agent is *not obligated to provide*. Everything else adversely affecting value and known to the seller's agent – **material facts** – are to be brought to the attention of prospective buyers as a *matter of law*.

As a minimum effort to be made before handing a prospective buyer information received from the seller, the seller's agent is to:

- review the information received from the seller;
- include comments about the agent's actual knowledge and observations made during their visual inspection of the property which expose the inaccuracies or omissions in the seller's statements; and
- identify the source of the information as the seller.

No duty to provide advice, but must respond fully and fairly

A seller's agent on a one-to-four unit residential property owes **no affirmative duty** to a prospective buyer to gather or voluntarily provide any facts unknown to the seller's agent about:

affirmative duty
An agent's obligation to voluntarily undertake an advisory activity when in a fiduciary relationship.

- the property's *title conditions*, consisting of encumbrances such as easements, Covenants, Conditions and Restrictions (CC&Rs), legal descriptions, trust deed provisions, etc.;
- the *operating expenses* and any tenant income the buyer will experience during ownership, such as utilities and property taxes;
- the *zoning* or other *use restrictions* which may affect the buyer's future use of the property, except for the existence of industrial zoning which affects the property, and nearby military ordnance locations;
- the *income tax aspects* of the buyer's acquisition of the property, such as limitations on interest deductions;
- the *suitability of the property* to meet the buyer's objectives in the acquisition; and
- information or data on any *mixed use* of the property, such as acreage

included in the purchase for use as subdividable lands, groves or other farming operations, or for use for tenant income or as a vacation rental.

Further, the seller's agent owes no duty to prospective buyers to:

- give advice;
- make recommendations;
- offer suggestions;
- comment on the extent of any adverse facts disclosed;
- state an opinion; or
- explain the effect on the buyer of any facts about the property's physical, natural or environmental conditions which have been provided by the seller's agent.

Likewise, a seller's agent does not owe a duty to the prospective buyer to explain the consequences of the **customer's failure to further investigate** or analyze adverse facts sufficiently disclosed by the agent to put the buyer on notice of the condition.

However, *when asked* by the prospective buyer or buyer's agent about any aspect, feature or condition which relates to the property or the transaction in some way, the seller's agent is **duty-bound** to respond *fully and fairly* to the inquiry. The response is to include material facts known to the seller's agent about the subject matter of the inquiry and not contain misleading statements.

Conversely, it is the buyer or the buyer's agent who has a *duty to care for and protect* the buyer's best interests.

The buyer's agent, not the seller's agent, are to determine what due diligence efforts are necessary to learn the extent to which the facts disclosed by the seller's agent interfere with the buyer's expectations for the use and enjoyment of the property.

Distinguishing advice given by the buyer's agent

A buyer is entitled to far more assistance from their **buyer's agent** than the naked suggestions or recommendations contained in preprinted *advisory disclosures* about the availability of various enumerated services. The duty of the buyer's agent goes well beyond the seller's agent's limited fundamental factual disclosure obligations they owe to the buyer and the buyer's agent.

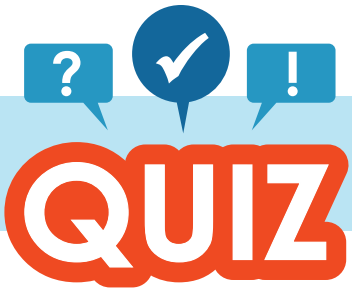
Here, the buyer's broker and their agent limit their use of an advisory statement of recommended investigations to that of a **checklist** of activities to be considered. From this checklist the buyer's agent is to identify those services they believe the buyer needs to undertake for the buyer to best protect their interests in the proposed transaction.

More importantly, services the buyer's agent has reason to believe the buyer needs to engage in are made the subject of *contingency provisions* included in the purchase offer. Thus, the buyer's agent provides their buyer with the opportunity to investigate and analyze the agent's concerns prior to closing, with the right to cancel and avoid the transaction if the investigation discloses unacceptable conditions.

For example, a buyer's agent has an affirmative duty to protect their buyer by pointing out why a recommended activity needs to be undertaken when the activity may uncover a situation which, if it exists, is to be dealt with before closing.

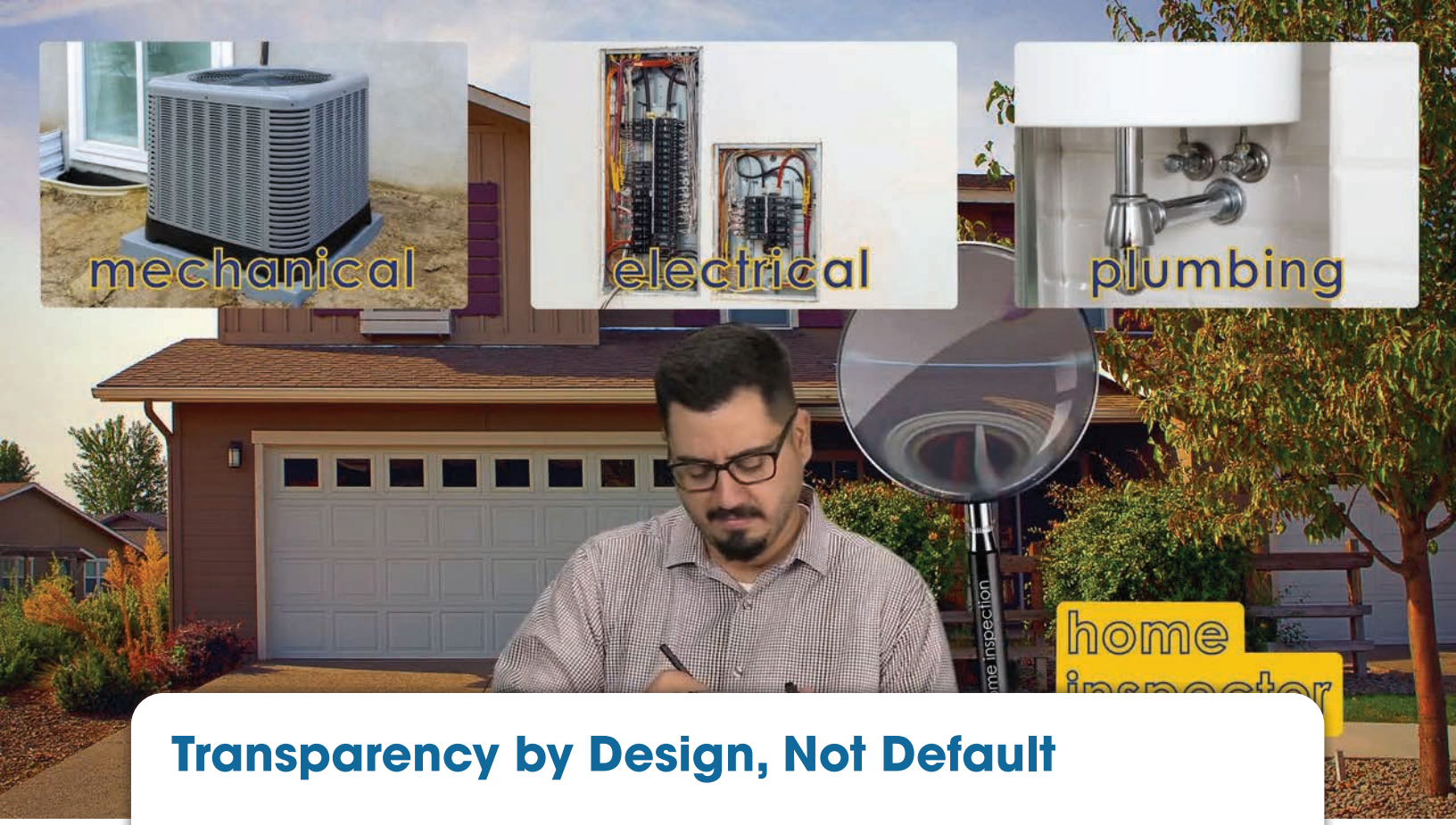
The buyer's agent using an advisory statement of *recommended activities* as a checklist will:

- determine which of the itemized activities their buyer needs to undertake before closing;
- assist the buyer to weigh the probability of discovering undisclosed defects or conditions which might have consequences adverse to the buyer's objectives after closing; and
- help the buyer analyze the risk of loss upon discovery of defects of the type suspected will likely be discovered after closing.



1. A seller's agent needs to:
   a. volunteer information about the income tax aspects of the buyer's acquisition of the property, such as limitations on interest deductions.
   b. make recommendations about the extent of any adverse facts disclosed.
   c. review all property information received from the seller for any inaccuracies or untruthful statements known or suspected to exist.

2. When directly asked by the prospective buyer about any aspect, feature or condition which relates to the property or the transaction, the seller's agent is:
   a. duty-bound to respond fully and fairly to the inquiry.
   b. only required to refer the buyer to the buyer's agent.
   c. not required to provide their working knowledge of the underlying facts.



Transparency by Design, Not Default

Investigative reports flesh out the marketing package

The primary objective of a seller's agent on taking a listing is to solicit and locate prospective buyers to submit an offer to acquire the listed property, as sufficiently disclosed by the seller and their agent so not to mislead the buyer about its condition. When a prospective buyer is located, directly or indirectly via a *buyer's agent*, the seller's agent owes the buyer a **general duty** to voluntarily and promptly provide critical information on the listed property that might adversely affect its value. This property information is collectively referred to as **material facts**.

