



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

Realty Publications, Inc.



CITE THIS READING MATERIAL AS:

Realty Publications, Inc.

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

Seventh Edition

Cutoff Dates:

All economic data cited in this book have been researched and brought current as of August 2020.

**Copyright © 2020 by Realty Publications, Inc.
P.O. Box 5707, Riverside, CA 92517**

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopy, recording, or any information storage or retrieval system, without permission in writing from the publisher.

Printed in the United States of America

Editorial Staff

Legal Editor/Publisher:
Fred Crane

Project Editor:
Oscar M. Alvarez

Senior Editors:
Connor Wallmark

Contributing Editors:
Carrie B. Reyes
Benjamin Smith
Bethany Correia
Emily Kordys

Editorial Assistant
Mary LaRochelle

Comments or suggestions to:

Realty Publications, Inc., P.O. Box 5707, Riverside, CA 92517
contact@realtypublications.com

<i>Table of Forms</i>	<i>iv</i>
<i>Glossary</i>	<i>313</i>

Table of Contents

Chapter 1	Brokerage activities: agent of the agent <i>Introduction to agency</i>	1
Chapter 2	Creation of office policies, rules and systems for review <i>Setting standards for recruiting agents</i>	15
Chapter 3	Review of agent activities, records, funds and reports <i>Tracking transactions handled by a broker's agents</i>	31
Chapter 4	Federal and state prohibited discriminatory practices <i>Property rights for all citizens</i>	51
Chapter 5	Marketing and advertising <i>Choose your brand</i>	59
	<i>For FREE, customizable marketing materials, go to realtypublications.com/FARM</i>	
Chapter 6	Appointment and supervision of an office manager <i>The supervisory role of an office manager</i>	69
Chapter 1	Agency: authority to represent others <i>Introduction to agency</i>	81
Chapter 2	The agency law disclosure <i>Legislated order</i>	85
Chapter 3	Agency confirmation provision <i>Mandated for purchase agreements</i>	95
Chapter 4	Dual agency and subagency <i>Agency and fee sharing concepts</i>	101
Chapter 5	A broker's use of supervisors <i>Delegated supervision, not agency</i>	107
Chapter 6	Opinions with erroneous conclusions <i>When an opinion becomes a guarantee</i>	113
Chapter 1	The Federal Fair Housing Act <i>Introduction to fair housing</i>	127
Chapter 2	The Civil Rights Acts of 1866 and 1870 <i>Property rights cannot be based on race</i>	135

Office Management and Supervision

Agency

Fair Housing

Chapter 3	Americans with Disabilities Act <i>Providing access to commercial real estate</i>	139
Chapter 4	California protected civil rights <i>The Unruh Civil Rights Act</i>	145
Chapter 5	Fair housing for disabled persons <i>California-style access for disabled tenants</i>	151
Chapter 6	California Fair Employment and Housing Act <i>Discriminatory practices, exemptions and remedies</i>	155
Chapter 7	DRE regulation of discrimination <i>Guidelines for broker conduct</i>	159
Chapter 8	Equal Credit Opportunity Act <i>Federal fair lending rules</i>	163
Chapter 9	The Housing Financial Discrimination Act of 1977 <i>California's fair lending laws</i>	169
Chapter 10	Home Mortgage Disclosure Act <i>Lenders release home mortgage data</i>	175
Chapter 11	HUD advertising guidelines for sales and rentals <i>Avoiding discrimination in advertising</i>	179
Chapter 12	Prior occupant's use, affliction and death <i>When and when not to disclose</i>	183
Trust Funds		
Chapter 1	Trust funds overview <i>Introduction to trust funds</i>	187
Chapter 2	Advance fees are trust funds <i>Deposits retain trust status until disbursed as instructed</i> .	195
Chapter 3	Advance costs are trust funds <i>Funds handed to the broker for marketing costs</i>	199
Chapter 4	Trust account management <i>The withdrawal of trust funds</i>	205
Chapter 5	Trust fund accounting <i>Trust account bookkeeping</i>	211
Chapter 6	Penalties for misuse of trust funds <i>Commingling, conversion and restitution</i>	221

Chapter 1	Conflict of interest <i>Professional relationships compromised</i> 227
Chapter 2	Counteroffers to promote clarity <i>Defacing a previously signed document</i> 235
Chapter 3	Property related disclosures <i>Sold “as-is” is a prohibited disclaimer</i> — <i>property is sold “as disclosed”</i> 239
Chapter 4	The borrower and mortgage broker relationship <i>The accurate representation of mortgage terms</i> 251
Chapter 5	Kickbacks, price fixing and MLS access <i>Duplicate charges for services</i> 259
Chapter 1	Management of exposure to liability <i>The reduction of uncertainties for harm</i> 265
Chapter 2	An agent’s impact on their broker <i>The agent of the agent</i> 273
Chapter 3	Due diligence obligations of the seller’s and buyer’s broker <i>Due diligence by the seller’s agent</i> 279
Chapter 4	Disclosure of known or suspected adverse facts <i>Selecting and hiring a home inspector</i> 291
Chapter 5	A seller’s residence in foreclosure <i>The equity purchase investor scheme</i> 297
Chapter 6	Cancellation, release and waiver <i>Known and unknown claims</i> 307
	Defines key terms and supplies page references for further study 313

Ethics**Risk
Management****Glossary**

Table of Forms

For full-size, fillable copies of forms cited in this book plus our entire library of 400+ legal forms, go to **www.realtypublications.com/forms**.

Full Forms

No.	Form Name	Page
104	Loan Broker Listing Agreement.....	255
107	Marketing Package Cost Sheet.....	200
180	Counteroffer.....	237
181	Cancellation of Agreement.....	310
219	Denial of Credit.....	166
305	Agency Law Disclosure.....	89
504	Agent Income Data Sheet.....	18
507	Assistant Employment Agreement.....	25
510	Office Manager Employment Agreement.....	109
535	Interest-Bearing Trust Account Agreement.....	209
522	Listing Information Report.....	33
536	Record of All Trust Funds Received.....	216

Partial Forms

150	Purchase Agreement.....	97, 192
156	Equity Purchase Agreement.....	301
505	Broker-Agent Employee Agreement.....	7
506	Independent Contractor Employment Agreement.....	9, 276
520	File Activity Sheet.....	37
521	Transaction Coordination Sheet (Seller's Agent).....	38
527	Conflict of Interest.....	231



Brokerage activities: agent of the agent

After reading this chapter, you will be able to:

- understand an employing broker's responsibility to continually oversee the real estate activities of the agents they employ;
- appreciate the office policies, procedures, rules and systems a broker implements to comply with their duties owed to clients and others;
- develop a business model for implementing the supervisory duties required of a broker;
- use an employment agreement to establish the duties of a sales agent employed under a broker and the agent's need to comply with the broker's office policies; and
- discuss how a licensee's status relates to labor regulations, taxation and issues of liability.

business model

clients

**independent contractor
(IC)**

licensed activities

listing agreement

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

Chapter 1



Learning Objectives

Key Terms

Introduction to agency

- 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 transactional services as the agent of the client. [See **RPI** Forms 102 and 103]

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.¹

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.²

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**.³

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.⁴

clients

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

¹ Calif. Business and Professions Code §10131

² Bus & P C §10160

³ **Grand v. Griesinger** (1958) 160 CA2d 397

⁴ 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.⁵

As a result, brokers are responsible for all the activities their agents carry out within the *course and scope* of their employment.⁶

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 DRE.⁷

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.⁸

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.⁹

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;

Responsibility for continuous supervision

The employing broker's management

⁵ Calif. Civil Code §2079.13(b)

⁶ **Gipson v. Davis Realty Company** (1963) 215 CA2d 190

⁷ Bus & P C §10177(h)

⁸ CC §2079.13(b)

⁹ CC §2079.16

- *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.¹⁰

Business and licensed activities

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.

licensed activities

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

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.

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. [See Figure 1]

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

- *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.);
- *substantive 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 Figure 2 and Figure 3, **RPI** Forms 505 and 506]

¹⁰ California Department of Real Estate Regulations §2725

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 | • institutional advertising | • hours/agents' work schedules |
| • workers' compensation insurance | • franchise affiliation | • business cards |
| • automobile insurance binder | • trade organization membership | • storage of documents (three years) |
| • general comprehensive business insurance | • MLS subscriptions | • office meetings/attendance |
| • agent policy manual (on procedural, substantive and compliance activities) | • employment contracts with sales agents | • agent contribution to expenses |
| • new agent qualifications and interview procedures | • agent pay, advances, and escrow disbursements | • bank trust accounts |
| | • production goals | • general business bank accounts |
| | • phone/floor-time coverage | |

Organizational Procedures

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

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 | • trust fund logs periodic reports | • schedule of report due dates |
| • listing logs transaction logs | • listing reports | • other events which trigger notices or reports to management |
| | • sales reports | |

Supervision

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

Figure 1

Forming a Business Model

Licensed employees of the broker

A 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*.¹¹

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 Figure 2 and Figure 3, **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:

- **Broker-Agent Employee Agreement** [See Figure 2, **RPI** Form 505]; and
- **Independent Contractor Employment Agreement — For Sales Agents and Broker-Associates**. [See Figure 3, **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. [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 Figure 3, **RPI** Form 506]

Alternatively, brokers may choose other pay and tax withholding arrangements documented by an **employee agreement** form. [See Figure 2, **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.

Employee under labor law

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 Figure 3, **RPI** Form 506]

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

- broker supervision of licensed agent activities;

¹¹ Calif. Civil Code §2079.13(b)

BROKER-AGENT EMPLOYEE AGREEMENT

NOTE: This form is used by an employing broker when entering into an agreement employing a sales agent or a broker on terms calling for income tax withholding and tax treatment as an employee, to establish the duties of the broker and agent, actual fees and how fees due the employee will be allocated and shared.

DATE: _____, 20____, at _____, California

1. Broker hereby employs Agent as a real estate sales agent or broker-associate, until terminated by either party, on the following stated terms:

1.1 Agent to be treated as an employee for tax and employment purposes.

2. **AGENT agrees:**

2.1 To maintain a real estate license in the State of California.

2.2 To provide brokerage services only on behalf of Broker.

2.3 To follow the Broker's policy manual and any directions orally given by Broker.

2.4 To use only those real estate forms authorized by Broker.

2.5 To make complete and immediate disclosure to Broker of any correspondence or document made or received.

2.6 To immediately deliver and account to Broker for funds received by Agent in the course of this employment.

2.7 To participate in educational programs and meetings specified by Broker.

2.8 To fully inspect the physical conditions of any property to be sold or bought for clients.

2.9 To obligate Broker to no agreement without Broker's prior consent.

2.10 To expose Broker to no liability to any third party without Broker's prior consent.

2.11 To furnish their own transportation and carry a liability and property damage insurance policy in an amount satisfactory to Broker with a policy rider naming Broker as co-insured.

2.12 To faithfully adhere to the Real Estate Law of the State of California.

2.13 To join and pay fees for membership to professional organizations in which Broker is a member.

2.14 To contribute to the defense and settlement of litigation arising out of transactions in which Agent was to or shared fees, in an amount equal to Agent's percentage share of the fees.

2.15 Social Security Number _____

2.16 Other _____

3. **BROKER agrees:**

3.1 To maintain a real estate Broker's license in the State of California.

3.2 To maintain office(s) with proper facilities to operate a general real estate brokerage business.

3.3 To maintain membership in the following professional organization(s):
Multiple Listing Service _____
Local Branch of the California Association of Realtors and National Association of Realtors _____

3.4 To maintain listings.

3.5 To provide advertising approved by Broker.

3.6 To provide worker's compensation insurance for Agent.

3.7 To maintain the following insurance coverages for Agent:
Errors and Omissions _____ Life _____ Health _____ Dental _____

3.8 To pay Agent as specified in the Broker's fee schedule.

3.9 To withhold from Agent's share of fees all appropriate state and federal income taxes, state disability and unemployment insurance and social security taxes.

3.10 Other _____

4. **General Provisions:**

4.1 Agent has the right to purchase any properties listed by Broker on full disclosure to the seller of the Agent's activities as a principal, and without derivation of fees to Broker.

4.2 Broker has the right to reject any listing or retain obtained by Agent.

4.3 Broker to determine whether any litigation or dispute involving Broker, or their business and third parties, arising from Agent's activities, will be prosecuted, defended or settled.

4.4 Arbitration: Any dispute between Agent and Broker or with any other Agent employed by Broker that cannot be settled by Broker, or resolved by the State Labor Commission or by non-binding mediation, will be arbitrated under the rules of the American Arbitration Association.

4.5 See addendum for additional provisions. [See R Form 505]

5. **Broker's Fee Schedule:**

5.1 Broker is to pay Agent a fee for participating in a sales transaction evidenced by a purchase agreement which confirms Agent is acting as an agent for the Broker and Broker receives a brokerage fee on the transaction.

--- PAGE ONE OF TWO --- FORM 505 ---

--- PAGE TWO OF TWO --- FORM 505 ---

5.2 The amount of fee due Agent is _____ % of the funds remaining from the brokerage fee received by Broker under sections 5.1 or 5.10 after first deducting the following amounts:

A. Payment to other brokerage offices of sums due them for their participation in the transaction;

B. Payment to Broker's franchisor of the fee due the franchisor from the transaction;

C. Payment to Broker of one-half of the then remaining funds if another Agent of Broker is entitled to a fee for negotiating the other end of the transaction;

D. Other deductions _____

5.3 From each fee due Agent and before disbursement, Broker will deduct the following amounts and any amounts otherwise due Broker from Agent:

A. An advertising or promo charge of \$ _____

B. An errors and omissions insurance coverage charge of \$ _____

C. A charge of \$ _____ for _____

D. Disbursement to another Agent of the Broker, transaction coordinator or finder with whom Agent agreed to share the fee due under section 5.2.

5.4 The percentage participation by Agent in the funds remaining under sections 5.2 is adjusted to _____ % on the following event _____

5.5 Agent is to pay Broker, on the first of each month of employment, a desk fee of \$ _____

5.6 Any expenses incurred by Broker in a transaction negotiated by Agent, such as travel expenses, meals, attorney fees, printing, listing service fees, etc., will be deducted from the fee due Agent.

5.7 If all or part of the fee is received in property other than cash, Agent is to obtain Broker's prior approval. In this event, Broker will make one of the following determinations for disposition of the property:

A. Divide the property between Broker and Agent in kind, based on the fee schedule; or

B. Pay Agent their dollar share of the fee in cash; or

C. Retain the property in the names of Broker and Agent, or their trustee, and thereafter dispose of it when and on terms Broker and Agent previously agree. Any ownership income and expenses will be shared between Broker and Agent in proportion to their share of ownership.

5.8 On termination, Agent to be paid as follows:

A. Closed Transactions: Agent will receive their share of fees on all transactions which are closed before termination.

B. Pending Transactions: Agent will receive their share of fees on all pending transactions which close after termination, subject to fee limitations under section 5.9.

C. Unexpired Listings and Retainers: Agent will receive their share of fees if the client enters into a transaction during the written listing or retainer period. Agent will not earn a fee under any extension of the listing or retainer obtained after termination, subject to fee limitations under section 5.9.

5.9 Fee Limitation: If on termination Agent has pending transactions under section 5.1 or unexpired listings or retainers procured by Agent which require further services normally rendered by Agent, Broker will direct another employed Agent or himself to perform those services. For these services after termination, a reasonable share of the fee will be deducted from the fee due Agent.

5.10 Compensation From Prior Employment: Monies received by Broker from Agent's prior employing brokers representing fees earned by Agent while employed by that broker are to be disbursed by Broker as follows:

A. Agent to receive 100% of the monies received by Broker.

B. The monies are to be shared with Agent at the percentage set in section 5.2.

C. Broker and Agent, respectively, to share the monies _____

I agree to render services on the terms stated above.
Date: _____, 20____
Agent's Name: _____

I agree to employ Agent on the terms stated above.
Date: _____, 20____
Broker's Name: _____

Agent's Signature: _____
Address: _____
Phone: _____
Cell: _____
Email: _____

Broker's Signature: _____
Address: _____
Phone: _____
Cell: _____
Email: _____

FORM 505 08-15 ©2015 RPI - Realty Publications, Inc. P.O. Box 5707, RIVERSIDE, CA 92517

Figure 2

Form 505

Broker-Agent
Employee
Agreement

For a full-size, fillable copy of this or any other form in this book that may be legally used in your professional practice, go to realtypublications.com/forms

- 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.¹² [See Figure 2 and Figure 3, **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 Figure 2 and Figure 3, **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*.¹³

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 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.

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

¹³ Internal Revenue Code §3508

INDEPENDENT CONTRACTOR EMPLOYMENT AGREEMENT
For Sales Agents and Associated Brokers

NOTE: This form is used by an employing broker when entering into an agreement employing a sales agent or a broker on terms calling for the employee to be treated for tax purposes as an independent contractor, to establish the status of the broker and agent, earned fees and how the fees due the employee will be allocated and shared.

DATE: _____, 20____, _____, California.
Items left blank or unchecked are not applicable.

FACTS:

1. Broker hereby employs Agent as a real estate sales agent or broker-associate, until terminated by either party, on the following terms.
 - 1.1 Agent to be treated as an independent contractor for tax purposes.
2. **AGENT agrees:**
 - 2.1 To maintain a real estate license in the State of California.
 - 2.2 To provide brokerage services only on behalf of Broker.
 - 2.3 To follow the Broker's policy manual and any directions orally given by Broker.
 - 2.4 To use only those real estate forms authorized by Broker.
 - 2.5 To make complete and immediate disclosure to Broker of any correspondence or document made or received.
 - 2.6 To immediately deliver and account to Broker for funds received by Agent in the course of the employment.
 - 2.7 To participate in educational programs and meetings specified by Broker.
 - 2.8 To visually inspect the physical conditions of any property to be sold or bought for clients.
 - 2.9 To obligate Broker to no agreement without Broker's prior consent.
 - 2.10 To expose Broker to no liability to any third party without Broker's prior consent.
 - 2.11 To furnish their own transportation and carry a liability and property damage insurance policy in an amount satisfactory to Broker with a policy rider naming Broker as a co-insured.
 - 2.12 To faithfully adhere to the Real Estate Law of the State of California.
 - 2.13 To file and pay quarterly estimated taxes and self-employment taxes.
 - 2.14 To contribute to the defense and settlement of litigation arising out of transactions in which Agent was to or should have, in an amount equal to Agent's percentage share of the fees.
 - 2.15 To join and pay fees for membership to professional organizations in which Broker is a member.
 - 2.16 Other _____.
3. **BROKER agrees:**
 - 3.1 To maintain a real estate Broker's license in the State of California.
 - 3.2 To maintain office(s) with proper facilities to operate a general real estate brokerage business.
 - 3.3 To maintain membership in the following professional organization(s):
Multiple Listing Service
Local Branch of the California Association of Realtors and National Association of Realtors.
 - 3.4 To maintain listings.
 - 3.5 To provide advertising approved by Broker.
 - 3.6 To provide worker's compensation insurance for Agent.
 - 3.7 To file informational tax returns on Agent's fee or other compensation, under State and Federal Tax regulations.
 - 3.8 To pay Agent as specified in the Broker's fee schedule at section 5.
 - 3.9 To maintain the following insurance coverage for Agent:
Errors and Omissions Life Health Dental
 - 3.10 Other _____.
4. **General Provisions:**
 - 4.1 Agent has the right to purchase any properties listed by Broker on full disclosure to the Broker of the Agent's activity as a principal, and without deduction of fees to the Broker.
 - 4.2 Agent is authorized to enter into any documents required to perform any of the services referenced in this agreement.
 - 4.3 Broker has the right to reject any listing or realtor agreement obtained by Agent.
 - 4.4 Broker has the right to determine whether any litigation or dispute involving the Broker, or their business and third parties, arising from Agent's activities, will be prosecuted, defended or settled.
 - 4.5 Arbitration: Any dispute between the Agent and the Broker or with any other Agent employed by Broker that cannot be settled by the Broker, or resolved by the State Labor Commission or by non-binding mediation, will be arbitrated under the rules of the American Arbitration Association.
 - 4.6 See addendum for additional provisions.

FORM 506 08-15 ©2015 RPN - Realty Publications, Inc. P.O. Box 9707, RIVERSIDE, CA 92517

Figure 3

Form 506

Independent
Contractor
Employment
Agreement

For a full-size, fillable copy of this or any other form in this book that may be legally used in your professional practice, go to realtypublications.com/forms

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.¹⁴

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.

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.

The IC: an agent of the broker

In spite of the 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 injury presented in the prior scenario occurred while the agent was acting within the course and scope of their agency with the broker. Thus, the broker cannot escape liability for their agent's negligence.¹⁵

¹⁴ Gipson, *supra*

¹⁵ Gipson, *supra*

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.¹⁶

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.¹⁷

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

Unemployment insurance benefits

Minimum wage exclusion

¹⁶ Grand, *supra*

¹⁷ Calif. Unemployment Insurance Code §650

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.¹⁸

Workers' compensation coverage for employees

Brokers often ignore or are unfamiliar with **workers' compensation** requirements for their agents. Erroneously, employing brokers — of which there are about 23,600 with one or more agents — 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.¹⁹

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.²⁰

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.

¹⁸ Calif. Labor Code §1171

¹⁹ Lab C §2750.5

²⁰ California Department of Real Estate Bulletin, Fall 2004, Page 10

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.²¹

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.²²

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.²³

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.

²¹ Lab C §4150

²² Lab C §3700

²³ Lab C §3351(c)

**Office
Management
Chapter 1
Summary**

To ensure a greater degree of consistency and competence in the rendering of brokerage services, California law regulates:

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

Only licensed brokers are authorized to provide brokerage services to members of the public. Sales agents are representatives of the licensed broker, and render brokerage services on the broker's behalf.

When a broker employs a sales agent, 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 California Department of Real Estate (DRE).

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.

Most sales agents receive compensation from their brokers as independent contractors (ICs) 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.

However, even though the agreement is called an "independent contractor" agreement, the agent is an agent of their employing broker and not a separate operator independent of their broker.

As an outside salesperson who regularly works more than half of their time away from their place of employment, a real estate sales agent is excluded from collecting a minimum wage from their broker. However, all real estate brokers in California have to provide workers' compensation insurance coverage for their sales agents.

**Office
Management
Chapter 1
Key Terms**

business model	pg. 4
clients	pg. 2
independent contractor (IC)	pg. 6
licensed activities	pg. 4
listing agreement	pg. 2



Creation of office policies, rules and systems for review

After reading this chapter, you will be able to:

- successfully recruit and interview prospective agents;
- recognize the positive attitudes and characteristics of an agent seeking employment;
- develop and implement a risk reduction program to minimize liability exposure;
- identify the types of risk a brokerage office may be exposed to and what steps can be taken to mitigate them; and
- properly hire and manage unlicensed assistants to perform administrative activities on behalf of the broker or their agents.

business model
errors and omissions (E&O)
insurance

pure risk
risk reduction program
unlicensed assistant

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 brokers with track records that exceed typical production standards. Regardless of your **business model**, the process of recruiting always includes:

- a recruiting goal;
- a plan of action; and

Chapter 2

Learning Objectives

Key Terms

Setting standards for recruiting agents

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.

- minimum standards. [See *Office Management* Chapter 1]

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 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 an agent

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

- **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.
- **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.
- **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.
- **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.

- **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.
- **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.
- **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.

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 Form 504 accompanying this chapter]

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 Form 504 §§1 and 2]

Interviewing an agent

Form 504

Agent Income
Data Sheet

Page 1 of 2

AGENT'S INCOME DATA SHEET		
NOTE: This form is used by an agent or broker when analyzing the income and expenses they are likely to experience while employed by a broker, to estimate their entry or change-of-office costs and their anticipated annual gross income and expenses resulting from the employment.		
DATE: _____, 20____ Brokerage office: _____		
ANNUAL INCOME AND EXPENSES:		
1. Gross Brokerage Fees [See instructions at line 11.4]	\$ _____	100 %
1.1 Franchise fee disbursement (_____ % of \$ 1.) (-) \$ _____		
a. Subtotal	\$ _____	
1.2 Broker retains _____ % of <input type="checkbox"/> \$1., or <input type="checkbox"/> \$1.1a. (-) \$ _____		
2. Gross Fees due Agent	\$ _____	_____ %
3. Transaction Deductions by Broker:		
3.1 Less:		
a. E & O premium (\$ _____ per closing) \$ _____		
b. Prior client promotion (_____ % of fee) . . . \$ _____		
c. Listing/Transaction coordinator \$ _____		
d. Other _____ . . . \$ _____		
3.2 Total charges withheld (-) \$ _____		_____ %
4. Office Expenses:		
4.1 Equipment rent \$ _____		
4.2 Forms & manuals. \$ _____		
4.3 Desk space and parking charges \$ _____		
4.4 Membership:		
a. Trade association \$ _____		
b. MLS fees. \$ _____		
c. Affiliations \$ _____		
4.5 Supplies/software updates \$ _____		
4.6 Postage/delivering services \$ _____		
4.7 Library/subscriptions. \$ _____		
4.8 Photocopies. \$ _____		
4.9 Equipment use charge \$ _____		
4.10 Total office expenses: (-) \$ _____		_____ %
5. Agent's Business Expenses:		
5.1 Telephone:		
a. Phone/fax \$ _____		
b. Cell phone \$ _____		
5.2 Auto:		
a. Gas/oil. \$ _____		
b. Repairs and maintenance/carwash \$ _____		
c. Insurance \$ _____		
d. Loan/lease payment. \$ _____		
e. Registration \$ _____		
5.3 Printing:		
a. Farm letters \$ _____		
b. Postage \$ _____		
5.4 Licensing fees and education \$ _____		
5.5 Internet service \$ _____		
5.6 Legal and accounting. \$ _____		

PAGE ONE OF TWO — FORM 504 —

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

----- PAGE TWO OF TWO ----- FORM 504 -----

5.7	Marketing sessions	\$	_____	
5.8	Travel/hotel	\$	_____	
5.9	Entertainment	\$	_____	
5.10	Insurance (business and health)	\$	_____	
5.11	Total Business Expenses	(-) \$	_____	_____ %
6. Marketing and Sales Expenses:				
6.1	Printing flyers/mailler for listings.	\$	_____	
6.2	Property ads:			
a.	Newspaper/magazine	\$	_____	
b.	TV/radio/web	\$	_____	
6.3	Postage (marketing)	\$	_____	
6.4	Property preparation	\$	_____	
6.5	Open house (food/drinks)	\$	_____	
6.6	Gifts on closing	\$	_____	
6.7	Transactional expenses	\$	_____	
6.8	Total marketing and sales expenses	(-) \$	_____	_____ %
7.	Agent's Net Income:	\$	_____	_____ %
7.1	Income, SS & medicare taxes	(-) \$	_____	_____ %
8.	Agent's After-Tax Income	\$	_____	_____ %
9. Other Income Sources:				
9.1	Draw/Advance	\$	_____	
9.2	Other	\$	_____	
9.3	Other	\$	_____	
10. Cost-of-Entry/Change-of-Office Analysis:				
10.1	Marketing course	\$	_____	
10.2	Lock boxes	\$	_____	
10.3	Open house signs	\$	_____	
10.4	Stationary/cards	\$	_____	
10.5	Computer/programs/printer	\$	_____	
10.6	Office furniture	\$	_____	
10.7	Photocopier	\$	_____	
10.8	Phone/fax equipment	\$	_____	
10.9	Phone installation	\$	_____	
10.10	Camera/printer	\$	_____	
10.11	Vehicle	\$	_____	
10.12	Other	\$	_____	
10.13	Other	\$	_____	
10.14	Total Entry/Relocation Costs:	\$	_____	
11. Gross Brokerage Fee Projection/Forecast:				
11.1	Annual after-tax income desired by agent.	\$	_____	
11.2	Divide by percentage of after-tax income at \$8.	(+) _____		
11.3	Annual Gross Brokerage Fee needed at \$1.			
	to earn the desired after-tax income at \$11.1:	(=) _____		
11.4	Analyze the source of Gross Brokerage Fees at \$1 by setting the price of the typical transaction Agent will close, the dollar amount Broker will receive as the Gross Brokerage Fee on the typical transaction, and the number of typical transactions Agent must close within one year to attain the Gross Brokerage Fees set as the goal at \$11.3.			

FORM 504 08-15 ©2015 RPI – Realty Publications, Inc. P.O.Box 5707, RIVERSIDE, CA 92517

Form 504

Agent Income
Data Sheet

Page 2 of 2

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 if the agent is employed by the broker.