Upfront factual disclosures put the buyer on notice of conditions on or about the property known to the seller or the seller's agent. Without this information, a prudent buyer is unable to set a price and make an offer. For the most efficient delivery of property information for timely presentation to prospective buyers, the seller's agent at the listing stage gathers data on the property and organizes it into a **marketing package**.

The marketing package contains **third-party investigative reports** prepared by unbiased professionals or government agencies addressing essential aspects of the property's condition that are of concern to prudent buyers. [See **RPI** Form 133]

One such investigative report is the **home inspection report (HIR)** to accompany mandated property disclosures. [See **RPI** Form 130]

The agent for a seller of a one-to-four unit residential property asks the seller to

home inspection report (HIR)
A report prepared by a home inspector disclosing defects in improvements on a property and used by the seller's agent to complete a Transfer Disclosure Statement (TDS) and assure prospective buyers about a property's condition.

grant them authority to order an *HIR* on the seller's behalf. [See **RPI** Form 130]

The home certification process is a cost the seller incurs to properly *market* the property if they are to avoid claims by buyers about defective property conditions after a purchase agreement is entered into.

The seller's agent explains the HIR is also used to prepare the seller's *Transfer Disclosure Statement (TDS)*. The HIR will then be attached to the seller's TDS. Both will be included in the agent's marketing package presented to prospective buyers who seek additional property information. [See **RPI** Form 304]

On receipt of the HIR, the seller may act to eliminate some or all of the deficiencies noted in the report. Sellers are not obligated to eliminate defects they disclose when offering a property for sale, unless they choose to. If a defect is eliminated, an updated HIR report is ordered out for use with the TDS for property disclosures to interested buyers.

The seller's TDS as reviewed by the seller's agent and supplemented with the HIR, is used to inform prospective buyers about the precise condition of the property before they make an offer to purchase. Thus, the seller will not be later confronted with demands to correct defects or to adjust the sales price in order to close escrow. The property will have been purchased by the buyer "as disclosed."

The marketing role of the seller's agent

The task of gathering information about the condition of the property listed for sale and delivering the information to prospective buyers lies with the *seller's agent*. [Calif. Civil Code §2079]

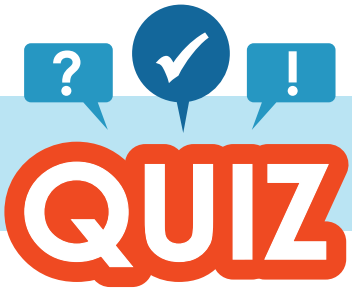
Further, for the seller's agent to retain control throughout the process of marketing, selling and closing escrow with a buyer, the seller's agent needs to request and use the HIR (on behalf of the seller) to assist in the preparation of the TDS. Thus, they avoid exposing themselves and their seller to claims of misrepresentation when the buyer goes under contract without first having reviewed an HIR (or TDS). [See **RPI** Form 130]

As part of the management of the home inspection process, the seller's agent needs to be present while the **home inspector** carries out the investigation of the property. The agent can discuss the *home inspector's* observations and whether

home inspector
A professional employed by a home inspection company to inspect and advise on the physical condition of property improvements in a home inspection report for reliance by the seller, the seller's agents and the buyer as a warranty of the condition of improvements.

the *findings are material* in that they affect the desirability, habitability or safety of the property, and thus its value to prospective buyers.

If the seller's agent cannot be present, they need to ask the home inspector to call the agent before the HIR is prepared to discuss the home inspector's findings and any recommendations for further investigation. On receipt and review of the HIR by the seller and seller's agent, any questions or clarifications they may have on its content is followed up by a further discussion with the home inspector, and if necessary, an amended or new report.



1. A(n) _____ prepared by a home inspector discloses defects in improvements on a property, and is used by the seller's agent to complete a Transfer Disclosure Statement (TDS) and assure prospective buyers about a property's condition.

   a. appraisal report
   b. home inspection report
   c. broker price opinion (BPO)

2. A professional employed to inspect and advise on the physical condition of property improvements as a warranty of the condition of improvements is referred to as a(n):

   a. dual agent.
   b. escrow officer.
   c. home inspector.

A Home Inspector's Qualifications

Hiring a home inspector

Any individual who holds themselves out as being in the business of conducting a home inspection and preparing a home inspection report on a one-to-four unit residential property is a home inspector. No licensing scheme exists to set the minimum standard of competency or qualifications necessary to enter the home inspection profession. [Calif. Business and Professions Code §7195(d)]

However, some real estate service providers typically conduct home inspections, such as:

- general contractors;
- registered engineers;
- architects; and
- structural pest control operators.

Home inspectors occasionally do not hold any type of license relating to construction, such as a person who is a construction worker or building department employee. However, they are required to conduct an inspection of a property with the same "degree of care" a reasonably prudent home inspector would exercise to locate material defects during their physical examination of the property and report their findings. [Bus & P C §7196]

Sellers and seller's agents are encouraged by legislative policy to obtain and rely

on the content of an HIR to prepare their **Transfer Disclosure Statement (TDS)** for delivery to prospective buyers. [See **RPI** Form 304]

The buyer's reliance on a *home inspection report (HIR)* at the time a purchase agreement is entered into relieves the seller and their agent of any liability for property defects they did not know about or were not observable during the mandatory visual inspection conducted by the seller's agent.

However, for the seller's agent to avoid liability in the preparation the TDS by relying on an HIR, the seller's agent needs to select a **competent** home inspector to inspect and prepare the HIR. Thus, the seller's agent needs to *exercise ordinary care* when selecting the home inspector.

Non-invasive physical examination

A home inspection is a **physical examination** conducted on-site by a home inspector. The inspection of a one-to-four unit residential property is performed for a non-contingent fee.

The purpose of the physical examination of the premises is to identify material defects in the condition of the structure and its systems and components. **Material defects** are conditions which affect the property's:

> **material defect**
> Information about a property which might affect the price and terms a prudent buyer is willing to pay for a property.

- market value;
- desirability as a dwelling;
- habitability from the elements; and
- safety from injury in its use as a dwelling.

Defects are *material* if they adversely affect the price a reasonably prudent and informed buyer would pay for the property when entering into a purchase agreement. As the report may affect value, the investigation and delivery of the home inspection report to a prospective buyer is legislated to precede a prospective buyer's offer to purchase. [Bus & PC §7195(b)]

The home inspection is a *non-invasive examination* of the mechanical, electrical and plumbing systems of the dwelling, as well as the components of the structure, such as the roof, ceiling, walls, floors and foundations.

Non-invasive indicates no intrusion into the roof, walls, foundation or soil by dismantling or taking apart the structure which would disturb components

or cause repairs to be made to remove the effects of the intrusion. [Bus & P C §7195(a)(1); see **RPI** Form 130]

The **home inspection report (HIR)** is the written report prepared by the home inspector which sets forth the findings while conducting the physical examination of the property. The report identifies each system and component of the structure inspected, describes any *material defects* the home inspector found or suspects, makes recommendations about the conditions observed and suggests any further evaluation needed to be undertaken by other experts. [Bus & P C §7195(c)]

The seller's agent needs to make sure the report addresses the cause of any defect or code violation found which constitutes a significant defect in the use of the property or cost to remedy the defects. The report will also include suspicions the home inspector might have which need to be clarified by further inspections and reports by others with more expertise.

The agent, or anyone else, may also request that the home inspector conduct an inspection on the energy efficiencies of the property and include the findings in the report. On a request for an **energy efficiency inspection**, the home inspector will report on items including:

- the R-value of the insulation in the attic, roof, walls, floors and ducts;
- the quantity of glass panes and the types of frames;
- the heating and cooling equipment and fans;
- water heating systems;
- the age of major appliances and the fuel used;
- thermostats;
- energy leakage areas throughout the structure; and
- the solar control efficiency of the windows. [Bus & P C §7195(a)(2)]

The home inspector's conflicts of interest

The home inspector who prepares a HIR, the company employing the home inspector and any affiliated company may not:

- pay a referral fee or provide for any type of compensation to brokers, agents, owners or buyers for the referral of any home inspection business;
- agree to accept a contingency fee arrangement for the inspection of the report, such as a fee payable based on the home inspector's findings and conclusions in the report or on the close of a sales escrow;

- perform or offer to perform any repairs on a property which was the subject of a HIR prepared by them within the past 12 months; or
- inspect any property in which they have a financial interest in its sale. [Bus & P C §7197]

The home energy rater

Consider a first-time homebuyer who, acting on their own and without the advice of a buyer's agent, buys a fixer-upper for a starter home.

In the first month of residence, the uncapped air conditioning ducts, badly sealed window frames and insufficient ceiling insulation cause the buyer's utility bills to skyrocket past the pre-closing estimates for operating the property as the owner.

Had the buyer retained a buyer's agent prior to making an offer or entering into a purchase agreement, the buyer would likely have been advised to ask for a **home energy audit** (energy audit).

home energy audit
An audit conducted by a Home Energy Rater evaluating the energy efficiency of the home.