Tracking agent compliance with policy

After a broker locates and hires a staff of agents, without an **administrative structure** to verify the broker's agents are conducting themselves as intended, the broker is exposed to an unnecessary *risk of loss*. **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 maintenance of client files.

Sexual harassment prevention

By 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 **Department of Fair Employment and Housing** publishes free online sexual harassment prevention training courses that satisfy California's legal training requirements at www.dfeh.ca.gov/shpt.*

Risk reduction program

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 others in real estate transactions. Thus, brokers need to maintain a **risk reduction program** to keep claims from clients and others under control.

Steps necessary to establish a *risk reduction program* include:

- All activities exposing the broker to liability are **identified** based on whether the activity risks causing the client or others to be injured financially.
- 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 eliminated or performed properly to avoid causing a loss to a client, others or the broker.
- An **evaluation** is undertaken into what types of loss a client, others or the broker might experience if the broker or their agents engage in the identified activity, or a modified or alternative version of the activity.
- Brokerage activities are **chosen** and procedures **adopted** to set parameters for the agent's conduct, based on whether they fall within the broker's comfort zone for an acceptable level of exposure to liability.
- Agent **compliance** with authorized activities is tracked, coupled with ongoing remedial training and dispute resolution conduct for claims made by clients and others.

risk reduction program

Office procedures implemented and actively overseen by a broker to mitigate risk of liability by ensuring the broker's employees conduct themselves as the broker expects.

To initiate an analysis for managing a broker's 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.

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.

The broker needs to determine what it is about a particular activity that could expose them to liability. This question is to be considered when defining the handling of an activity, such as a diligent visual inspection of property, the preparation of a *Transfer Disclosure Statement (TDS)* or review of an *annual property operating statement (APOD)*. This break down of the identified activity into its component parts becomes the checklist of proper and improper conduct. [See **RPI** Forms 304 and 352]

One of the activities to be identified in the first step of a risk reduction program is the giving of an **opinion** in response to an inquiry regarding a property.

Statements made by an agent to their client are expressed as either an *opinion* about an uncertain future event, or as an **assurance** the events and conditions will occur, becoming a **guarantee**. The difference between the wording used by an agent to express either an opinion or a guarantee exposes the agent and their broker to liability when the buyer acts in reliance on the information and the event or condition fails to occur.

Identification of activities creating risk

Opinion versus assurance

In an opinion, the event or condition expressed is not a *factual representation*. An opinion does not create any liability if the event does not occur, so long as the agent's opinion is a belief honestly held by the agent. However, a special condition or circumstance may exist which imposes liability.

Due to an agent's experience or special training in a particular aspect of a property or type of transaction, agents may find their opinion is given extra weight by a buyer. Thus, an agent's wording of their opinion needs to express that the opinion is only their belief on the matter.

To prevent an opinion from becoming an *assurance*, the buyer's broker needs to recommend the client investigate the terms of the opinion independently. Coupling an opinion with advice that no further investigative action is necessary elevates the opinion to the level of a *guarantee*.

The difference between the wording used by an agent to express an *opinion* or a *guarantee* exposes the agent and their broker 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.

Thus, brokers need a *checklist of actions* to take regarding the process for the agent's development and communication of an opinion.

Activities that create risk

Risky actions are occasionally incorporated into an otherwise appropriate activity, exposing the seller to loss and the broker to liability.

For example, agents often do not advise sellers that property disclosures are mandated to be delivered to prospective buyers as soon as possible after the prospect first seeks further information about the property. Likewise, seller's agents improperly present adverse information about a property to the buyer at the last minute – well after a binding purchase agreement exists, escrow is open and the buyer has arranged financing.

Nondisclosure *before entry* into a purchase agreement creates an ambiguity about the property's conditions, and thus the proper price to pay. This conduct exposes brokers to liability (read: risk) when the buyer experiences lost expectations of value.

Other components of an identified activity also evaluated for risk of loss include:

- Who is the source of information given to a client?
- How credible is the source of the information?
- When is due diligence information gathering activity be undertaken?
- What is the proper time for releasing known information to prospects?
- What readily available information needs to be obtained and reviewed for unknown (but knowable) facts?

- What other decisions could produce adverse consequences while performing the identified activity?

Having created a list of brokerage activities and actions a broker's agents will be engaged in, an **assessment** is 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 might occur, the significance of the loss needs to be **evaluated** to determine its financial impact – 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.

As a buffer against liability, a broker can purchase negligence insurance, called **errors and omissions insurance**, or more simply, **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 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.

Even with insurance, each broker hiring agents needs to determine what level of risk is acceptable for them when undertaking a chosen brokerage activity.

For example, risks in providing information to clients and others might only result in minimal liability exposure for claims. These are **absorbable risks** the broker and their agents can take which are either uninsured or within the range of the deductible not paid by the insurer. When brokers authorize absorbable-risk conduct, an agent needs to agree to contribute to any settlement paid by the broker on claims generated by the agent's conduct.

However, some conduct in the performance of agency duties are **pure risks** which need to be avoided since they lead to *absolute liability* as entirely unacceptable acts. *Pure risks* include:

- deceit;
- withholding known or unknown but readily available information; or

Assessment of adverse consequences

E&O insurance to mitigate risk

errors and omissions (E&O) insurance
An insurance policy protecting brokers and agents from negligent conduct when acting as a licensee.

Avoiding acceptable levels of conflict

pure risk
Entirely unacceptable acts leading to absolute liability for the misconduct.

- misstating or permitting the misstatement of facts or consequences of facts which cause the person relying on the statements to suffer a financial loss.

Substandard activity, sometimes called a **classified risk**, needs to be given special emphasis. This activity generally leads to a lack of proper performance. Occasionally it is the activity itself which is considered improper and automatically imposes liability for any losses it may cause.

Each broker hiring agents will have a different level of acceptable risk they are comfortable with. Whatever that level may be, policy measures need to be adopted to provide guidelines and instructions on just what steps agents are to take when conducting a brokerage activity chosen by the broker as an acceptable risk.

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. Simply: **continuing management**.

A broker's management of unlicensed assistants

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. [See **RPI** Form 507]

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.

All employees of a broker must be hired under written contracts of employment, including *unlicensed assistants*. [See **RPI** Form 507 accompanying this chapter]

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.¹

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.²

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

- handling documents;
- performing tenant-related negotiations;

¹ Calif. Business and Professions Code §10131.01(a)

² Bus & P C §10137

ASSISTANT EMPLOYMENT AGREEMENT Unlicensed Administrative Assistant
<p>NOTE: This form is used by an employing broker when entering into an agreement hiring an unlicensed administrative assistant for the broker or a licensee employed the broker, to set forth the assistant's activities and compensation and establish the supervisory role of the broker and the licensee.</p>
<p>DATE: _____, 20____, at _____, California. <i>Items left blank or unchecked are not applicable.</i></p>
<p>FACTS:</p> <p>1. _____, as the Broker, hereby employs _____, as the Assistant, to perform nondiscretionary administrative duties on behalf of <input type="checkbox"/> Broker, or <input type="checkbox"/> Licensee _____, until terminated by Broker.</p> <p>1.1 Assistant is an employee subject to income tax withholding and unemployment insurance coverage.</p>
<p>AGREEMENT:</p> <p>2. ASSISTANT AGREES TO:</p> <p>2.1 Comply with office policies established by Broker.</p> <p>2.2 Diligently perform duties assigned by the Broker or Licensee.</p> <p>2.3 Assist in the implementation of Licensee's activities in the course and scope of Licensee's employment with Broker. [See RPI Form 505 and 506]</p> <p>2.4 Schedule appointments for Broker or Licensee to meet with clients and others as requested by Broker or Licensee.</p> <p>2.5 Prepare documents and design advertising, brochures and fliers as instructed by Broker or Licensee.</p> <p>2.6 Arrange for or deliver or pick-up reports, informational statements and documents related to Broker's or Licensee's transactions.</p> <p>2.7 Arrange for and give third-party service providers access to properties in Licensee's transactions.</p> <p>2.8 Perform administrative activities while assisting at an open house, such as greeting the public, providing pre-printed facts sheets, arranging appointments and greeting the public.</p> <p>2.9 Participate in any educational programs or meetings when advised by Broker or Licensee.</p> <p>2.10 Furnish their own transportation and carry a liability and property damage insurance policy in an amount satisfactory to Broker with a policy rider naming Broker as a co-insured.</p> <p>2.11 <input type="checkbox"/> Solicit prospective buyers, owners, borrowers, or tenants for referral to Broker's services as an unlicensed finder. [See RPI Form 115]</p> <p>2.12 Enter into no agreement obligating Broker or Licensee without Broker's or Licensee's prior instructions.</p> <p>2.13 Divulge to no one the business or names of clientele, lists or descriptions of forms, trade secrets or business practices of Broker or Licensee during or after the term of this agreement.</p> <p>2.14 Engage in no activity that requires a real estate license.</p> <p>2.15 Other _____</p>
<p>3. LICENSEE AGREES TO:</p> <p>3.1 Oversee and supervise all activities of Assistant to ensure compliance with Broker's office policy and that Assistant is not conducting any licensed activity.</p> <p>3.2 Maintain a real estate license in the State of California.</p>
<p>4. BROKER AGREES TO:</p> <p>4.1 Maintain a license as a real estate broker in the State of California.</p> <p>4.2 Maintain an office with proper facilities to operate a real estate brokerage business.</p> <p>4.3 Provide worker's compensation insurance for Assistant.</p> <p>4.4 Maintain the following insurance coverage for Assistant: <input type="checkbox"/> Health <input type="checkbox"/> Dental <input type="checkbox"/> Life <input type="checkbox"/> _____</p>
----- PAGE 1 OF 2 — FORM 507 -----

Form 507

 Assistant
 Employment
 Agreement

Page 1 of 2

- 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.³

Form 507

Assistant
Employment
Agreement

Page 2 of 2

----- PAGE 2 OF 2 — FORM 507 -----

4.5 Withhold from the Assistant's compensation all appropriate state and federal income taxes, state disability insurance, and social security taxes.

4.6 Other _____

5. **COMPENSATION:**

5.1 Assistant to be compensated by Broker as follows:

a. ☐ \$ _____ per hour bi-weekly in equal installments on every other _____.

b. ☐ \$ _____ per hour semi-monthly on _____ and _____.

c. ☐ _____ [See RPI Form 250]

5.2 Assistant to be reimbursed for reasonable business expenses incurred while fulfilling the duties of this employment.

5.3 ☐ Broker, or ☐ Licensee to keep record of Assistant's work hours.

6. **GENERAL PROVISIONS:**

6.1 Any dispute between Assistant, Broker or Licensee that cannot be settled by Broker, or resolved by the State Labor Commission or by non-binding mediation, will be arbitrated under the rules of the American Arbitration Association.

6.2 _____

6.3 ☐ See addendum for additional provisions. [See RPI Form 250]

I agree to render services on the terms stated above.

Date: _____, 20____ Address: _____

Assistant's Name: _____

Agent's Name: _____ Phone: _____ Cell: _____

Email: _____

Signature: _____

I agree to employ Assistant on the terms stated above.

Date: _____, 20____

Broker's Name: _____ Licensee's Name: _____

CalBRE #: _____ CalBRE #: _____

Signature: _____ Address: _____

Address: _____

Phone: _____ Cell: _____

Phone: _____ Cell: _____

Email: _____ Email: _____

FORM 507 09-15 ©2015 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517

Handling
documents

A common activity for an unlicensed employee is to act as a **transaction coordinator (TC)**. Here, the assistant 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.⁴ [See **RPI** Form 507 §2.6]

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 negotiations, 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.⁵

An **unlicensed finder** is someone who identifies and refers potential real estate clients or participants to a broker, agent or principal in exchange for a fee.

A finder in California may only:

- 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].

A finder may not:

- aggressively solicit participants to a real estate transaction;
- take part in any negotiations;⁶
- discuss the price;

Property management

Referrals for prospective clients

⁴ DRE Bulletin, Winter 1993

⁵ Bus & P C §10131.01(a)(1)

⁶ Bus & P C §10131(a)

- discuss the property; or
- discuss the terms or conditions of the transaction.⁷

A finder who crosses into any aspect of negotiation which leads to the creation of a real estate transaction needs a real estate license since they are both *finding 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**. Also, 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.⁸

In addition, a broker who permits a finder or anyone in their employ to perform any type of “licensed” work beyond a referral may have their license suspended or revoked.⁹

Editor's note — A broker's ongoing employment of a finder to find clients is permitted by California statute and case law. However, the DRE views finder activities in a more limited capacity, restricting them to occasional, nonrecurring referrals.

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.¹⁰

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

⁷ **Spielberg Granz** (1960) 185 CA2d 283

⁸ Bus & P C §§10137, 10139

⁹ Bus & P C §§10131, 10137

¹⁰ DRE Bulletin, Winter 1993

- 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.

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. [See *Office Management* Chapter 6]

Without an administrative structure and oversight to verify a broker's agents are conducting themselves as intended, the broker is exposed to an unnecessary risk of loss.

Oversight requires:

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

Steps necessary to establish a risk reduction program include:

- identifying activities exposing the broker to liability based on whether an activity creates financial risks for a client or others;
- evaluating the types of loss a client, the broker or others may experience if the broker or their agents engage in identified activities;
- adopting brokerage activities and setting parameters for the agent's conduct to reduce exposure to liability; and
- tracking agent compliance with authorized activities, and providing ongoing remedial training and dispute resolution for claims made by clients and others.

Limited communications

Office Management Chapter 2 Summary

As a buffer against liability, a broker can purchase errors and omissions (E&O) negligence insurance. E&O insurance protects brokers from the full cost of defending against a negligence claim made by a client or others.

Brokers may hire unlicensed assistants to perform administrative and nondiscretionary activities on their behalf and on behalf of their agents. Brokers may assign tasks to their unlicensed employees, such as:

- handling documents;
- performing tenant-related negotiations;
- canvassing for prospective clients; and
- opening a property to third-party service providers.

All unlicensed personnel performing on the broker's behalf need to do so with the broker's permission and their activities continuously supervised.

**Office
Management
Chapter 2
Key Terms**

business model	pg. 15
errors and omissions (E&O) insurance	pg. 23
pure risk	pg. 23
risk reduction program	pg. 21
unlicensed assistant	pg. 24



Review of agent activities, records, funds and reports

Chapter 3

After reading this chapter, you will be able to:

- properly document, track and supervise all activities which arise within a broker's office due to the existence of an employment;
- generate a complete client file to house all the information and documents related to a transaction;
- abide by the California Department of Real Estate's (DRE's) regulations concerning the three year retention of real estate documents;
- manage, receive, deposit, hold, oversee and disburse trust funds;
- implement an office-wide safety education program and enforce office safety standards;
- properly notify the DRE when a salesperson is terminated for violating real estate law.

client file
commingling
office manager

transaction coordinator
trust funds
broker-associate

Learning Objectives

Key Terms

Only a California Department of Real Estate (DRE)-licensed broker is authorized to advertise, contract for and provide services to real estate clients in expectation of compensation. Further, the broker is the only individual who may lawfully pay the sales agent for real estate related services. All types of compensation arising out of licensed services are first paid to the broker, and in turn the broker pays the sales agent as agreed in writing.¹ [See **RPI** Forms 505, 506 and 507]

¹ Calif. Civil Code §2079.13(b)

Tracking transactions handled by a broker's agents

As an employee, a sales agent's real estate activities need to be supervised at all times by their **employing broker**. The broker is responsible for the consequences of all their agents' activities carried out *within the course and scope* of their employment with the broker. When a broker fails to properly supervise their sales agents, they face review from the DRE upon a complaint made by another licensee or member of the public.²

Duties to supervise sales agents include:

- establishing *office policies* and procedures;
- storing all *transaction documents* appropriately;
- handling *trust funds* received by the agent for deposit, retention or transmission;
- overseeing *advertisements*;
- ensuring compliance with *unlawful discrimination, fair housing and agency laws* [See *Office Management* Chapter 4];
- soliciting and negotiating client *listings and real estate transactions – sales, property management/leasing and mortgage activity*; and
- reviewing periodic *transaction reports* from agents for compliance with office policy.³

Tracking the transaction

At the core of broker supervision is the duty owed the DRE to be aware of the agent's activity on real estate transactions. To accomplish this, the broker needs to require their employed agents, whether sales agents or broker-associates, to report when:

- a listing is taken;
- an offer is accepted; and
- the sale closes escrow.

However, it's most prudent to have their agents report transaction activity by documentation at every step of the process. Documentation provides primary evidence of the agent's activities which helps the broker fulfill their duty to supervise. It also gives the broker a paper trail to refer to when something goes wrong (i.e. if an agent is negligent or a client pursues legal action against the broker and sales agent).

Documentation of activities undertaken

When a sales agent enters into a listing with a client for the services of their broker's staff, they need to prepare and submit a checklist type of form to the broker's *transaction coordinator*. On the form, they note all relevant information about activities undertaken in the employment. This includes information on:

- the type of listing;
- the client;
- how the listing was obtained;

² **Gipson v. Davis Realty Company** (1963) 215 CA2d 190; Calif. Business and Professions Code §10177(h)

³ California Department of Real Estate (DRE) Regulations §2725

LISTING INFORMATION REPORT For Broker's Administrative Use	
NOTE: This form is used by a seller's agent when setting up a file for a property listing as part of their employment with a broker, to summarize the terms and details of a property listing for their broker's supervisory review.	
DATE: _____, 20____, prepared and submitted by _____, office _____	
Instructions to Listing Agent: Check and enter information about the listing as appropriate.	
1. Listing status: 1.1 <input type="checkbox"/> New listing (Agent to fully complete this report) 1.2 <input type="checkbox"/> Modification of a listing (Agent to enter changes in appropriate blanks)	
2. The Listing Employment: 2.1 This employment is for an <input type="checkbox"/> exclusive right to sell, _____ 2.2 This employment commenced on _____, 20____ and expires _____, 20____ 2.3 Award credits due Agent for this listing include _____ 2.4 The listing price is \$ _____ 2.5 The property was previously listed with _____ under a listing expired on _____, 20____. a. Prior listing contained a safety clause which <input type="checkbox"/> expired, or expires _____, 20____.	
3. Brokerage Fees: 3.1 The brokerage fee to be paid by Seller is _____% of the sales price, or a flat fee of \$ _____ 3.2 Listing Agent's name _____ office _____, _____% split. 3.3 Referring Broker/Agent name _____ office _____ _____ % split, or referral fee of \$ _____, or _____%. 3.4 Name of Broker/Agent for registered Buyers _____ office _____ _____ % split, or referral fee of \$ _____, or _____%. 3.5 Name of unlicensed individual entitled to a finder's fee _____ _____ % split, or referral fee of \$ _____, or _____%. 3.6 Name of Seller's relocation Broker/company _____ Referral fee due our office _____	
4. Property Information: 4.1 Street address/legal _____ 4.2 City, State, ZIP _____ 4.3 Occupancy: <input type="checkbox"/> owner, <input type="checkbox"/> vacant, or <input type="checkbox"/> tenant 4.4 <input type="checkbox"/> New home, <input type="checkbox"/> resale, <input type="checkbox"/> previously bought or sold through office 4.5 Type of property: (check appropriate box) <input type="checkbox"/> single family detached <input type="checkbox"/> condo <input type="checkbox"/> condo high rise <input type="checkbox"/> town house/attached <input type="checkbox"/> mobilehome <input type="checkbox"/> vacant lot <input type="checkbox"/> two-to-four units <input type="checkbox"/> five-or-more units <input type="checkbox"/> acreage <input type="checkbox"/> commercial <input type="checkbox"/> office <input type="checkbox"/> industrial <input type="checkbox"/> farm with residence <input type="checkbox"/> farm with groves	
5. Source of Listing: (check appropriate boxes) 5.1 Publications and periodicals as source of lead: <input type="checkbox"/> newspaper advertisement by Broker, <input type="checkbox"/> classified, or <input type="checkbox"/> display. <input type="checkbox"/> curbside stand publication <input type="checkbox"/> local magazine display advertisement _____ 5.2 Broker and Agent activities as source of lead: <input type="checkbox"/> walk-in/floor call <input type="checkbox"/> prior client <input type="checkbox"/> direct mail <input type="checkbox"/> open house <input type="checkbox"/> discount program <input type="checkbox"/> office seminar <input type="checkbox"/> yard sale <input type="checkbox"/> radio <input type="checkbox"/> TV <input type="checkbox"/> farming <input type="checkbox"/> FSBO conversion <input type="checkbox"/> expired listing <input type="checkbox"/> MLS (local) <input type="checkbox"/> online MLS <input type="checkbox"/> Broker website	
----- PAGE ONE OF THREE ----- FORM 522 -----	

Form 522**Listing
Information
Report****Page 1 of 3**

- the property involved;
- the agreed-to brokerage fees; and
- office duties required to service the client. [See **RPI** Form 522 accompanying this chapter]

It is the broker's **transaction coordinator** or **office manager** who works with the listing agent to identify the steps to be taken to fulfill their **due diligence obligations** owed the client. This includes actions the coordinator can assist with, like ordering the for-sale sign and installing the key safe on a sales listing. [See *Office Management* Chapter 6; see **RPI** Forms 521 and 521-1]

**transaction
coordinator**

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

office manager

A licensee hired by a broker to fulfill the supervisory responsibility of reviewing documents and maintaining office files. [See **RPI** Form 510]

Form 522

Listing
Information
Report

Page 2 of 3

----- PAGE TWO OF THREE ----- FORM 522 -----

5.3 Referrals as source of lead:

<input type="checkbox"/> acquaintance	<input type="checkbox"/> escrow officer	<input type="checkbox"/> lender representative
<input type="checkbox"/> Broker reputation	<input type="checkbox"/> prior client	<input type="checkbox"/> other Broker or Agent
<input type="checkbox"/> finder	<input type="checkbox"/> relocation department	

6. Client Information:

6.1 Name of Seller _____
Mailing address _____
Phone numbers: Cell _____, Work _____ ext. _____, Home _____
Seller's email address _____

6.2 Name of Seller _____
Mailing address _____
Phone numbers: Cell _____, Work _____ ext. _____, Home _____
Seller's email address _____

6.3 Seller's motivation to sell: (check appropriate boxes)

<input type="checkbox"/> retirement home	<input type="checkbox"/> REO	<input type="checkbox"/> medical
<input type="checkbox"/> debt reduction	<input type="checkbox"/> need larger home	<input type="checkbox"/> need smaller home
<input type="checkbox"/> divorce/death	<input type="checkbox"/> foreclosure	<input type="checkbox"/> build/develop
<input type="checkbox"/> marriage	<input type="checkbox"/> reinvest	<input type="checkbox"/> estate/probate
<input type="checkbox"/> relocate for job	<input type="checkbox"/> become a tenant	<input type="checkbox"/> leave area

6.4 Seller's relocation intentions: (check or enter information as appropriate)
Seller is relocating to (city/state) _____
☐ already owns relocation property
☐ remaining in local area
☐ relocation broker _____ referral fee _____ %; to _____

7. Office activity due to listing:

7.1 ☐ Thank you letter to Seller
7.2 ☐ Listing/property information to marketing and advertising
7.3 ☐ Flyer preparation
7.4 ☐ Order For Sale signs
7.5 ☐ MLS profile sheet and Broker lead
7.6 ☐ Internet submissions
7.7 ☐ Lockbox. If no lockbox, key is _____
7.8 ☐ Notice to tenant that property is for sale with 24-hour telephonic notice to show [RPI Form 116]
7.9 ☐ Caravan: MSL caravan date _____ Office caravan date _____
7.10 ☐ Advertising submitted
7.11 ☐ Agent/Seller instructions for showing _____
7.12 ☐ _____

8. Addenda to the Listing Agreement:

8.1 ☐ Agency Law Disclosure – Real Estate Agency Relationships [RPI Form 305]
8.2 ☐ Federal Residency Declarations – Citizen Status [RPI Form 301]
8.3 ☐ California FTB Withholding Certificate [FTB Form 590]
8.4 ☐ Good Faith Estimate of Seller's Net Proceeds – On Sale of Property [RPI Form 310]
8.5 ☐ Work Authorization [RPI Form 108]
8.6 ☐ Listing Package Cost Sheet – Due Diligence Checklist [RPI Form 107]
8.7 ☐ Affiliated Business Arrangement Disclosure Statement – Residential Broker (Regulation X (RESPA); 24 CFR §3500.51) [RPI Form 519]
8.8 ☐ Conflict of Interest Disclosure – Kinship, Position or Undue Influence [RPI Form 527]
8.9 ☐ _____

9. Listing Package:

9.1 ☐ Property profile report from title company:
☐ agent to order, cost paid by ☐ Seller, or _____

----- PAGE TWO OF THREE ----- FORM 522 -----

The broker reviews these completed forms, directly or through the office manager they have employed. [See *Office Management* Chapter 6]

The review needs to be done regularly, once a week or at minimum once a month depending on the nature of the listing and the size of the broker's staff.

The broker also needs to decide how often the agent will update the status of the listings with the transaction coordinator on the listings they obtained. For smaller brokerages, the broker may want to meet with the sales agent themselves for regular updates, especially with sales agents new to the office, to make sure they're acting in compliance with the policies set and conduct expected by the broker.

----- PAGE THREE OF THREE ----- FORM 522 -----

9.2 ☐ Natural Hazard Disclosure Statement [RPI Form 314]:
☐ agent to order [RPI Form 131], cost paid by ☐ Seller, or _____

9.3 ☐ Home (property) Inspection Report:
☐ agent to order [RPI Form 130], cost paid by ☐ Seller, or _____

9.4 ☐ Transfer Disclosure Statement (TDS) [RPI Form 304]

9.5 ☐ Structural Pest Control Report, ☐ corrective work and clearance:
☐ agent to order [RPI Form 132], cost paid by ☐ Seller, or _____

9.6 ☐ Lead-Based Paint Disclosure – On Sale of Real Estate [RPI Form 313] (for property built before 1978)

9.7 ☐ Residential Earthquake Hazards Report [RPI Form 315] (for property built before 1960)

9.8 ☐ Local Ordinance Occupancy and Retrofit Report, ☐ compliance:
☐ agent to order [RPI Form 133], cost paid by ☐ Seller, or _____

9.9 ☐ Homeowners' Association (HOA) Documents (CID-condos):
☐ agent to order [RPI Form 135], cost paid by ☐ Seller, or _____

9.10 ☐ Seller's Neighborhood Security Disclosure Statement [RPI Form 321]

9.11 ☐ Request for Notice of Mello-Roos Assessment:
☐ agent to order [RPI Form 137], cost paid by ☐ Seller, or _____

9.12 ☐ Occupant's Operating Expense Sheet – Ongoing Operating Costs [RPI Form 562]

9.13 ☐ Hazard Insurance Conditions (fair plan/prior claims) [RPI Form 261]

9.14 ☐ Annual Property Operating Data Sheet (APOD) [RPI Form 352]

9.15 ☐ Energy benchmarking compliance disclosure for commercial properties.
☐ agent to order, cost paid by ☐ Seller, or _____

9.16 ☐ RPI's Income Property Brokerage (IPB) Suite of Forms

9.17 ☐ _____

9.18 ☐ _____

9.19 ☐ _____

9.20 ☐ _____

FORM 522 09-15 ©2015 RPI – Realty Publications, Inc. P.O.Box 5707, RIVERSIDE, CA 92517

Form 522

Listing
Information
Report

Page 3 of 3

The broker will find it helpful to have agents report all actions taken on behalf of a listed client in a single **file activity sheet** for that listing. Additionally, reports tracking each action on the listing assist the sales agent as a review of their time spent with each client. Keeping records induces efficiencies when scheduling activities and planning for future listings. [See Figure 1, excerpt from **RPI Form 520**]

Finally, when escrow is closed on a sales transaction a **property sold report** is prepared. This lists the property's sales price and the fees paid to the broker, listing agent and any referral fees. It also contains information on trust account funds, service providers and the buyer and seller for structuring future marketing. [See **RPI Form 523**]

Property sold
report

Or, if the property does not sell and the listing expires, the agent files an **expired listing report**. Here, the agent details the steps taken to sell the property, why the property did not sell and whether or not the brokerage should consider working with this client in the future. [See **RPI Form 522-1**]

Agents and broker-associates aren't the only individuals who perform duties on behalf of the broker. It's common for a corporate broker to hire office managers, administrative assistants and *transaction coordinators*. [See *Office Management* Chapter 6]

Supervision of
all employees

Methods of tracking

To ensure everyone is doing their job, the broker needs to set procedures in place for documenting the transaction across all participants from start to finish.