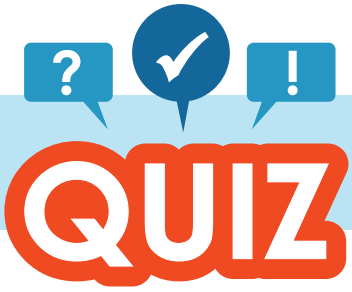
With the *energy audit* in hand, a buyer can incorporate the costs of the recommended energy efficient updates into the total costs for acquisition they are willing to pay for the property. A buyer can also use that information to compare the energy-efficiency of the home in consideration to other properties before making an offer.

In addition to ensuring the seller has hired a competent home inspector to complete the HIR, a buyer's broker may also insist a home energy audit be performed by a competent **Home Energy Rater (Rater)**, which can be the home inspector.

Home energy audit providers are private, non-profit organizations approved by the Department of Energy (DOE) as part of the **California Home Energy Rating System (HERS)** program. Audit providers have the exclusive rights to train, test and certify professional Raters.

California Home Energy Rating System (HERS)
A California state system used to create a standard rating for energy efficiency and certify professional raters.

Although Home Energy Raters are specially trained and certified, any home inspector may perform a home energy audit provided the audit conforms to the HERS regulations established by the California Energy Commission. [Bus & P C §§ 7199.5, 7199.7]



1. Some real estate service providers who typically conduct home inspections include general contractors, structural pest control operators and:

   a. architects.
   b. registered engineers.
   c. Both a. and b.

2. The home inspection is a(n) _____ of the mechanical, electrical and plumbing systems of the dwelling, as well as the components of the structure.

   a. retrofitting and overhaul
   b. invasive examination
   c. non-invasive examination

Eliminate the Risk

Pricing and asymmetric information

When a home with wood components goes on the market, the war over the Wood Destroying Pests and Organisms Inspection Report, commonly called a **Structural Pest Control report (SPC)**, and the repairs begins.

Structural Pest Control report (SPC)
A report disclosing any active infestations, damage from infestations or conditions which may lead to infestations.

First, in one corner is the seller. The seller will tell the seller's agent that they have seen neither hide nor hair of anything resembling a termite infestation. Thus, there is no need for either a report or a clearance. As for repairs, the seller is all for selling the property in an "as the buyer sees things" condition.

The seller's paladin on this field of battle is the seller's agent. Conscientious seller's agents will push their sellers to order out the *SPC report* and repair any fixable conditions now in the name of **transparency**—and an earlier and better priced sale.

Armed with a pest control operator's **certificate of clearance**, the seller's agent will be better able to get the listing price for the property. Later renegotiations of the sales price due to a delayed, in-escrow disclosure of discoverable material defects like wood-destroying infestations and infections is avoided.

Others, of course, prefer to do nothing and let sleeping termites lie, just as the sellers want. Thus, the uncertainty of a risk of loss is shifted to the buyer, letting buyers check out the property to see what they may find.

The buyer's agent as champion

In the other corner is the prospective buyer. During their observations of the property, buyers are likely blind to all that moves (like termites) beneath the painted surface. Buyers want to purchase a sound home, but do not know all the right questions to ask, or worse, all the silence games the multiple listing service (MLS) gatekeepers have learned to play as seller's agents.

Here, the buyer's champion is the buyer's agent. It is the buyer's agent who is burdened with the mission of fighting industry-wide **seller bias** by:

- ferreting out the *undisclosed facts known or readily available* to the seller and the seller's agent;
- determining the *veracity of the disclosures* they do receive; and
- reviewing a *due diligence checklist* with the buyer to make sure the buyer takes the necessary steps so the buyer's purchase is, among other things, free of termites.

The seller who gets their way

Sellers are occasionally allowed to control the conversation with their agent at the listing stage and take a pass on the opportunity to order an SPC report and clearance. When termites are later disclosed to the buyer after acceptance of an offer to purchase, no one wins and ill-will is spread all around.

Consider an SPC report first delivered to the buyer *after* entering into a purchase agreement. It discloses the existence of termites or structural damage due to a termite infestation or a fungi infection which the buyer was not previously made aware of. The buyer was not told about their existence and did not observe termite conditions on the various walk-through reviews of the premises prior to the seller accepting the buyer's purchase agreement offer.

Upon finding out, the buyer feels taken. The seller is irritated, either at being found out or at not being properly advised by their agent on the likely need for a report. To keep the deal together, the two agents must now engage in testy negotiations over who is to pay for the corrections and the issuance of a **certificate of clearance**, and resolve an issue that need not have existed in the first place.

The real irritation for the buyer is the concept of **buyer responsibility** fostered by the pest control provisions in the real estate trade association purchase agreement

forms when their agent chose to use that form over others.

The provisions require the buyer to consider paying for repairs and clean-up in order to get a *certificate of clearance*—a contingency in the purchase agreement. But existing pest control issues adversely affect the value of the seller's property and the price the buyer will pay.

Full transparency in marketing

In **boom times**, sellers get their way since they can demand top dollar, not disclose property defects until just prior to closing, refuse to correct any of those deficiencies and, by agreement, force buyers to incur the cost if they are going to finance and buy the property. Using a trade association purchase agreement with such termite provisions places the buyer at a serious disadvantage.

Worse yet, no *contractual relief* exists for the buyer when the seller knows termites exist before accepting a purchase offer, repairs are needed to obtain a clearance and the seller refuses the buyer's demands for the seller to get a clearance by removing the termites and their damage.

In **bust times**, such as experienced during the recovery from the 2008 recession and financial crisis, it's the buyers who get all they demand.

With *full transparency* at the marketing stage when the prospective buyer is first exposed to the property instead of a belated disclosure of the defects after the buyer's purchase offer has been accepted, the seller avoids all the in-escrow demands to get the defects repaired, the property maintained, and most importantly, the price reduced for any minor dislikes threatening the close of the deal.

Unlike a **Transfer Disclosure Statement (TDS)** or a **Natural Hazard Disclosure (NHD)**, an SPC report is not a legislatively mandated disclosure in a California real estate transaction. Most conventional lenders do not require a report or clearance.

A prudent buyer's agent is alert to the rule they are duty-bound to act in the best interests of their buyers. Thus, as a matter of good practice, buyer's agents simply prepare purchase agreement provisions to include a call for the seller to provide an SPC inspection, report and certification. Thus, an **SPC contingency provision** is placed in the purchase agreement to eliminate uncertainty about the property's condition, regardless of the nature of the buyer's purchase-assist financing. [See **RPI** Form 150 §12.1(a)]

Seller's agents acting in the best interest of their sellers will urge their sellers to authorize a prompt inspection and report upon taking the listing. The report, or better yet the clearance after all recommended repairs are completed, will be

included in the seller's agent's **marketing package**.

Upfront disclosure before the seller accepts an offer promotes **transparency** in real estate transactions. *Transparency* avoids personal liability for withholding information about a material fact known to the seller or the seller's agent before acceptance of an offer from a prospective buyer – conduct called **deceit**.

When to deliver the SPC report

The existence of pests such as termites **adversely affects** the value of property. Since these facts relate to value, disclosure is compelled before the buyer sets the price and closing conditions in an offer submitted to the seller.

In a transparent real estate market, the report and clearance are part of the *marketing package* a prudent seller's agent gives to prospective buyers. A request for further information by a prospective buyer constitutes the **commencement of negotiations** for the purchase of a property. Property disclosures are mandated to be made on *commencement of negotiations*.

To best comply with pest control disclosure, a copy of the SPC report is delivered to the prospective buyer or buyer's agent by the seller or their agent **as soon as practicable** (ASAP). If the SPC report is available, ASAP means the SPC report is to be provided at the time the prospective buyer inquires further into the property.

This always occurs prior to the seller accepting or countering a purchase agreement offer submitted by a buyer. Delivery of the SPC report after acceptance of the offer is deficient. Not only is this delivery tardy based on the "ASAP" guideline, but the price has been set without the buyer's full knowledge of the facts adverse to value.

However, if the SPC report is not available and cannot be handed to the prospective buyer until after the seller's acceptance of the purchase offer, closing is automatically contingent on the buyer's right to cancel the purchase transaction. [Calif. Civil Code §1099(a)]

The term "as soon as practicable" actually carries the same meaning as does the term "as soon as possible." Thus, ASAP means an existing termite report will be delivered to the *prospective buyer* when the seller's agent involved become aware the buyer is going to submit an

offer, whether or not it will call for an SPC report or for financing which requires an SPC report.

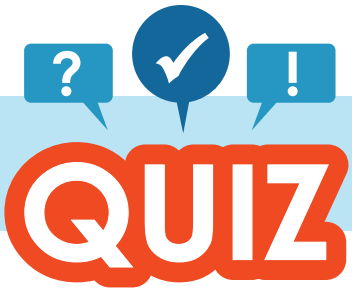
When an offer is submitted to the seller without prior indication the buyer will require an SPC report, a counteroffer may be made. The counteroffer would deliver the SPC report, and if not available, advise the buyer in the counter of the termite information known to the seller or the seller's agent. [Calif. Attorney General Opinion 01-406 (August 24, 2001)]

A counteroffer is best used even if its sole purpose is to make the SPC disclosure, without needing to change the terms of the buyer's offer. Disclosure is always most **practical** before the acceptance occurs—ASAP—to determine if the buyer's knowledge of the contents of a report or other knowledge of the termite conditions causes the buyer to reconsider the price or terms of the offer.

The **failure to disclose** before the seller accepts the buyer's offer is the result of one of two situations:

- No one knows about the existence of termites or the damage they created because the readily available inspection and report was not ordered and the discovery was not made before the property was put under contract with the buyer.
- The seller or the seller's agent resorts to deceit as the existence of a condition which adversely affects value is known to the seller or the seller's agent and not disclosed before the seller accepts the buyer's purchase offer.

The second situation is fraudulent and allows the buyer to pursue the seller and the seller's broker/agent to recover the **cost of repairs**. Contract provisions in the purchase agreement allowing the seller to entirely avoid the cost of termite clearance and repairs are not enforceable when known defects go undisclosed at the time the buyer goes under contract. [**Jue** v. **Smiser** (1994) 23 CA4th 312]



1. A(n) _____ discloses any active pest infestations, damage from infestations or conditions which may lead to infestations.

   a. Structural Pest Control report (SPC)
   b. appraisal report
   c. Natural Hazard Disclosure Statement (NHD)

Issuance of a Certificate of Clearance

Pest Control Certification

An active termite infestation or fungus infection is occasionally found on an inspection prior to marketing the property. The seller then needs to consider taking *corrective measures* to both protect the property from further damage and ready it for a prospective buyer by eliminating the issue of termites.

A **Pest Control Certification**, a certificate of clearance by the SPC company indicating the property is free of infestation or infection in the visible and accessible areas, will then be issued. This certification is commonly called a **termite clearance**. However, if any signs of infestation or infection **have not been corrected**, it will be noted in the certification. [Calif. Business and Professions Code §8519]

Pest Control Certification
A certificate of clearance by the Structural Pest Control company indicating the property is free of pest infestation or infection in the visible and accessible areas, commonly called a termite clearance.

Section II conditions which may lead to future infestations or infections will be noted on the Pest Control Clearance so the SPC company will not be liable for the costs incurred to eliminate those conditions. Section II conditions usually are only observed in homes that do not have a slab foundation and have a crawl space beneath the floor of the structure. [Bus & P C §§8516(d), 8519]

What and when to disclose

Consider a one-to-four unit residential property of wood frame construction listed with a broker who is employed to locate a buyer.

The seller's agent explains they want the seller to order an SPC inspection and report at the time of the listing since any prospective buyer will want an SPC Report and Pest Control Certification before escrow can close.

The seller's agent receives **written authorization** from the seller and orders an inspection and separated report from an SPC company known to the seller's agent to be competent and diligent. [See **RPI** Form 132]

The inspection report received from the SPC company states conditions exist which will likely lead to an active termite infestation (Section II items) and recommends repairs and further inspection into inaccessible areas.

Unhappy with the report and the estimated cost of repairs, the seller has the seller's agent get a second opinion from a different SPC company.

The second company states there is an active termite infestation (a Section I item) and lists estimates for repair more extensive than the first company's estimates.

Seller's agent's delivery of all inspection reports

Continuing our previous example, a buyer is located for the property. Deciding to go with the first SPC company's report, the seller completes the repairs recommended by the first company. The seller's agent delivers a copy of the first company's inspection report to the buyer (or buyer's agent), but does not inform the buyer or the buyer's agent of the second inspection report.

Escrow closes and the buyer moves in. The buyer discovers termites and the existence of the second inspection report. The buyer, after paying for extensive repairs and corrective measures, makes a demand on the seller's agent for the costs to correct the damage, claiming the seller's agent was liable since the agent knew about the second report and the termite infestation, a material fact the agent did not disclose.

Is the seller's agent liable for the costs the buyer incurred to cure the termite damage since the agent knew about the second report and the termite damage and failed to disclose the report or its contents?

Yes! The existence of the second report disclosing an active infestation is a material fact requiring its disclosure to the buyer. Here, the condition adversely affected the value and desirability of the property. The seller's agent is responsible to ensure the delivery of all known inspection reports to a buyer. The seller's agent cannot

pick and choose which reports to deliver. [**Godfrey** v. **Steinpress** (1982) 128 CA3d 154; Department of Real Estate Bulletin, Summer 2004]

Reinspections for corrections made

If an estimate for corrective work is not given by the structural pest control (SPC) company, the company is not required to perform a reinspection. A reinspection is mandated when a separated report is requested. The separation requires an estimate for repairs to allocate the costs to perform each and every recommendation for corrective measures for Section I and II items.

The **reinspection** is performed within 10 days of a requested inspection. A simple reinspection and certification will occur at that time. However, if more than **four months have passed** since the original inspection and report, a reinspection will not suffice. A full (original) inspection is then completed and a new (original) inspection report is issued. [Calif. Business and Profession Code §8516(b); 16 Calif. Code of Regulations §1993]

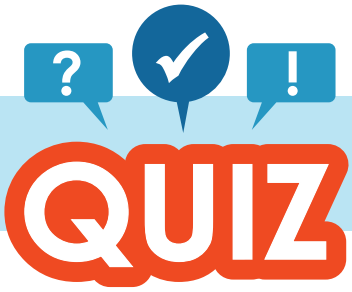
The person who ordered the report is never required to hire the SPC company that inspected the property to perform any corrective measures. For instance, a second SPC company can be called in to work on the structure. However, this second company sends a Branch 3 licensee to inspect the property since they may not rely on the report furnished by the original SPC company to perform repair work. [Bus & P C §8516(b); **Pestmaster Services, Inc.** v. **Structural Pest Control Board** (1991) 227 CA3d 903]

Further, the owner may not want to use an SPC company to perform the **corrective work**. Here, the owner may hire a licensed contractor to remove and replace a structure damaged by wood-destroying pests or organisms if the work is incidental to other work being performed or is identified by an SPC inspection report. A licensed contractor cannot perform any work that requires an SPC license to complete. [Bus & P C §8556]

However, when the original SPC company gives an estimate or makes a bid to undertake corrective measures and the owner hires someone else to perform the corrective measures, the original SPC company will need to **return and reinspect** the property before issuing a certification. The original SPC company will not certify treatments performed by another SPC company without a reinspection. [Bus & P C §8516(b)]

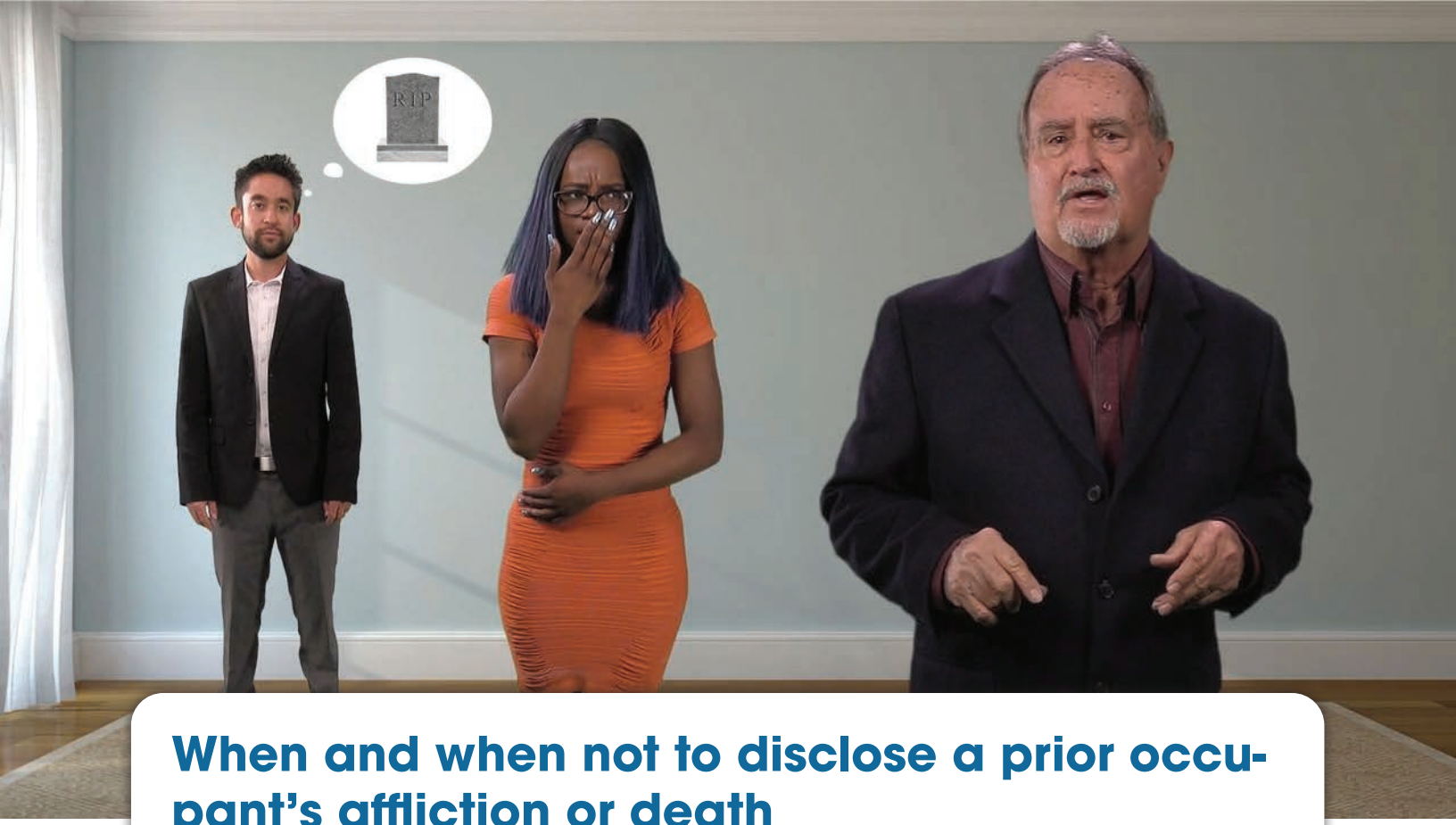
An SPC company is required to prepare a **Notice of Work Completed and Not Completed** for any work they undertake on a structure. The notice is given to the owner or the owner's agent within 10 working days after completing any work. The notice includes a statement of the cost of the completed work and the estimated cost of any work not completed. A copy of the Notice of Work Completed and

Not Completed is delivered by the seller or seller's agent to the buyer or buyer's agent as soon as possible. [Bus & P C §8518; 16 CCR §1996.2; CC §1099(b)]



1. A certificate of clearance by the Structural Pest Control company indicating the property is free of pest infestation or infection in the visible and accessible areas is called a(n):

   a. abstract of title.
   b. Pest Control Certification.
   c. separated report.