Depending on how tech savvy the brokerage is, the preferred method of tracking varies. The bare bones tracking method is a spreadsheet with the listing details, dates and amounts paid. And while relying on spreadsheets and filing cabinets is a time-tested way to follow and record sales agent activities, more efficient — *digitized* — ways of tracking now exist to make everyone's lives easier.

For example, **customer relationship management (CRM)** software such as *Property Base* helps brokers manage their agents' listings by storing documents, tracking emails, tracking agent fees and even generating leads. It works with many other online platforms, like *DocuSign* and *MailChimp*, allowing brokers and agents to run their entire business from one platform.

Other programs, such as *Broker Mint*, track transactions, agent fees and offers. It's also integrated with *Quickbooks* to make office accounting easier.

Finally, if a broker wants to take their management activities from paper to the screen, they ought to ask their transaction coordinator what programs they recommend. The coordinator may be familiar with a software already. Or, they may have other ideas about making the tracking process run more smoothly.

The supervisory role of the agent's broker on listing property

The agent who obtained the listing becomes the individual in the broker's office who is initially responsible to the broker for the care and maintenance of the **client's file**.

On entering into a listing employment, the agent sets up a *physical client file* to house information and documentation on all activity which arises within the broker's office due to the existence of the employment.

For example, the file on a listing for the sale of a property is to contain:

- the **original listing agreement** [See **RPI** Form 102];
- the **Agency Law Disclosure** [See **RPI** Form 305];
- any **addenda** and other attachments needed as part of the listing agreement;
- **property disclosure documents** the seller and seller's agent provide to prospective buyers and their agents during the marketing of the property, such as the:
 - Transfer Disclosure Statement (TDS) [See **RPI** Form 304];
 - Natural Hazard Disclosure Statement (NHD) [See **RPI** Form 314];
 - home inspection report [See **RPI** Form 130];
 - pest control report [See **RPI** Form 132]; and
 - local ordinance compliance disclosure [See **RPI** Form 307];

client file

A physical file established at the beginning of a listing to house information and document all the activity which arises within the broker's office due to the existence of the employment.

FILE ACTIVITY SHEET			
NOTE: This form is used by an agent or broker when engaged in a real estate transaction and maintaining records for the employing broker's oversight, to enter information identifying all contacts with the client and others regarding activities which transpired during the agency undertaken.			
FILE# _____			
CLIENT _____			
PROPERTY _____			
DATE	INITIAL	FILE ACTIVITY	TIME SPENT

Figure 1

Form 520

File Activity Sheet

- an **activity sheet** for the entry of information on all activities generated by the employment and marketing effort [See Figure 1, excerpt from **RPI** Form 520]; and
- a **listing information report**. [See Form 522]

The client file contains any paperwork, notes, billings, correspondence, email printouts, fax transmissions, disclosure sheets, worksheets, advertising copy, copies of offers/counteroffers and rejections and all other related documentation. Thus, everything that occurs as a result of the client employment is centrally retained in the client file to be reviewed by the broker.

The **Listing Information Report** — published by **RPI (Realty Publications, Inc.)** — is used by the seller's agent when setting up a file on listing a property for sale. On it, the agent summarizes the terms of the employment and details of the property for their broker's supervisory review.

The listing information report

The report is used when:

- a new listing agreement for the sale of property is taken; and
- modifications are made to the employment or terms for marketing the property. [See Form 522 §1]

The *Listing Information Report* documents:

- details on the employment under the listing agreement [See Form 522 §2];

Figure 2

Excerpt from
Form 521Transaction
Coordination
Sheet (Seller's
Agent)

Reports/Docs Needed		Prepare, Sign, Return		Check Items Needed	Itemized Listing, Marketing, and Closing Activities:
Ordered or Requested Date	Received Date	Sent to Date	Returned Date		LISTING TAKEN:
					Seller's Listing Agreement – Exclusive Right to Sell, Exchange or Option [RPI Form 102]
					Agency Law Disclosure – Real Estate Agency Relationships [RPI Form 305]
					Listing Package Cost Sheet [RPI Form 107]
					Listing information to marketing/advertising
					Photo taken, picked up, distributed
					Weekly ads mailed

----- PAGE ONE OF FOUR -- FORM 521 -----

- the brokerage fee to be paid by the seller and how it is to be split between the broker and agent [See Form 522 §3];
- property information [See Form 522 §4];
- the source of the listing lead [See Form 522 §5];
- the client's information [See Form 522 §6];
- all office activity which arises within the broker's office due to the existence of the listing [See Form 522 §7];
- any addenda to the listing agreement [See Form 522 §8]; and
- all information provided in the listing package. [See Form 522 §9]

Additional forms and documents used to build a file's content may vary depending on the type of property and transaction involved. These forms and documents typically include:

- checklists prepared by a broker or their listing coordinator;
- a transaction coordinator's (TC's) closing checklist [See Figure 2, excerpt from **RPI** Form 521];
- escrow worksheets [See RPI Form 403];
- work authorization forms [See **RPI** Form 118 and 130-134];
- advance fee and advance cost checklists; or
- income property analysis forms. [See **RPI's** Income Property Brokerage (IPB) Suite of Forms]

The broker's file

The client file belongs to the *broker*, not the seller's agent. However, it will likely remain with the listing agent the sale is closed or the listing expires un-renewed. The agent hands the broker the entire file on the close of escrow. Delivery of the file with the agent's final closing report is usually a **condition precedent** to payment of the agent's share of the fee received by the broker.

The broker or office manager periodically reviews the file as a supervisory requirement. Initially on taking a listing and on employment modifications, the filled-out Listing Information Report, along with other pertinent forms and documentation, is thoroughly reviewed by the broker. When the file is closed out by the agent, the report provides the broker or manager with all the information necessary to distribute fee splits and referral fees.

Checklists belong in the file and are used by the agent. They are reviewed periodically by the agent, office manager, TC or employing broker for oversight and to determine future tasks needed to better service the listing and earn a fee.

Following are some — but certainly not all — steps a broker and their agent may undertake to fulfill their employment responsibilities owed to the client.

They include:

- A **property profile** of the seller's title from a title company in order to identify all owners needed to list, sell and convey the property.
- A TDS filled out and signed by the seller. [See **RPI** Form 304]
- A *home inspection report* prepared by a home inspector. [See **RPI** Form 130]
- A **natural hazard disclosure (NHD)** on the property from a local agency or a vendor of NHD reports. [See **RPI** Form 314]
- An **Annual Property Operating Data sheet (APOD)** covering the expenses of ownership and any income produced by the property. [See **RPI** Forms 352 and 562]
- Copies of all the Covenants, Conditions and Restrictions (CC&Rs), disclosures and assessment data from any *homeowners' association* involved with the property. [See **RPI** Form 150 §11.9]
- A *termite report* and clearance paid for by the seller. [See **RPI** Form 150 §11.1(a)]
- A statement on the amount and payment schedule for any special district property improvement bonds which are liens on the property.
- A **visual inspection** of the property and a survey of the surrounding neighborhood by the seller's agent to become informed about readily available facts affecting the marketability of the property.
- *Advising* the seller about the marketability of the listed property based on differing prices and terms for payment of the price, and the financial and tax consequences of various sales arrangements which are available.
- A *marketing 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. This consists of copies of all the property disclosures required to be handed to prospective buyers.
- A *marketing plan* prepared by the seller's agent and reviewed with the seller for locating prospective buyers, such as distributing flyers, disseminating property data in multiple listing services (MLSs), posting "For Sale" signs on the premises and hosting open house events.
- 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. [See **RPI** Form 310]

Guidelines and checklists

- Informing the client of the listing agent's sales activities by weekly due diligence 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.
- Keeping records in a client file of all communications, activities and documents generated due to the listing. [See **RPI** Form 525]

Broker-associate reporting rules

broker-associate

A California Department of Real Estate (DRE)-licensed broker who works in the employment of another DRE broker.

Effective January 1, 2018, real estate brokers are required to notify the DRE in writing when they:

- *enter into an agreement* employing another broker who will act in the capacity of a salesperson, called a **broker-associate**; and
- *terminate the employment* of a broker-associate.⁴

A broker-associate's affiliation will be made public on the DRE Public License Information website.⁵

To notify the DRE of broker-associate employment, the employing broker needs to fill out and mail in DRE Form RE 215. Electronic filing is currently not permitted.

Brokers who entered into employment agreements with broker-associates prior to January 1, 2018 need to file an RE 215 for every broker-associate currently employed. For retroactive reporting, responsible brokers need to use the date of the broker-associate's written employment agreement as the date of employment.

When a broker-associate is employed by more than one broker, each employing broker has a separate duty to file an RE 215 to report the employment to the DRE.

Additionally, when a broker-associate plans to perform real estate activities from a different location than their employing broker's address, their employing broker is required to notify the DRE of the broker-associate's location as a branch office. [See RE 203]

Willful failure to report broker-associate employment or termination of employment is considered a misdemeanor violation of the Real Estate Law, and exposes the employing broker to fines, disciplinary action and/or imprisonment.⁶

Duty to DRE to keep records

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**.⁷

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

⁴ Calif. Business and Professions Code §10161.8(a)-(b)

⁵ Bus & P C §10032

⁶ Bus & P C §10185

⁷ B & P C §10148

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.⁸

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.

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.⁹

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.¹⁰

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

Electronic image storage media

Planning for digital storage

⁸ Bus & P C §10148

⁹ DRE Regs. §2729(a)

¹⁰ DRE Regs. §2729(b)

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.

Funds belonging to others which a broker and their agents handle when acting as agents in a transaction are known as **trust funds**.

Trust funds include:

- rents and security deposits collected under a property management agreement [See **RPI** Form 590];
- good faith deposits tendered by a buyer or tenant with an offer to purchase or lease;
- 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.

Trusts 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.

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.

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**.

Trust fund(amentals)

trust funds

Items which have or evidence monetary value held by a broker for a client when acting in a real estate transaction.

Handling cash and checks

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.¹¹

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.¹²

Also, if trust funds are to be placed in an interest-bearing account, the broker is to 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.¹³ [See **RPI** Form 535]

The withdrawal of trust funds

Once trust funds are deposited, they may only be withdrawn or disbursed as authorized and instructed by the owner of the funds. A third party who has an interest in the funds, such as a seller who acquires an interest in the buyer's good faith deposit on acceptance of a purchase agreement offer, may also be necessary to authorize disbursement.¹⁴

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** Forms 505 and 506]; or
- an unlicensed employee of the named broker, provided the unlicensed employee is **bonded** for the total amount of the trust funds the employee can access.¹⁵ [See *Office Management* Chapter 2]

A **signer** is an employee other than the broker-employer 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.

¹¹ Bus & P C §10145; DRE Regs. §2832(a)

¹² Bus & P C §10145(c)

¹³ Bus & P C §10145(d)(4)

¹⁴ Bus & P C §10145(a)(1)

¹⁵ DRE Regs. §2834(a)

Certain types of restricted licenses are issued by the DRE when a license has been:

- *suspended;*
- *revoked; or*
- *denied after a hearing. [Calif. Bus & PC §10177(k)]*

In effect, restricted licenses are probationary licenses subject to specific restrictions.

The DRE Commissioner may restrict licenses by:

- *employment under a particular broker if the restricted licensee is a salesperson;*
- *duration (such as one month, three months, etc.);*
- *limitation to a certain area or type of activity;*
- *requiring the licensee or their employing broker to supply detailed reports of each transaction;*
- *requiring the restricted licensee to file a surety bond in an amount specified by the DRE; or*
- *other conditions or combinations of conditions.*

Broker supervision over restricted licensees

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 [See *Office Management* Chapter 6]; or
- a licensed or unlicensed employee with the written authorization of the designated officer.¹⁶

The authorization from the corporation is made as part of the employment agreement with each signatory. [See **RPI** Forms 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 DO of a corporate broker from liability for any loss or misuse of trust funds.¹⁷ [See *Office Management* Chapter 6]

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.¹⁸

commingling

The mixing of personal funds with client or third-party funds held in trust.

Except to the limited extent authorized by the *DRE*, commingling is always improper.

Commingling of trust funds is grounds for suspension or revocation of the broker's license.¹⁹

¹⁶ DRE Regs. §2834(b)

¹⁷ DRE Regs. §2834(c)

¹⁸ **Stillman Pond, Inc. v. Watson** (1953) 115 CA2d 440

¹⁹ Bus & P C §10176(e)

Safety first: taking precautions as a real estate agent

Real estate agents regularly encounter new people and places they are not familiar with – it is the nature of the business. To minimize risk, prudent brokers establish office policies which encourage their agents to:

- **Limit initial contact with a client.** Only agree to meet for the first time at the client's office or a listed home where the current occupant is present. This ensures their first point of contact is in a safe environment where they are not alone with a prospective client.
- **Screen prospective clients.** Have them fill out a client profile that collects contact details, and attach a copy of their driver license or identification card. This gives agents sufficient information to identify their client and is likely to discourage those with ill intentions.
- **Use the buddy system.** Have someone accompany the agent to open houses and home showings to reduce the chances of interacting with threatening people or situations. Pairing up does not necessarily call for the agent to partner with another agent – a friend, assistant, lender or spouse can be brought.

At the very least, make sure at least one person knows where you're going, and approximately when you'll be back. [See **RPI** Form 502]

Editor's note — Any participation by an unlicensed individual is limited as they are not permitted to offer advice or information to the agent's clients. [See Office Management Chapter 2]

- **Don't lead, follow behind.** When showing a home, let the prospective buyer walk ahead to maintain visual control of your surroundings. This is both a safety precaution to protect agents, as well as a reliable method for theft prevention. Bonus: letting clients walk ahead allows them to view a home at their own pace.
- **Always carry your phone and keys.** Having a phone accessible at all times allows agents to quickly and easily contact someone in an emergency. Prudent agents will also want to keep hold of their car keys in case they need to quickly exit an out-of-control situation.

Additional safety procedures

In the event an agent feels uneasy around a client or other person they encounter, they are advised to:

- call their office, law enforcement or other person for help;
- have a prewritten text message or distress code ready to send to an emergency contact;
- maintain a safe distance from anyone whose mannerisms indicate potential conflicts;
- come up with an excuse to return to their car or check in with their office; and
- ensure their vehicle is parked in front of a property, not in the driveway, to allow an unobstructed exit.

Further, an agent who maintains professionalism at all times with their appearance and conversation may discourage inappropriate or dangerous

behavior from people they come in contact with over the course of their business. Agents can best set the tone for their interactions with prospective clients or customers by:

- highlighting their professional aptitude with limited personal information;
- providing only their office phone number and address;
- dressing professionally in person and in photos used in advertising;
- foregoing expensive jewelry and accessories; and
- ensuring all marketing material is polished and accurate. [See *Office Management* Chapter 5]

Brokers have the ability to enforce **safety standards** and procedures for the benefit of the agents in their office. To prioritize personal safety, brokers are advised to consider implementing an office-wide *safety education program*. As part of this program, brokers are to review safety tips with agents, provide resources and standardize basic procedures to minimize risk.

A broker's safety plan may include:

- encouraging use of the buddy system as with a team;
- enforcing an office-wide distress code for use by agents in emergencies;
- requiring agents to provide daily itineraries or follow check-in procedures [See **RPI** Form 502];
- designating an emergency contact or network in the office [See **RPI** Form 501];
- developing procedures for handling a missing agent or other emergency; and
- helping agents create advertisements that maximize personal safety.

Implementing safety measures in a broker's office creates a secure environment for their agents and helps develop a dependable support system to build camaraderie during a crisis.

Further, brokers are encouraged to maintain and update records of an agent's contact information, license plate number and a copy of their driver license or identification card. [See **RPI** Form 501]

Brokers are required to notify the DRE when they fire a salesperson for violating real estate law. The penalty for failing to notify the DRE ranges from a temporary license suspension to permanent revocation of the broker's license.²⁰

However, the DRE recently noted that brokers rarely report these violations as required. Brokers fear (rightfully so in some cases) they will also be disciplined for failing to *properly supervise* their employee as required by law.

Broker implementation

Agent violation of real estate law

²⁰ Bus & P C §10178

The DRE assures these brokers they will not be automatically suspect as a result of their former employees' actions. However, if the broker failed to oversee their employees or participated in unlawful activities themselves, they will be subject to disciplinary action.

Of course, the best course of action for a broker is to supervise all employees to ensure they act within the law. Any unlawful activity uncovered needs to be reported to protect the broker's own license. [See *Office Management* Chapter 2]

The other way the DRE may be alerted to unlawful activity is through a **consumer complaint**. An individual negatively affected by a licensee's activity may submit a complaint directly to the DRE, which then investigates that licensee.

Finally, the DRE completes routine audits on select brokerages. These audits can be the result of unannounced office surveys, in which a representative of the DRE visits a brokerage and observes the broker's business practices. If noncompliance is suspected, an official audit is ordered. In other cases, the DRE audits are ordered on random brokerages engaged in activities with a high risk of financial loss, like:

- mortgage loan brokers;
- property managers; and
- broker-owned escrows.

In these random audits, DRE reviews the brokerage's:

- trust fund records;
- licensing compliance;
- transaction files; and
- recordkeeping.

Office Management

Chapter 3 Summary

A sales agent's real estate activities need to be supervised at all times by their employing broker. When a broker fails to properly supervise their sales agents, they face review from the California Department of Real Estate (DRE) upon a complaint made by another licensee or member of the public.

At the core of broker supervision is the duty owed the DRE to be aware of the agent's activity on real estate transactions. Thus, the broker requires their employed agents to report when:

- a listing is taken;
- an offer is accepted; and
- the sale closes escrow.

However, it's most prudent for brokers to have their agents report all transaction activity by documentation at every step of the process.

Documentation provides primary evidence of the agent's activities which helps the broker fulfill their duty to supervise.

On entering into a listing employment, a physical client file is set up to house information and document all activity arising from the broker's office due to the existence of the employment.

For example, the file on a property listing for sale is to contain:

- the original listing agreement [See **RPI** Forms 102 and 103];
- any addenda to the listing;
- all property disclosures provided to prospective buyers during the marketing of the property [See **RPI** Form 304]; and
- an activity sheet for entry of information on all manner of file activity. [See **RPI** Form 520]

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.

Employing brokers are also required to report to the DRE when they hire or terminate the employment of a broker-associate.

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.

The broker needs to regularly account to the owner on the status, expenditure and location of the negotiable trust funds.

To prioritize personal safety, brokers are advised to implement an office-wide safety education program. As part of this program, brokers are to review safety tips with agents, provide resources and standardize basic procedures to minimize risk.

Brokers are required to notify the DRE when they fire a salesperson for violating real estate law. The penalty for failing to notify DRE ranges from a temporary license suspension to permanent revocation of the broker's license.

**Office
Management
Chapter 3
Key Terms**

broker-associate	pg. 40
client file	pg. 36
commingling	pg. 45
office manager.....	pg. 33
transaction coordinator.....	pg. 33
trust funds.....	pg. 43

Chapter 4

Federal and state prohibited discriminatory practices

After reading this chapter, you will be able to:

- distinguish discriminatory practices prohibited under state and federal fair housing laws;
- avoid penalties and liability for losses resulting from the practice of illegal housing discrimination;
- recognize and avoid cases of implicit discrimination; and
- understand the need for brokers and agents to be committed to fair and equitable housing practices.

Civil Rights Act
implicit discrimination
material fact

redlining
Unruh Civil Rights Act

Learning Objectives

Key Terms

Regardless of race, all citizens of the United States have the right to purchase, sell, lease, inherit or hold real estate under the federal **Civil Rights Act**.¹

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.²

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

Property rights for all citizens

Civil Rights Act

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

¹ 42 United States Code §1982

² 42 USC §1981

Anti-discrimination in residential property

Federal protection against racial discrimination given under the Civil Rights Act is a broad protection which applies to prohibited discrimination in all activities between individuals present in the country.

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.³

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 purchase or lease for residential dwelling purposes, such as a lot or space made available to hold a mobilehome unit.⁴

The FFHA bars the use of any discriminatory actions a seller or landlord might take against a prospective buyer or tenant when handling a residential sale or rental based on an individual's:

- race or color;
- national origin;
- religion;
- sex;
- familial status; or
- handicap.⁵

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.⁶

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.⁷

The term "handicap" excludes individuals who illegally use a controlled substance. However, alcoholics and individuals who are considered "recovering or recovered addicts" are protected as handicapped individuals.⁸

Fair housing in California

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.

Federal **fair housing laws** protect individuals from illegal discrimination and harassment in the renting, leasing or purchase of housing.

Further, California's **Fair Employment and Housing Act** and **Unruh Civil Rights Act** protect individuals from housing discrimination. In addition to this state legislation, the **California Department of Real Estate (DRE)** enforces numerous regulations prohibiting discriminatory practices by real estate brokers and agents in real estate transactions.

³ 42 USC §53601 et seq.

⁴ 42 USC §3602(b)

⁵ 42 USC §3604

⁶ 42 USC §3602(k)

⁷ 42 USC §3602(h)

⁸ **United States v. Southern Management Corporation** (4th Cir. 1992) 955 F2d 914

A broker has a duty to advise their agents and employees of anti-discrimination rules, including DRE regulations, the Unruh Civil Rights Act, the California Fair Employment and Housing Act, and the FFHA.⁹

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.

The state *Unruh Civil Rights Act* provides the most detailed protections, and thus controls in most cases. It protects against all **intentional** and **implicit discrimination** in all business establishments (including housing). Implicit discrimination is more nebulous and less overt, being actions which are not openly discriminatory, but result in discriminatory effects.¹⁰

The Unruh Civil Rights Act protects against discrimination due to:

- age;
- ancestry;
- color;
- disability;
- genetic information;
- national origin;
- marital status;
- medical condition
- race;
- religion;
- sex (including gender and gender identity and expression);
- pregnancy; or
- sexual orientation.¹¹

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 (SFR) owners renting or selling are considered to be in the business of providing housing.¹²

Further, all persons within California are entitled to full and equal accommodations, advantages, facilities, privileges or services in all business establishments regardless of their **genetic information**.

Genetic information is defined as any of the following:

- the genetic tests of the individual;

The Unruh Civil Rights Act

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

⁹ DRE Reg. §2725(f)

¹⁰ Calif. Civil Code §§51; 51.2; 51.3

¹¹ CC §§51 et. seq.

¹² CC §51.5

- the genetic tests of the individual's family members; or
- the manifestation of a disease or disorder in family members of the individual.

Genetic information includes a request or receipt for genetic services, or participation by an individual or the individual's family members in clinical research which includes genetic services.¹³

Lingering racial discrimination: subtle, but no less sinister

Despite federal and state law to the contrary, racial discrimination still measurably impedes minorities' home searches and access to housing, according to a recent *Department of Housing and Urban Development (HUD)* study of housing markets in 28 metropolitan areas nationwide.

The decennial survey found **overt racial discrimination** by real estate agents and housing providers has decreased substantially since the survey was first conducted in 1979.

Overt discrimination includes, due to an individual's race, gender or ethnicity, outright refusals to:

- show properties; and/or
- take rental or purchase applications.

O outright racial discrimination may have declined, but African-, Hispanic- and Asian-American renters and buyers continue to suffer from **implicit racial discrimination** at the hands of real estate brokers and agents. Minority groups are still shown and given information on fewer properties than their equally-qualified non-minority counterparts.

The study measured *implicit racial discrimination* by comparing the experiences of one White and one minority tester, both with identical socioeconomic profiles, with the same rental or sales listing.

White and minority testers obtained listing information and scheduled viewings in equal measure, demonstrating that blatant racial discrimination has fallen significantly.

However, compared to White buyers and renters responding to the same listings:

- African-Americans were shown 18% fewer for-sale listings and 4% fewer rental listings;
- Asian-Americans were shown 19% fewer for-sale and 7% fewer rental listings; and
- Hispanic-Americans were shown 7% fewer rental listings.

Agents also exposed all minority participants to fewer available units than their White counterparts.

¹³ CC §§51 et. seq.

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

As a broker, train your agents to be more concerned about the person inquiring about a listing than their own comfort zone and preconceptions. Establish office policies and procedures that allow the client to steer agents to the property they want, rather than agents steering clients to the property they believe the client ought to like. Agents are not to discriminate unwittingly by trying to predict the will of the client.

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

Implicit racial discrimination affects 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 that has gripped many American cities in the years since outright segregation was outlawed.

This disparate treatment of users by agents is compounded by the disparate impact of lending practices on buyers, known as **redlining**. This makes the market unfriendly to minorities seeking financing.

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. Thus, the DRE has more than just moral cause to pursue discriminatory agents.

Discriminatory practices by brokers and agents subject licensees to disciplinary action from the DRE, including license suspension or revocation. Further, an employing broker is also liable for the discriminatory activities of their agents.

The effect of implicit discrimination

redlining

Failure to provide financing in certain communities based on the demographics of that community.

Enforcement is needed

These practices include implicit forms such as:

- refusing to show users property or provide information whether voluntarily or on request;
- steering users away from specific properties to properties located elsewhere;
- reducing the level of services or not responding to an inquiry into a listing; and
- discriminating in the terms and conditions of a sale, such as charging minority users higher prices.

With the DRE independent of the *Department of Consumer Affairs* effective July 1, 2018, it now has access to a muscular investigative arm with the power to stringently pursue agents who violate Real Estate Law.

The DRE Commissioner has stated the DRE will not pursue ethics violations in the absence of a formal complaint. Thus, it now becomes the duty of brokers and agents on the ground to report, or cause renters and buyers to report, suspected implicit discrimination to the Commissioner.

Disclosure of demographic information

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 and, thus, needs to be disclosed.

State and federal fair housing laws prohibit the use of a person's race, color, religion, sex, handicap, familial status or national origin as a reason for:

- refusing to sell or rent;
- discriminating against any person in the terms or conditions of a sale or lease;
- making and/or distributing any advertising that discriminates against any person;
- claiming a dwelling is not available for rent or sale when it in fact is; and
- inducing someone to sell their property.

There is nothing — not a hint, touch, implication, innuendo, insinuation or allusion — in the law that bars a real estate agent from providing **demographic information** to their client. There is certainly nothing in the law that prohibits agents from opining on the safety or suitability of a particular neighborhood. Quite the opposite is true.

Duty to disclose all material facts

A real estate agent owes a duty to their client to disclose all **material facts** affecting the value and desirability of a property. Further, a real estate agent is to counsel their client to the best of their ability based on the full scope of their education and experience.¹⁴

Of course, this does not give any agent carte blanche to espouse their personal opinions, racist, misogynist or otherwise. The key term in all of this discussion is *material facts*.

¹⁴ Calif. Civil Code §2079.16; *Field v. Century 21 Klowden-Forness Realty* (1998) 63 CA4th 18

Facts: A roommate pairing service, not licensed as real estate brokers, required users to disclose their sex, sexual orientation and familial status and matched potential roommates based on these disclosures.

Claim: A fair housing council sought to stop the service from requiring users to disclose this information, claiming it violated the Federal Fair Housing Act (FFHA), which prohibits discrimination on the bases of sex or familial status.

Counter claim: The service claimed roommate selection was excluded from these FFHA prohibitions, since controlling who may or may not share a living space raises constitutional concerns.

Holding: A federal appeals court held the roommate pairing service's practice of soliciting and disclosing information on an individual's sex, sexual orientation and familial status is not prohibited by FFHA, since individuals may select roommates for shared living units based on these factors. [*Fair Housing Council of San Fernando Valley v. Roommate.com, LLC* (9th Cir. 2014) 666 F3d 1216]

Editor's note — The FHA applies only to "dwellings," meaning a living unit designed for occupancy by a family. Thus, the FHA does not apply to roommate situations, as they have to do with relationships within the dwelling, as subparts of the larger living space. When enacting the FHA, Congress intended to prevent landlords and sellers from discriminating in the renting and selling of property. It did not intend to regulate the arrangement between people sharing the same living space.

Case-in-point

Prohibited discriminatory practices allowed for roommate selection

When asked, "is this area safe?", agents are best served directing their client to one of the many websites that publish local crime rates, in addition to providing state-mandated Megan's Law disclosures. If a client inquires, "is this area liberal or conservative?", agents are to simply do the research and provide the results of the most recent election.