When and when not to disclose a prior occupant's affliction or death

Stigmatized property

Occasionally, a homebuyer will be concerned about whether a death has occurred on the property. To these homebuyers, a death on the property is a **material defect** in the suitability of the property, regardless of when it occurred.

The **manner of death** makes a difference to the property's market value for some homebuyers. Some types of death, such as a murder or suicide, carry heavier stigmas than, say, an elderly occupant who died of natural causes.

A death occurring on a property, and the manner of the death, are always **material facts** to be disclosed to potential homebuyers if:

- the death occurred within three years prior to the date of the homebuyer's offer to purchase; and
- the death affects the property's value or desirability to the homebuyer. [Calif. Civil Code §1710.2]

However, neither the seller nor the agents is required to disclose that an occupant of the property was afflicted with or died from *AIDS*, regardless of when the death occurred. [CC §1710.2(a)]

Thus, for a death occurring on the property more than three years before the date of the homebuyer's offer to purchase, neither agent owes an affirmative

duty to voluntarily disclose information regarding a prior occupant whose death, from any cause, occurred on the property.

Consider a seller's agent employed by a seller who locates a buyer for the seller's real estate. Prior to making an offer, the seller's agent hands the buyer the seller's Transfer Disclosure Statement (TDS). The TDS discloses the seller's and agent's knowledge about the present physical condition of the property. [See **RPI** Form 304]

All other mandatory property and transaction disclosures are made.

The buyer does not inquire into any deaths which might have occurred on the property. Ultimately, the buyer acquires and occupies the property.

Later, the buyer is informed a prior occupant died on the property from AIDS more than three years before the buyer submitted their purchase offer. The buyer would not have purchased the property had they known about this event.

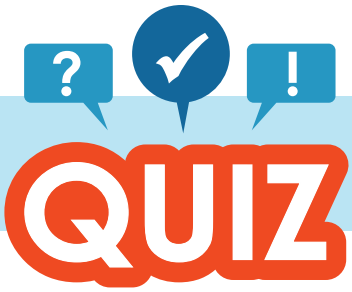
The buyer discovers the seller's agent knew of the prior occupant's death on the property resulting from AIDS. The buyer claims the seller's agent breached their agency duties by failing to voluntarily disclose the death to the buyer.

Did the seller's agent breach their general agency duty to the buyer by failing to disclose the death on the property occurring more than three years before the buyer submitted their offer?

No! The seller's agent has no affirmative duty to voluntarily disclose information to a potential buyer regarding a prior occupant:

- whose death, from any cause, occurred on the real estate more than three years prior to the purchase offer; or
- who was afflicted with the HIV virus or [CC §1710.2(a)]

*Editor's note — Deaths on the property which occurred **within three years** of the offer are treated differently.*



1. A death occurring on a property needs to be disclosed to potential homebuyers when the death occurred within _____ prior to the date of the homebuyer's offer to purchase.

   a. three years
   b. four years
   c. five years

Disclosure on an Inquiry – Always

Affirmative duty on direct inquiry

Regardless of whether a death occurred within three years of the buyer submitting a purchase offer, on direct inquiry by the buyer or their agent, the seller's agent needs to disclose their knowledge of any deaths on the real estate. [CC §1710.2(d)]

Consider a buyer who asks the seller's agent whether any deaths have ever occurred on the property.

No matter when the death occurred, on **direct inquiry**, the seller's agent must disclose their knowledge of the existence of any deaths which occurred on the real estate. [CC §1710.2(d)]

An intentional misrepresentation or concealment of a known fact after a buyer makes a direct inquiry is:

- a breach of the seller's agent's **general duty** owed to the buyer to truthfully respond when the seller's agent represents the seller exclusively; or
- a breach of the buyer's agent's **agency duty** owed the buyer since the agent is the buyer's representative in the transaction. [CC §1710.2(d)]

Further, an inquiry by the buyer into deaths indicates a death on the premises is a fact which *might affect* the buyer's use and enjoyment of the property. Thus, a death occurring on the property is a **material fact**.

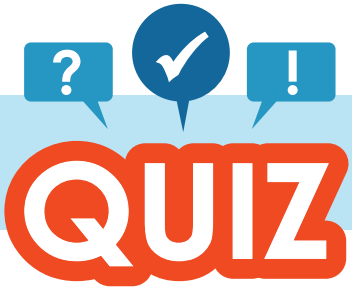
On an inquiry into deaths by a buyer, an affirmative duty is imposed on the buyer's

agent to either:

- investigate the death; or
- recommend an investigation by the buyer before an offer is made, unless the offer includes a further-approval contingency on the subject of death.

An agent who discloses, on inquiry, that they do not know whether a death occurred on the real estate, is to hand the buyer a memorandum stating:

- the buyer has made an inquiry about deaths on the property;
- the agent has disclosed all their knowledge concerning the inquiry; and
- whether the agent or others will further investigate any deaths on the property.



1. No matter when the death occurred, on direct inquiry, the seller's agent:
   a. is duty bound to disclose only deaths resulting from criminal activity which occurred on the real estate.
   b. must disclose their knowledge of the existence of any deaths which occurred on the real estate.
   c. has no obligation to disclose any information about deaths on the real estate.

2. 2. Intentional misrepresentation or concealment of a known fact after a buyer makes a direct inquiry is:
   a. a breach of the seller's agent's general duty owed to the buyer to truthfully respond when the seller's agent represents the seller exclusively.
   b. a breach of the buyer's agent's agency duty owed the buyer since the agent is the buyer's representative in the transaction.
   c. Both a. and b.

Deaths Affecting Market Value

Disclosing deaths with an adverse effect on the property's market value

An agent's duty to disclose material facts known to them is not limited to disclosures of the property's physical condition.

Consider a buyer who enters into a purchase agreement negotiated by an agent, acting either as the buyer's agent or the seller's agent. The offer includes the seller's TDS about the condition of the property. However, the buyer is unaware multiple murders occurred on the property more than three years before the buyer's purchase offer.

The agent *conceals their knowledge* of the murders from the buyer. The agent is aware that the notoriety of the murders *adversely affects* the market value of the property, placing its value below the price the buyer is agreeing to pay.

The transaction closes and the buyer occupies the property. The buyer learns of the murders and sues the agent to collect their *price-to-value money* losses. The buyer claims the agent had a duty to disclose the deaths since the agent knew the property's market value was measurably lower than the purchase price paid due to the stigma of the deaths.

The agent claims they do not have a duty to disclose the deaths since the deaths occurred over three years ago and, thus, were not required to be disclosed on the TDS.

Did the agent have an affirmative duty to disclose the deaths?

Yes! The deaths had an *adverse effect* on the property's market value and were *material facts* intentionally concealed from the buyer.

Thus, both the buyer's and seller's agent have an affirmative duty to disclose prior deaths when the death might affect the buyer's valuation or desire to own the property. [**Reed** v. **King** (1983) 145 CA3d 261]

Desirability based on events within three years

Consider a buyer's agent who is aware a death occurred on the real estate *within three years* of the buyer's purchase offer.

The value of the property is not adversely affected by the death. Thus, the death is not a material fact.

The buyer does not ask their agent if any deaths have occurred on the property. After closing, the buyer learns of the death and is deprived of the pleasurable use and enjoyment of the property. The buyer's attitude about death is an *idiosyncrasy* which was unknown to their agent.

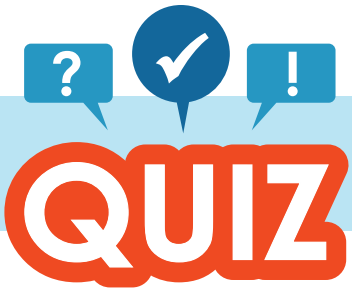
The buyer claims their agent breached their agency duty by failing to disclose the death since it inflicted an intangible harm on the buyer, preventing them from enjoying the real estate.