The potentially tricky question to answer, "what kind of people live in this neighborhood?" is easily dispatched by a true professional and uniform office policy. A little digging on the Census Bureau web site and the client will be swimming in material facts about the demographics of their potential neighbors.

Seller's agents ought to use caution when considering publishing demographics information in their listing advertisements. The FFHA explicitly forbids an individual from expressing any preference, limitation or discrimination based on race, color, religion, sex, handicap, familial status or national origin in any form of *housing advertising*. [See *Office Management* Chapter 5]

Rather than risk an uncharitable interpretation of an agent's advertising, save the hard demographic facts for when a client makes a direct inquiry.

However, there are some client questions that may be off limits, such as "Is the seller/buyer (old, young, single, married, Hispanic, gay, etc.)?"

An agent is not required to disclose any information that may be deemed **confidential** by the other party if it does not *materially affect* the value

Check the habits of your agents

or desirability of the property. The sexual preference or marital status of the owner/seller has no relevance to the value of a property and thus the agent ought not share it.¹⁵

Real estate brokers and agents have a duty to share the wealth of knowledge they've gained from their experience and state mandated education. If a client asks for demographic information about a neighborhood they are interested in, brokers are to advise their agents to provide a well-researched, reasonable and, above all else, factual response.

¹⁵ CC §2079.16

**Office
Management
Chapter 4
Summary**

All citizens of the United States have the right to purchase and rent both residential and commercial real estate under the federal Civil Rights Act. While the federal Civil Rights Act provides general protection against all prohibited discriminatory activity, Federal Fair Housing Act (FFHA) protections are specifically limited to dwellings, including rental housing.

California has its own set of fair housing laws. The state Fair Employment and Housing Act and Unruh Civil Rights Act further protect individuals from housing discrimination. The California Department of Real Estate (DRE) also enforces numerous regulations prohibiting discriminatory practices by real estate brokers and agents in real estate transactions.

The Unruh Civil Rights Act provides the most detailed protections for both intentional and implicit discrimination, and thus controls in most cases.

Discriminatory practices by brokers and agents subject licensees to disciplinary action from the DRE, including license suspension or revocation. Further, an employing broker is also liable for the discriminatory activities of their agents.

While state and federal fair housing laws prohibit discriminatory activity, there is no law that bars a real estate agent from providing demographic information to their client. If a client asks for demographic information about a neighborhood they are interested in, brokers are to advise their agents to provide a well-researched, factual response.

**Office
Management
Chapter 4
Key Terms**

Civil Rights Actpg. 51
implicit discrimination pg. 53
material factpg. 56
redliningpg. 55
Unruh Civil Rights Actpg. 52



Marketing and advertising

After reading this chapter, you will be able to:

- implement a successful FARMing campaign for your real estate services within a targeted community;
- design a brand and slogan for your practice that can be infused into all forms of your marketing strategy; and
- properly abide by the rules regarding the use of a fictitious business name or team name.

For FREE, customizable marketing materials, such as FARM letters on a wide variety of topics and styles and door hangers, go to realtypublications.com/FARM

FARM

fictitious business name

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**. [See Figure 1]

Chapter 5

Learning Objectives

Key Terms

Choose your brand

FARM

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.

Figure 1**FARMinG:
cultivating
new leads and
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.

The key to FARMing success is...

Consistency: *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.*

Persistence: *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.*

Commitment: *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.*

Figure 1

**FARMing:
cultivating
new leads and
harvesting
cont'd**

Aside from being a neighborhood expert, some other residential specializations to mention are:

- relocation;
- Veterans Affairs (VA)-guaranteed mortgage;
- Federal Housing Administration (FHA)-insured mortgage;
- military-friendly;
- first-time homebuyer;
- Spanish-speaking or different language other than English;
- condo or multi-family;
- luxury home;
- affordable home;
- land;
- investment;
- energy-efficient or green home; and
- senior living.

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

Another iffy situation has to do with the photo you use with your brand materials. One major pet peeve of real estate agents (and their clients) is when an agent uses a headshot taken twenty years ago. If you choose to include

Residential specializations

your picture in your marketing materials, have a professional photo taken every two or three years. It avoids awkwardness or confusion when a client finally meets you.

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."

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;
- professional email signature;
- business cards;
- FARM materials that you drop off while door knocking in the neighborhood(s) you FARM [See Figure 2];
- 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.



JUST SOLD

in your neighborhood

\$ Price goes here

Thinking about selling but aren't sure now is the right time?

Today is a terrific time to list your home. Low inventory in our area has caused prices to steadily rise. In fact, I recently had the pleasure of assisting one of your neighbors sell their home quickly and for an excellent price.

Want to learn more about what's driving home sales in your neighborhood? I'm always eager to share my knowledge of our local market. Contact me today for a free consultation!



Your
Image
here

Your Name

CalBRE Lic#
555.555.5555
youremail@mail.com
yourwebsite.com

Extra Information
(delete if not needed)



YourCompanyLogo

For FREE, customizable marketing materials, go to realtypublications.com/FARM

Figure 2

Sample FARM
Materials

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 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

Figure 2


Sample FARM
Materials

cont'd

SELL YOUR CONDO



Your
Image
here



Are you ready to sell your condominium unit? I can help! As a real estate agent who specializes in condo sales, I understand your market's dynamics and know what it takes to sell your condo.


I will diligently market your property and ensure it's priced to sell quickly.

Let me help you find your buyer! Call me today to set up an appointment.

Your Name

Lic #
Phone number
Email Address
Website

Brkr Name
Broker Lic #



For FREE, customizable marketing materials, go to realtypublications.com/FARM

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.

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.

Facts: Two real estate agents employed by the same broker enter into oral and written agreements to share fees earned by either party on the sale of real estate within two years of the signed agreement. No signature from their broker is on the agreement. Before the end of the two-year period following the agreement, the first agent finds employment with a new broker and closes a sale on a property, receiving compensation without the partnering agent's knowledge.

Claim: The partnering agent seeks half of the first agent's earned fees on the sale, claiming the first agent breached their fee sharing agreement since the sale occurred within the two-year period specified in the written agreement.

Counter claim: The first agent claims the fee sharing agreement is unenforceable since a broker is required to be a party to any fee sharing agreement as agents may only receive compensation from their broker, and only the agents signed the agreement.

Holding: A California court of appeals holds the fee sharing agreement is enforceable and the partnering agent is entitled to half of the fee earned on the sale since agents are permitted to enter into an agreement to share earned fees after initial compensation by a broker. [*Sanowicz v. Bacal* (2015) 234 CA4th 1027]

Case-in-point

Salespersons working as a team

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.

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.¹

Always identify the broker

The *responsible broker's identity* is defined as the employing broker's name,

¹ Calif. Business and Professions Code §10140.6

New advertising regulations for nongovernmental entities

A nongovernmental entity, including a real estate brokerage, may not use any seal, emblem, insignia, symbol, trade or brand name, term or content in advertisements which may imply a connection to or approval by any government or military organization for products and services it offers unless the nongovernmental entity:

- *has an expressed connection to or approval from a government agency; OR*
- *displays the following disclosure conspicuously on all advertisements, including television commercials:*

“THIS PRODUCT OR SERVICE HAS NOT BEEN APPROVED OR ENDORSED BY ANY GOVERNMENTAL AGENCY, AND THIS OFFER IS NOT BEING MADE BY AN AGENCY OF THE GOVERNMENT.”

If mailed, the envelope is to state:

“THIS IS NOT A GOVERNMENT DOCUMENT.” [Business and Professions Code §17533.6]

or name and license number, not merely a team name or fictitious business name filed by the sales agent with the broker’s authorization.²

“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?

fictitious business name

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

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

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. [See *Office Management* Chapter 6]

A real estate salesperson may not use a fictitious business name that is not identified with their employing broker.³

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.

² Bus & P C §10159.7

³ Bus & P C §10159.5, California Department of Real Estate Regulation §2731

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.

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.

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.⁴

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

Rules for fictitious business names and team names

"Independent" real estate professionals

⁴ DRE Licensee Advisory September 2015

**Office
Management
Chapter 5
Summary**

Image and branding is critical in the real estate profession. In marketing yourself and your agents, encourage your agents to establish and consistently follow a FARMing campaign. FARMing is a business strategy undertaken to convert a set of neighborhoods into a collective of owners and sellers, branded to turn to the dedicated agent and broker. The key to FARMing success is consistency, persistence and commitment.

Licensees can further brand themselves by creating a slogan, based on a personal characteristic they want to highlight, like honesty, friendliness or speed.

Once a licensee has established a brand for their real estate services, they are best served infusing their brand into all forms of marketing, including their:

- professional website;
- email signature;
- business cards;
- FARM materials that are dropped off while door knocking in the neighborhood(s) they FARM;
- signs; and
- mailed marketing materials which are sent to former and potential clients.

Real estate brokers and corporations often use fictitious business names when conducting activities requiring a real estate license. A fictitious business name is the name under which a business or operation is conducted, also known as a d.b.a. ("doing business as...").

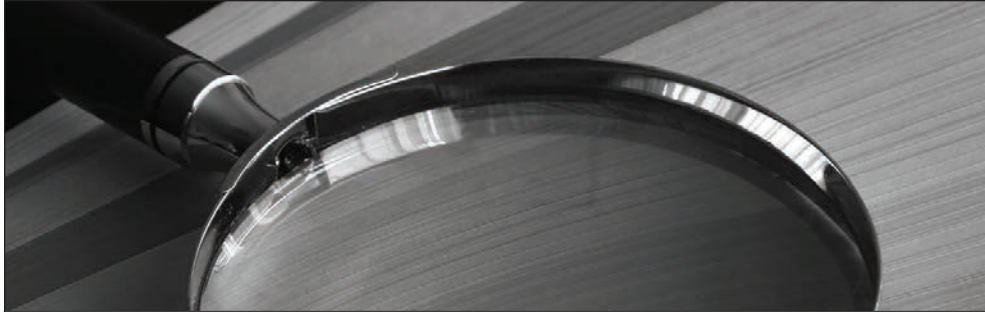
Any marketing materials using a fictitious business name or team name need to conspicuously display:

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

If an agent intends to act and advertise as an "independent" or "freelance" licensee, they need to obtain a broker license.

FARM	pg. 59
fictitious business name	pg. 66

**Office
Management
Chapter 5
Key Terms**



Appointment and supervision of an office manager

After reading this chapter, you will be able to:

- employ a licensee as an office manager to carry out a broker's supervisory responsibility to review documents and maintain files;
- properly document the duties and fee schedule of an office manager using an employment agreement, and comply with the California Department of Real Estate (DRE's) notification requirements; and
- understand how a corporation can be licensed as a real estate broker through a designated officer (DO) who qualifies the corporation to hold a license.

designated officer

office manager

In 2015, nearly 12,000 **individual** and **corporate broker licensees** employed two or more real estate agents to represent them and render real estate services on their behalf. As employers of licensees, these brokers are required under the California Department of Real Estate's (DRE's) **supervisory scheme** to *reasonably supervise* the activities of their employees to protect members of the public with whom they deal.

Reasonable supervision includes establishing policies, rules, procedures and reports to review and manage:

- transactions and conduct requiring a real estate license;

Chapter 6

Learning Objectives

Key Terms

The supervisory role of an office manager

office manager

A licensee hired by a broker to fulfill the supervisory responsibility of reviewing documents and maintaining office files. [See **RPI** Form 510]

- documents materially affecting the rights or obligations of clients in transactions;
- the filing, storage and maintenance of documents related to the real estate services rendered;
- the handling and documentation of trust funds;
- advertisement of real estate services requiring a license;
- employee's knowledge of anti-discrimination, fair housing and agency laws; and
- reports on the activities of employees.¹

For the employing broker who is too busy to provide continuous oversight over all the licensees they employ, the broker may also employ a licensee as an **office manager** to carry out their supervisory responsibility to review documents and maintain files.

The broker or *office manager* reviewing documents is to observe and take steps to correct any unacceptable documentation at the earliest possible moment.

Without corrective activity, the broker becomes exposed to liability for money losses incurred by others through an error or other malfeasance committed by their agents.

Responsibilities of an office manager

In addition to reviewing documents, the responsibilities of the appointed office manager include:

- the oversight and supervision of day-to-day operations of all licensed activities in the real estate branch or division;²
- supervising the on-the-job activities of employed licensees; and
- managing clerical staff employed in the branch office or division. [See **RPI** Form 507; see *Office Management* Chapter 2]

The real estate licensee who is appointed by a broker as their office manager also assumes obligations for any sanctions and disciplinary actions by the DRE for the office manager's failure to properly supervise the activities of licensees and administrative employees.³

Broker retains liability on assigning oversight

A **written agreement** to carry out the broker's responsibility for oversight and management of their employees' activities in sales, leasing and mortgage transactions is always prepared and signed by the broker and the licensed office manager they employ.⁴ [See Form 510 accompanying this chapter]

While the broker may employ the services of an office manager, the broker retains the overall **supervisory responsibility**. Thus, the broker, as the ultimate authority with responsibility for employees, needs to periodically review the actions of the office manager, and in turn, each employee.⁵

¹ California Department of Real Estate Regulations §2725

² Calif. Business and Professions Code §10164(a)

³ Bus & P C §10164(b)

⁴ Bus & P C §10164(c)

⁵ DRE Regs. §2725

Besides assigning the office manager *administrative tasks*, the office manager's primary responsibility is to review all correspondence and documents made or received by the agents — employees — acting on behalf of the broker. The actions of a sales agent or broker-associate, as well as administrative employees in the employ of a broker, are considered the acts of the employing broker.⁶

An individual or corporate employing broker may appoint a real estate licensee as the office manager of a branch or division of the employing broker's real estate business. Licensees who may be appointed as an office manager cannot include individuals who:

- hold a restricted DRE license;
- have been debarred by the DRE; or
- are salespersons with less than two years of full-time real estate experience within the past five years prior to the appointment.⁷

To appoint an office manager, the employing broker and the office manager enter into a *written employment contract*, a copy of which the employing broker retains in their files. [See Form 510]

The **Office Manager Employment Agreement** published by **RPI (Realty Publications, Inc.)** is used by an employing broker or designated officer when employing a licensee as an office manager for their broker operations. The agreement establishes the licensee's:

- duties as the office manager; and
- the fee schedule for their compensation. [See Form 510]

On employing an office manager, the employing broker notifies the DRE by preparing and filing the **Branch or Division Manager Appointment** form provided by the DRE. [See RE 242]

Likewise, on termination or change in the appointment of an office manager, the employing broker will promptly notify the DRE in writing by filing the *Branch or Division Manager Appointment* form, which is also used to notify the DRE of a change or termination of a branch or division office manager. [See RE 242]

An *office manager* is a DRE-licensed employee who is authorized to represent the broker. Like a sales agent or broker-associate, the office manager represents the broker in dealings with members of the public and the broker's employees.⁸

As an office manager, the manager owes the employing broker a duty to supervise all activities rising out of the operations of the branch or division

Conditions for appointing a branch office manager

The office manager's exposure to personal liability

⁶ Calif. Civil Code §2079.13(b)

⁷ Bus & P C §10164(d)

⁸ DRE Regs. §2724

Form 510

Office Manager
Employment
Agreement

Page 1 of 2

OFFICE MANAGER EMPLOYMENT AGREEMENT

NOTE: This form is used by a broker when employing a licensed broker or sales person as an office manager for their brokerage operations, to establish their duties as the office manager and the fee schedule for their earnings.