Here, as a matter of prudent practice, the buyer's agent needs to determine whether a known death may affect the buyer's decision to purchase the property. The buyer's agent has a greater *agency duty of care* to protect the buyer than does the seller's agent. Further, it is the buyer's agent's duty to *investigate and disclose* material facts about the property and the transaction.

Thus, a greater burden is placed on the buyer's agent to know and understand their client, known colloquially as the **know-your-client rule**.

Accordingly, a buyer's agent is to disclose any death occurring on the property within three years or otherwise when they believe the death may affect the buyer's decision to make a purchase agreement offer.

Conversely, buyers have a duty of care owed to themselves. Buyers themselves have a duty to *inquire and discover* facts readily available to them or their agent in an effort to protect their own personal interests.



1. Under the know-your-client rule, a greater burden is placed on the _____ to know and understand the motivations and preferences of the buyer.

   a. buyer's agent
   b. seller's agent
   c. Either a. or b.

Purchasing the Equity in a Seller's Residence in Foreclosure

The equity purchase investor scheme

An **equity purchase (EP) transaction** takes place when the owner-occupant of a one-to-four unit residential property in foreclosure conveys the property to a buyer who acquires it for *rental, investment or dealer purposes*. The non-occupying buyer taking title to the residence of a seller-in-foreclosure is called an **EP investor**. Unique statutory rules apply to all equity purchase transactions.

equity purchase (EP)
The acquisition of an owner-occupied, one-to- four unit residential property in foreclosure for rental, investment or dealer purposes.

equity purchase (EP) investor
A person who acquires title to an owner-occupied, one-to-four unit residential property in foreclosure for dealer, investment or security purposes.

Editor's note – Alternatively, an EP transaction does not occur and the EP rules do not apply when the buyer acquires the property for use as their personal residence.

Equity purchase statutes apply to all buyers who are EP investors, regardless of the number of EP transactions the investor completes. The investor does not need to

be in the business of buying homes in foreclosure for the statutes to apply. [**Segura** v. **McBride** (1992) 5 CA4th 1028]

Both the EP investor and their agent are to comply with EP law or be subject to penalties.

The EP regulations extend to control the type of form used to document the EP sale. The EP agreement signed by an EP investor will be printed in **bold type**, ranging from at least 10-point to 14-point font size, and be in the same language used during negotiations with the seller-in-foreclosure. [See **RPI** Form 156; Calif. Civil Code §§1695.2, 1695.3, 1695.5]

The written EP agreement is to also contain the required statutory EP notices. Failure to use the correct forms subjects the EP investor and the agents to liability for all losses incurred by the seller-in-foreclosure, plus further penalties. [Segura, *supra*]

*Editor's note — **RPI's** Equity Purchase Agreement, Form 156, complies with all statutory requirements and properly sets forth the right of the seller-in-foreclosure to cancel. [See **RPI** Form 156]*

Cancellation within five business days

Upon entering into an agreement to sell their principal residence and after proper notice of their rights, a seller-in-foreclosure has a **statutory five-business-day right to cancel** the EP agreement. Thus, the seller may avoid closing the sale, with or without cause.

The statutory right to cancel within five-business-days is contained in the mandated boilerplate language contained in an equity purchase agreement. When the seller cancels before the period expires, the sale under the purchase agreement may not be closed. As the EP agreement automatically incorporates the seller's five-business-day right to cancel before a closing may take place, compliance is assured.

The seller's *cancellation period* ends:

- midnight (12:00 a.m.) of the *fifth business day* following the day the seller enters into an equity purchase agreement with an EP investor; or
- 8:00 a.m. of the day scheduled for the *trustee's sale*, when it is to occur first. [CC §1695.4(a)]

The seller-in-foreclosure's five-business-day right to cancel does not begin to run until proper notice of the cancellation period is given to the seller. [CC §1695.4(b)]

Failure to use a purchase agreement containing the mandatory notice of right to

cancel allows the seller to cancel the sales agreement and escrow until proper notice and the time for cancellation has run. Further, the seller may even **rescind** the sale after closing when the notice of right to cancel was not delivered more than five business days before closing. The right to rescind the closed sales transaction and recover ownership of the property remains until the running of five business days after notice is ultimately given.

A **business day** is any day except Sunday and the following business holidays:

- New Year's Day;
- Washington's Birthday;
- Memorial Day, Independence Day;
- Labor Day;
- Columbus Day;
- Veterans' Day;
- Thanksgiving Day; and
- Christmas Day.

Saturday is considered a business day under EP law, unless it falls on an enumerated holiday. Many state holidays are not included as holidays. [CC §1695.1(d)]

Prohibited activities until expiration of right to cancel

Until expiration of the right of the seller-in-foreclosure to cancel the transaction, the EP investor may not:

- *accept or induce a conveyance* of any interest in the property from the seller;
- *record any document* regarding the residence signed by the seller with the county recorder;
- *transfer an interest* in the property to a third party;
- *encumber any interest* in the residence; or
- *hand the seller* a "good-faith" deposit or other consideration. [CC §1695.6(b)]

However, escrow may be opened on acceptance and deeds and funds deposited with escrow. This does not violate the right to cancel since the seller-in-foreclosure does not convey the property to the buyer and will not receive funds until the close of escrow.

Cancellation of the purchase agreement by the seller-in-foreclosure is *effective on delivery* of the signed written notice of cancellation to the EP investor's address

in the purchase agreement. [CC §1695.4(b)]

When the EP investor receives the seller-in-foreclosure's written notice of cancellation, the EP investor is to return all original contract documents within ten days following receipt of the notice. This includes the original EP agreement bearing the seller's signature to the seller. [CC §1695.6(c)]

When the cancellation period expires for lack of a cancellation, the purchase agreement becomes enforceable and escrow may be closed, unless other contingencies exist.

False representations prohibited

In negotiations with the seller-in-foreclosure, the EP investor may not make false representations or misleading statements about:

- the value of the property in foreclosure;
- the net proceeds the seller will receive on closing escrow [See **RPI** Form 310];
- the terms of the purchase agreement or any other document the EP investor uses to induce the seller to sign; or
- the rights of the seller in the EP transaction. [CC §1695.6(d)]

These rules also apply to the EP investor's agent.

Brokers limited to listing property

The buyer's broker representing an EP investor is to deliver to all the parties to an EP transaction a written **EP disclosure statement**. The EP disclosure statement confirms the agent for the EP investor is a licensed real estate broker.

The broker is to also provide proof of licensure to the seller-in-foreclosure. [CC

Representing a seller who is insolvent

Consider a first-time homebuyer who, acting on their own and without Prudent brokers and agents are inclined not to solicit or accept an **exclusive right-to-sell listing** from a seller-in-foreclosure.

Property in foreclosure has to be sold and escrow closed before the date of the trustee's foreclosure sale when the seller's goal of selling the property is to be achieved. Unless the delinquent mortgage is brought current prior to five business days before the trustee's sale, or

paid in full before the trustee's sales is completed, the home will be sold at the trustee's sale. When sold by foreclosure, the objectives of the listing employment are lost. Thus, the agent is not entitled to a fee. [CC §§2924c(e), 2903]

As a listing complication, the agent for a seller-in-foreclosure usually finds themselves in market conditions which require more time to locate a buyer and close escrow. In a troubled market, the frequency of foreclosures is inversely related to the frequency (volume) of negotiated sales; more distress sellers than ready buyers.

Time constraints imposed on the seller's agent by a trustee's sale date place extra pressure on the broker employed under an exclusive listing agreement to locate a buyer. As always, the seller's agent under an exclusive listing is to perform their agency duties by properly marketing the property with care and diligence.

Further, the seller-in-foreclosure is financially weak, if not completely insolvent, and not particularly forthcoming about closing issues. These cash-poor ownership situations lead to clouds on title, deferred maintenance and lack of upkeep on the listed property. These conditions make it difficult for the agent to market the property or perform and close escrow on a transaction.

Expectations of a seller-in-foreclosure are a further complication. They expect the broker to save what equity they may have (based on the listed price) by negotiating a sale of the property and closing escrow before the property is lost to the foreclosing lender.

When the insolvent seller loses their equity, they may claim a lack of due diligence or unprofessional conduct on the part of the broker. These risks face licensed brokers and agents who list property which is in foreclosure.

§1695.17(a)]

When the buyer's agent fails to deliver either the EP disclosure or the proof of licensure to the relevant parties, the EP agreement is **voidable** at the discretion of the seller any time before escrow closes.

Also, the EP investor is liable to the seller-in-foreclosure for any **losses arising** out of the EP investor's agent's nondisclosure of licensing requirements. [CC §1695.17(b)]

However, the EP investor is entitled to **equitable indemnity** from their agent. *Equitable indemnity* is available to the EP investor who, without active fault, is forced by legal obligation to pay for losses created by their agent's nondisclosure. [San Francisco Examiner Division, Hearst Publishing Company v. Sweat (1967) 248 CA2d 493]

equitable indemnity
When one party takes on the obligation to pay for a loss incurred by another party.

Two-year right of rescission

A two-year **right of rescission** period allows a seller-in-foreclosure to recover their residence when there is evidence the EP investor took **unconscionable advantage** of them when negotiating the purchase of the property.

right of rescission
The right to cancel a completed transaction such as a sale or letting of property, including restoration, after the transaction has been closed.

Consider a **Notice of Default (NOD)** recorded on a homeowner's personal residence after several months of delinquencies.

The homeowner, now in foreclosure on recording the NOD, is willing to sell on almost any terms to salvage their remaining equity in the property. The property is listed and the seller's agent markets the property primarily to buyers who will occupy the property as their personal residence.

Avoiding the agent, an offer is submitted directly to the seller-in-foreclosure by an EP investor. The EP investor is not represented by a broker. Under the EP offer, the seller-in-foreclosure will receive cash for their equity. Additionally, the EP investor will cure the seller's mortgage delinquencies and take over the mortgage, a classic equity purchase arrangement.

On review of the offer, the seller-in-foreclosure's broker recommends the seller accept the EP investor's offer. The broker further recommends that if an acceptable backup offer is received within the five-business-day cancellation period, the seller is to accept the backup offer and cancel the EP agreement.

The seller-in-foreclosure accepts the EP investor's offer. The five-day cancellation period expires without receiving a backup offer. The EP transaction is later closed and the property conveyed.

Does the EP investor receive good title when they accept the grant deed?

No! The EP investor's title remains subject to the seller-in-foreclosure's *right of rescission* for two years after closing. When at any time during the two years following the close of escrow and the recording of the grant deed the seller believes the EP investor's conduct and the price paid gave the EP investor an **unconscionable advantage**, the seller may attempt to rescind the transaction and recover the home they sold, called **restoration**. [CC §1695.14]

Unconscionable advantage
When an equity purchase investor or a mortgage holder exploits an element of oppression, helplessness or surprise to exact unreasonably favorable terms from a property owner or tenant.

These rescission conditions are more prevalent during periods of swift upward price movement. The market conditions which favor speculator activity are precisely the same conditions that cause a seller of a home to demand it be returned. A

Broker as principal

The EP legislation does not restrict the ability of an individual, who may be licensed as a broker or sales agent, to act solely for their own account as a **principal** purchasing property as an investor in an EP transaction.

Thus, a licensed real estate broker or agent may be the EP investor. This eliminates use of the agency law disclosure and avoids licensee disclosure and proof requirements, unless a broker fee is paid in the transaction to the buyer/licensee. The licensed real estate broker or agent, acting solely as an EP investor, is a *buyer* who coincidently holds a real estate license. As the licensee is not acting as an agent for anyone in the transaction, their licensed status need not be disclosed since it is not relevant.

Conversely, when a real estate broker is employed as the seller-in-foreclosure's broker, and the broker decides to directly or indirectly buy the property, the broker is to disclose to the seller-client the broker is also acting as a *principal* in the transaction. [Calif. Business and Professions Code §§10176(d), 10176(g), 10176(h)]

profit has come about within two years which is now sought by both the investor who speculated and gained by a flip, and the seller who believes they were ripped off of the profit taken by the investor.

The unconscionable advantage

The legislature has not clearly defined what exactly constitutes an act of unconscionable advantage by an EP investor. Thus, showing the existence of an unconscionable advantage in the **EP investor's conduct** is problematic. It is difficult for the seller-in-foreclosure to prove, and for the EP investor to refute.

What a reasonable sales price might have been under the circumstances at the time the EP transaction was entered into might appear to be unconscionable to the seller in the future. Thus, an EP investor assumes not only the risk that a rising economy may provide a profit on a flip, but that it will provoke the seller into attempting to rescind the sale to capture that profit as part of the original sale.

When real estate values rise rapidly and significantly, the "greed factor" may set in. This dynamic transforms a formerly desperate seller-in-foreclosure into an astute rescinding seller.

However, the test of unconscionable advantage is not based on events occurring after the seller-in-foreclosure enters into the purchase agreement. Thus, any increase in the value of the property after acceptance of the EP investor's offer may not be considered. It is the fair market value (FMV) of the property at the time of the EP investor's acquisition that is critical.

Market circumstances existing at the time of the negotiations, or when the parties entered into the agreement, are the economic considerations which form one of the two elements for testing unconscionable advantage. [**Colton** v. **Stanford** (1890) 82 C 351]

Aspects of unconscionability

Unconscionability has two aspects:

- the lack of a *meaningful choice* of action for the seller-in-foreclosure when negotiating to sell to the EP investor, legally called **procedural unconscionability**; and
- the purchase price or method of payment is *unreasonably favorable* to the EP investor, legally called **substantive unconscionability**.

To deprive the seller-in-foreclosure a meaningful choice between the EP investor's offer and offers from other buyers, a misrepresentation or other fraudulent activity needs to exist to establish the lack of a meaningful choice or alternative to the EP

investor's offer.

The **price paid**, like any other provision in a purchase agreement, might be considered unconscionable. When determining the unconscionability of the purchase price, justification for the price at the time of the sale and the terms of payment of that price will be examined.

An **unconscionable method of payment** could include:

- carryback paper with a below market *applicable federal rate interest rate (AFR)*, long amortization or a due date on the note that bears no relationship to current payment schedules; or
- an exchange of overpriced land, stock, gems, metals or zero coupon bonds at face value with a 20-year maturity date.

A form of payment which is uncollectible, unredeemable and with no present value is also unconscionable.

However, the existence of unreasonable pricing and payment alone is not enough to show the unconscionable advantage needed to rescind a closed transaction. Both the lack of a *meaningful choice* and *unreasonably favorable* terms needs to be present to show *unconscionability* existed.

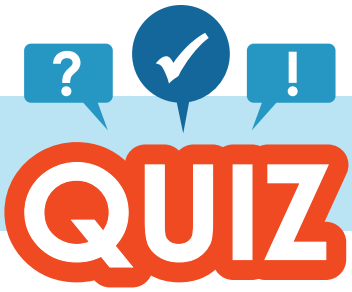
Un-American activity coupled with a low price

An **unconscionable advantage** occurs when the EP investor exploits an element of **oppression or surprise** and exacts an unreasonably low and favorable purchase price or terms of payment. These are elements of fraud from threats, undue influence or deceit.

Oppression by the EP investor exists when the inequality in bargaining power results in no real negotiations, a "take it or leave it" environment. The foreclosure environment itself often presents a one-sided bargaining advantage for an aggressive EP investor to exploit.

Surprise occurs due to the post-closing discovery of terms which are hidden in the lengthy provisions of the agreement or escrow instructions.

The greater the marketplace oppression or post-closing surprise discovered in the transaction, the less an unreasonably favorable price paid by an EP investor will be tolerated. [**Carboni** v. **Arrospide** (1991) 2 CA4th 76]



1. A person who acquires title to an owner-occupied, one-to-four unit residential property in foreclosure for dealer, investment or security purposes is referred to as a(n):

   a. syndicator.
   b. equity purchase (EP) investor.
   c. speculator.

2. A _____ right of rescission period allows a seller-in-foreclosure to recover their residence when there is evidence the equity purchase (EP) investor took unconscionable advantage of them when negotiating the purchase of the property.

   a. six-month
   b. one-year
   c. two-year

Release and Cancellation of Employment

Known and unknown claims

For brokers and agents, providing real estate brokerage services to members of the public is a rewarding profession. That said, the occupational *hazard of a dispute* with a client or other participant will inevitably surface to cause a moment of hesitation for a broker or sales agent. Even when brokers and agents fulfill all of their agency duties, act diligently and cooperate fully with the client and other parties, disputes may arise.

Unless the conflict with the client or other party is resolved at the earliest possible moment, the continuing aggravation takes a toll on a broker's time and effort – and possibly cash reserves.

Also, disputes with a client tend to make continued representation of the client less effective. During an extended dispute, the broker or agent may be rendered incapable of logically making normal discretionary decisions in the course of fulfilling their agency obligations owed to the client.

Worse, the unreasonable interference of an uncompromising client creates a stressful condition which can easily lead to errors in an agent's judgment.

As always, disputes need to be put to rest quickly.

Otherwise, they may turn into correspondence with attorneys, or worse, litigation. When a *settlement* is not promptly resolved so the employment can continue on sound footing, the agency relationship needs to be terminated.

To terminate an agency relationship due to a dispute, a **release and waiver** is entered into by all parties concerned.

Agency disputes arise during one of three periods in the representation of a client:

- the *marketing period* beginning on the client employment and authorization of the broker and their agent's to sell, locate, finance, lease or manage a property. The marketing period normally ends on the client's entry into an agreement to sell, buy, finance or lease the property in question;
- the *escrow period* beginning on the client's entry into a purchase agreement, mortgage agreement or lease. The escrow period typically ends on the close of escrow, the transfer of possession or the failure of the transaction to close; or
- the *post-closing period* following the closing of the purchase agreement, mortgage or lease transaction.

Marketing period disputes

Misunderstandings sometimes occur regarding the extent of the *marketing services* a client expects of their broker and the broker's agents. The client's extraordinary expectations may have existed before entering into the employment agreement. Or they may originate when the agent explained what will be done to market or locate property. Further, outside influences during the marketing period may cause the client to believe the agent ought to be doing more.

Conversely, a seller may become uncooperative in the marketing of the property.

For example, the seller may refuse to hand over property information needed by the seller's agent to effectively locate a buyer willing to make an offer on the property.

Reports a seller needs to provide to contribute to a better marketing package given to prospective buyers, include:

- home inspection reports;
- natural hazard disclosures [See **RPI** Form 314];
- common interest development (CID) documents;
- local ordinance compliances;
- property operating expense sheets [See **RPI** Form 352]; and
- rental income data. [See **RPI** Form 352-1]

Without proper disclosure of fundamental property information, prospective buyers cannot ascertain the value of the property and distinguish it from other properties they are considering.

Terminating the agency

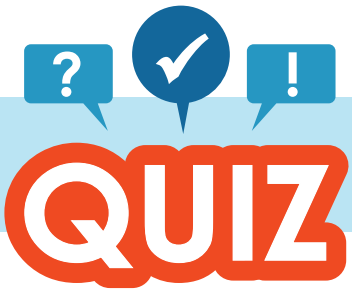
To resolve disputes when a compromise is unattainable, it is prudent to consider *terminating the agency*.

When the client unilaterally withdraws the property from the market, cancels the employment or continues to interfere in the sales effort without justification, the client owes the broker the fee due under the employment agreement. However, to justify collection of their fee when the client interferes, the seller's agent needs to have diligently performed the brokerage services owed the seller under the listing, whether or not a buyer has been located.

To formally end the agency relationship with a client, a **release and cancellation of employment agreement** is prepared and entered into. The resolution negotiated by the broker may be a mutual cancellation of the listing given in exchange for the client's payment of a fee. [See **RPI** Form 121]

The *consideration for cancellation* ranges from payment of the entire fee due under the listing on cancellation, to an agreed on lesser amount. For example, the client may agree to pay a fee when the client relists the property with another broker or sells the property, leases it, etc., during a fixed period after the mutual cancellation of the listing. [See **RPI** Form 121]

On entering into a *release and cancellation agreement*, the broker's exposure to future claims based on a purported failure of agency duties is eliminated.



1. To terminate an agency relationship due to a dispute, a(n) _____ is entered into by all parties concerned.

   a. conflict of interest disclosure
   b. release and waiver
   c. Agency Law Disclosure

Escrow Period and Post-Closing Disputes

Escrow period disputes

After opening a sales escrow for the purchase of real estate, disputes under two types of conditions may arise. Either type of dispute may ultimately require the termination of the agency relationship.

One set of disputes is classified as **agency disputes**. *Agency disputes* arise between the agent and their client after the client has entered into a purchase agreement. If the dispute cannot be resolved and the representation continued, the agency is terminated in the same manner as the listing period disputes discussed in the previous section.

agency disputes
Disputes between an agent and their client which arise during the marketing period, in escrow or after closing.

The other set of disputes is classified as **principal disputes**. *Principal disputes* develop between the buyer and seller and result in a refusal of one or the other to act further to close escrow. The refusal of one party to proceed with the transaction may be excused, justified or constitute a *breach* of the purchase agreement.

principal disputes
Disputes between a buyer and seller.

Negotiations to resolve the misunderstandings and close escrow may not be successful. If the escrow dispute becomes irresolvable, the agent needs to consider recommending the buyer and seller terminate the purchase agreement. At the same time the buyer and seller cancel the transaction, they need to release each other from any claims they may have against one another, by entering into a **cancellation, release and waiver agreement**. [See **RPI** Form 181]

The *cancellation, release and waiver agreement* entered into by the buyer and seller **releases everyone involved** in the transaction. Thus, any *liability exposure* the agents and client may have due to the transaction is eliminated.

Post-closing disputes

The expectations of a buyer in a purchase transaction are always high. Further, the condition of a property is almost never as rosy as it appeared before taking possession.

Thus, after closing a transaction, brokers and their agents are occasionally brought into *annoying disputes* by buyers. These buyers may be disgruntled over the condition of the property, its improvements, the neighborhood, hazards of the location, zoning, easements held by neighbors, fence locations, operating expenses, tenant problems, etc.

Buyers, believing they have gotten less than they bargained for, often attempt to *shift responsibility* for payment of expenses they have incurred to cure superficial obsolescence or deterioration. Worse yet, they may seek to recover a portion of the purchase price on a claim the property value received was measurably less than the price they paid.

However, the seller's broker, while responsible for their services, is not the guarantor of an obligation the seller may owe the buyer for property deficiencies. As the gatekeeper to real estate ownership, it usually is the broker who is the first person put upon by a disgruntled buyer to "cure the problem."

Brokers and agents often pay some of these claims to permanently remove themselves from a disputed purchase. On any settlement of a dispute on a closed transaction, the broker needs to demand a release and waiver settlement agreement. Once the buyer has "raided the cookie jar" for a few dollars, they may come back for more. The **release and waiver provisions** in a settlement agreement put an end to it. [See **RPI** Form 526]

The documentation

A mutual *cancellation agreement*, which does not include a **release of claims and waiver of rights**, merely serves to *terminate* any further activity under the

existing agreement or agency relationship. Thus, all parties are *excused* from further performing since the agreement and relationship have been terminated.

In essence, the cancellation "does away with" the remainder of the purchase agreement that has not yet been performed. A cancellation, by itself, does not affect the responsibilities of the buyer, seller, brokers or agents, for their activities which preceded the cancellation.

Conversely, a **release and waiver of rights**, commonly called a **rescission and restoration agreement**, returns the parties to the respective positions they held before entering into the terminated agreement. [See **RPI** Form 526]

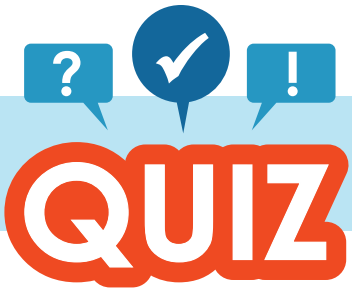
A *release agreement*, signed by all parties to a transaction as part of a cancellation agreement, retroactively extinguishes all *known claims* in disputes the parties have between themselves. Thus, the general release ends all liability between the parties for those claims *actually known* to the parties to exist in the dispute.

However, a general release does not affect unknown claims later uncovered. [Calif. Civil Code §1542]

Thus, under a general release a category of claims remain unresolved, i.e., those which might exist, come into existence or be later established and are unknown to the parties on entering into a general release. These claims are called **unknown and unsuspected claims**. To eliminate these unknown claims, a waiver of the right to later pursue these claims needs to be included with a general release and made part of the mutual cancellation agreement. [CC §1542]

unknown and unsuspected claims
Claims unknown to the parties which are later established and pursued after entering into a general release.

A written, signed release agreement does not require new consideration to be paid for the cancellation, release and waiver to be enforceable as a bar to further claims. [CC §1541]



1. _____ arise between the agent and their client after the client has entered into a purchase agreement.

   a. Agency disputes
   b. Principal disputes
   c. Primary disputes

Risk Management: Glossary

A

affirmative duty 15

An agent's obligation to voluntarily undertake an advisory activity when in a fiduciary relationship.

agency disputes 58

Disputes between an agent and their client which arise during the marketing period, in escrow or after closing.

C

California Home Energy Rating System (HERS) 26

A California state system used to create a standard rating for energy efficiency and certify professional raters.

D

due diligence 8

The concerted and continuing efforts of an agent employed to meet the objectives of their client given in exchange for the client's promise to pay a fee.

E

errors and omissions (E&O) insurance 5

An insurance policy protecting brokers and agents from negligent conduct when acting as a licensee.

equitable indemnity 50

When one party takes on the obligation to pay for a loss incurred by another party.

equity purchase (EP) **45**
The acquisition of an owner-occupied, one-to- four unit residential property in foreclosure for rental, investment or dealer purposes.

equity purchase (EP) investor **45**
A person who acquires title to an owner-occupied, one-to-four unit residential property in foreclosure for dealer, investment or security purposes.

F

fiduciary duty **1**
The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

G

general duty **2**
The duty a licensee owes to non-client individuals to act honestly and in good faith with up-front disclosures of known conditions which adversely affect a property's value.

H

home energy audit **25**
An audit conducted by a Home Energy Rater evaluating the energy efficiency of the home.

home inspection report (HIR) **20**
A report prepared by a home inspector disclosing defects in improvements on a property and used by the seller's agent to complete a Transfer Disclosure Statement (TDS) and assure prospective buyers about a property's condition.

home inspector **21**

A professional employed by a home inspection company to inspect and advise on the physical condition of property improvements in a home inspection report for reliance by the seller, the seller's agents and the buyer as a warranty of the condition of improvements.

M

material defect **23**

Information about a property which might affect the price and terms a prudent buyer is willing to pay for a property.

P

Pest Control Certification **33**

A certificate of clearance by the Structural Pest Control company indicating the property is free of pest infestation or infection in the visible and accessible areas, commonly called a termite clearance.

principal disputes **58**

Disputes between a buyer and seller.

R

right of rescission **50**

The right to cancel a completed transaction such as a sale or letting of property, including restoration, after the transaction has been closed.

S

Structural Pest Control report (SPC) **27**

A report disclosing any active infestations, damage from infestations or conditions which may lead to infestations.

U

Unconscionable advantage **51**

When an equity purchase investor or a mortgage holder exploits an element of oppression, helplessness or surprise to exact unreasonably favorable terms from a property owner or tenant.

unknown and unsuspected claims **60**

Claims unknown to the parties which are later established and pursued after entering into a general release.

V

visual inspection **14**

An inspection of a listed property performed by the seller's agent and undertaken to observe defects to be noted on a condition of property disclosure, called the Transfer Disclosure Statement (TDS).