DATE: _____, 20____, at _____, California.
Broker hereby employs Licensee as the Office Manager of Broker's real estate office located at _____

1. OFFICE MANAGER AGREES TO:

- 1.1 Maintain a real estate license in the State of California and act as Office Manager for Broker.
- 1.2 Provide managerial/supervisory service under the direction of the Broker or the Designated Officer in Broker's employ.
- 1.3 Diligently perform duties assigned and immediately deposit and account to Broker for all cash or checks received by Office Manager or employees assigned to him.
- 1.4 Develop a working relationship with each licensee employed at this office.
- 1.5 Assist in the implementation of Broker's policy manual and any other directions given by Broker.
- 1.6 Review all correspondence and documents made or received by Broker or his agents.
- 1.7 Organize and participate in any educational programs or meetings specified by Broker.
- 1.8 Assure the existence of a full inspection and disclosure of the conditions of any property to be sold, bought, leased or encumbered by Broker's clients.
- 1.9 Obligate Broker to no agreement without Broker's prior consent.
- 1.10 Expose Broker to no liability to any third party without Broker's prior consent.
- 1.11 Join and pay fees for Office Manager's membership in any professional organization in which Broker is a member.
- 1.12 Divulge to no one the business or names of clientele, lists or descriptions of forms, trade secrets or business practices of Broker during or after the term of this agreement.
- 1.13 ☐ Also be employed by Broker as an Independent Contractor. Concurrent herewith, Office Manager and Broker have entered into and signed a separate Independent Contractor's employment agreement. [See RPI Form 506]
 - a. Any conflicts in the terms of these agreements shall be controlled by this agreement.

2. BROKER AGREES TO:

- 2.1 Create the necessary resolutions to adopt this agreement.
- 2.2 Maintain a license as a real estate broker in the State of California.
- 2.3 Maintain an office with proper facilities to operate a real estate brokerage business.
- 2.4 Maintain membership in the following professional organization(s):
 - ☐ Multiple Listing Service
 - ☐ Local branch of the California Association of Realtors and National Association of Realtors
 - ☐ _____
- 2.5 Maintain listings.
- 2.6 Provide advertising approved by Broker.
- 2.7 Provide worker's compensation insurance for Office Manager.
- 2.8 Maintain the following insurance coverage for Office Manager:
 - ☐ Errors and Omissions ☐ Health ☐ Dental ☐ Life
 - ☐ _____
- 2.9 Indemnify Office Manager for the expense of any legal action arising out of the proper performance of Office Manager's duties.
- 2.10 Pay Office Manager as specified in the Office Manager's fee schedule, section 3 of this agreement.
- 2.11 Withhold from the Office Manager's compensation all appropriate state and federal income taxes, state disability insurance, and social security taxes.
- 2.12 Other _____

3. OFFICE MANAGER'S FEE SCHEDULE:

- 3.1 The Office Manager is to be compensated under this agreement solely for his administrative efforts.

----- PAGE ONE OF TWO --- FORM 510 -----

they manage. In turn, the broker is responsible to clients for any breach in agency duty caused by the office manager's failure to supervise agents and intercept and correct errors or omissions.

Thus, the office manager **indemnifies** the broker for losses caused by the manager's failure to properly supervise employees and their work product.⁹

An office manager is also subject to disciplinary action by the DRE when they fail to properly supervise licensed activity of employees in the office they manage. When an office manager fails to properly supervise the licensed activities of a branch office or division, the DRE Commissioner may suspend or revoke the manager's license.¹⁰

⁹ **Walters v. Marler** (1978) 83 CA3d 1

¹⁰ Bus & P C §§10164(b), 10165

----- PAGE TWO OF TWO - FORM 510 -----

3.2 Broker shall pay Office Manager monthly, on the tenth business day following the end of each calendar month of employment, _____% of Broker's share of gross fees, after deducting any portion earned by Broker's agents, other Brokers and any Franchisor, received in the brokerage business during the preceding calendar month.

3.3 The fee schedule may be changed by Broker on 30 days prior written notice to Office Manager.

3.4 On termination, Office Manager will be paid on a pro rata basis for any period of employment he has not been compensated.

4. TERMINATION:

4.1 This agreement shall continue until termination by mutual written agreement, or 30 days after either party serves written Notice of Termination, or either party, for cause, serves written Notice of Termination.

4.2 For one year after termination, Office Manager will not interfere with Broker's continuing relationship with his clients and employees, nor induce or attempt to induce any sales staff to discontinue representing Broker for the purpose of representing another broker.

4.3 For one year after termination and within 25 miles of the office, Office Manager is not to become employed with any real estate brokerage business, nor employ or become employed with any real estate licensee who was employed by Broker during the six months prior to termination.

5. GENERAL PROVISIONS:

5.1 Broker reserves the exclusive right to determine whether any dispute involving the Broker and third parties and arising from Office Manager's performance of assigned duties shall be prosecuted, defended or settled.

5.2 Before any party to this agreement files an action on a dispute arising out of this agreement which remains unresolved after 30 days of informal negotiations, the parties agree to enter into non-binding mediation administered by a neutral dispute resolution organization and undertake a good faith effort during mediation to settle the dispute.

5.3 **ARBITRATION:** Any dispute between Office Manager and Broker or any other licensee employed by Broker which cannot be resolved by the Broker or State Labor Commission shall be arbitrated under the rules of the American Arbitration Association.

5.4 _____

5.5 ☐ See addendum for additional terms. [See RPI Form 250]

<p>OFFICE MANAGER:</p> <p>I agree to render services on the terms stated above.</p> <p>Date: _____, 20____</p> <p>Name: _____</p> <p>Social Security Number: _____</p> <p>Signature: _____</p> <p>Address: _____</p> <p>Phone: _____</p> <p>Cell: _____</p> <p>Email: _____</p>	<p>BROKER:</p> <p>We agree to employ Designated Officer on the terms stated above.</p> <p>Date: _____, 20____ CalBRE #: _____</p> <p>Broker: _____</p> <p>Officer's Name: _____</p> <p>Title: _____</p> <p>Signature: _____</p> <p>Address: _____</p> <p>Phone: _____</p> <p>Cell: _____</p> <p>Email: _____</p>
--	---

FORM 510 08-15 ©2015 RPI - Realty Publications, Inc. P.O.Box 5707, RIVERSIDE, CA 92517

Form 510**Office Manager
Employment
Agreement****Page 2 of 2**

While most supervisory responsibilities of an employing broker may be *assigned* to an office manager, the **agency duty** the broker owes to clients in their transactions handled by the broker's employees may not be *delegated* to others. Thus, the broker's agency obligations to members of the public cannot be avoided.¹¹

A corporation is licensed as a real estate broker through a **designated officer (DO)** who qualifies the corporation to hold a license. [See **RPI** Form 511]

Only corporate entities can be licensed as real estate brokers, not:

- limited liability companies (LLCs);

designated officer

The individual who is the licensed officer qualifying a corporation for a corporate broker license. [See **RPI** Form 511]

**Obtaining a
corporation
license**

¹¹ **Barry v. Raskov** (1991) 232 CA3d 447

- partnerships; or
- trusts.

A **corporation license** is different and distinguishable from an individual broker license just as an entity is distinguishable from an individual. An individual acts on their own or through an agent, but a corporation can act only through an agent who is an individual.

The individual who intends to qualify a corporation for a broker license applies to the DRE to be the *DO* of a corporation. The application process includes submitting:

- a *Corporation License Application* [See RE 201] ;
- a *Corporation Background Statement*, if applicable [See RE 212];
- a *Live Scan Service Request* for fingerprints, if applicable [See RE 237];
- *Articles of Incorporation* (if filed with the California Secretary of State within six months before the date the application is submitted to the DRE), OR a *Certificate of Status*, *Certificate of Foreign Corporation*, or a *Certificate of Qualification* (if issued within 30 days before the date the application is submitted to the DRE);
- a *Branch Office Application* for each additional office location being added [See RE 203];
- a certified copy of the *Fictitious Business Name Statement (DBA)*, if the corporation intends to do business under a name other than the corporate name; and
- a completed *Salesperson Change Application* for any licensed sales agent the corporation intends to employ to conduct licensed real estate activity as an employee of the corporation. [See RE 214]

Filing a Corporation Background Statement

The DO/applicant is to complete and sign a certification regarding any criminal activities on the part of the corporation's officers. A *Corporation Background Statement* is required for all officers, and any individual who owns or controls more than 10% of the corporation's shares, who have been the subject of any of the following:

- received a court or governmental order or judgment during the preceding 10 years which temporarily or permanently restrained or enjoined any business conduct, practice or employment;
- has had a license to practice real estate or any other regulated profession, occupation, or vocation denied, suspended or revoked during the preceding 10 years;
- engaged in acts requiring a real estate license without a valid license during the preceding 10 years; or
- been convicted of a crime which is substantially related to the qualifications, functions or duties of a licensee of the DRE (excluding drunk driving, reckless driving and speeding violations), i.e.:

- the fraudulent taking, obtaining, appropriating, or retaining of funds or property belonging to another person;
- counterfeiting, forging or altering an instrument or uttering a false statement;
- willfully attempting to gain a personal financial benefit through the nonpayment or underpayment of taxes, assessments or levies;
- the employment of bribery, fraud, deceit, falsehood or misrepresentation to achieve an end;
- being required to register as a sex offender;
- willfully violating or failing to comply with California real estate law;¹²
- willfully violating or failing to comply with a statutory requirement that a license, permit or other entitlement be obtained prior to engaging in a business or course of conduct;
- engaging in any unlawful act with the intent of gaining a financial or economic benefit, or with the intent of doing substantial injury to another person or property;
- contempt of court or willful failure to comply with a court order;
- conduct which demonstrates a pattern of repeated and willful disregard of law; or
- two or more convictions involving drugs or alcohol when at least one of the convictions involve driving under the influence of either.¹³

The applicable fees for the processing, issuance and renewal of a corporate real estate broker license are as follows:

- if the applicant is currently licensed as an individual broker, the licensing fee is **\$300**;
- if the applicant has never been licensed or their license has been expired for more than two years, the licensing fee is **\$300**, plus **\$49** for fingerprinting;
- if the corporation's license has expired or if the applicant's license has expired within the past two years, the licensing fee is **\$450**; and
- if the corporation is currently licensed and only a substitution of a currently licensed additional DO is required, no fee is required.

If the qualifying broker lives in California, the \$49 fingerprint processing fee needs to be paid directly to the live scan fingerprint service provider. If the qualifying broker live outside of California, the fingerprinting fee needs to be submitted to the DRE along with a fingerprint card.

Fees for obtaining or renewing a corporation license

¹² Bus & P C §§10000 et seq.

¹³ DRE Regs. §§2746 and 2910

Upon submitting all of the above and being duly processed by the DRE, a corporation license will be issued, valid for four years from the date of issuance. The corporate license will need to be renewed every four years prior to expiration or within the two-year grace period after expiration.

Editor's note — The expiration date of the corporation is always the same as that of the DO. One license is issued for the corporation and the DO. The expiration date for the DO's individual broker license, if they hold one, will most likely be different as the individual broker license is separate and distinct from the DO (corporation) license.

Designated officer defined

The DO:

- needs to be licensed as an individual broker with the DRE or have qualified for a broker license by passing the broker exam within 12 months of the corporation submitting a *Corporation License Application* [See RE 201]; and
- hold an actual officer title in the corporation.

The term “broker-officer” or “broker of record” is not considered an official officer’s title by the DRE.

Official officer’s titles include, but are not limited to:

- director;
- chief executive officer (CEO);
- president;
- first level vice president;
- secretary; and
- chief financial officer.

An individual can be the DO for multiple corporations. A new corporation license application would need to be completed and submitted for each.

The designated officer’s duties

The corporation license issued to a corporation’s DO allows them to conduct licensed activities on behalf of the corporation. [See **RPI** Form 511]

Further, the DO is responsible for the supervision and control of the activities requiring a real estate license that are conducted on behalf of the corporation by its broker-officers.

However, by resolution of the board of directors, the DO may assign supervisory responsibility over salespersons licensed to the corporation to an additional licensed broker-officer or broker-officers.

A certified copy of the resolution and a completed *Certification (Assignment of Supervisory Responsibility)* needs to be forwarded to the DRE within five days after the adoption or modification of the resolution if supervisory responsibility has been delegated to other broker-officers. [See RE 210]

Additional broker-officers may be licensed to act for the corporation in any capacity which requires a broker license. Additional broker-officers are licensed by submitting a completed *Corporation License Application* with the current fee. [See RE 201]

Like the DO, additional broker-officers are also required to hold an officer title in the corporation (the terms "broker/officer" or "broker of record" are not official officer titles).

These additional broker-officers are not the same as the DO who licensed the corporation and who holds supervisory duties.

There is no limit to the number of broker-officers who can be added and an individual can be a broker-officer for multiple corporations.

A *Corporation Change Application* is used to:

- change the corporation's mailing or main office address;
- change the corporation's name;
- add or cancel a DBA; or
- change the DO to another licensed officer. [See RE 204A]

Consider a DO who wishes to leave the corporation prior to the expiration of the corporation license. In order to substitute a fellow broker-officer in as the new DO, the following documents need to be submitted in tandem to the DRE:

- a *Corporation License Application* from the broker-officer wishing to be the new designated officer of the corporation [See RE 201]; AND EITHER
 - a copy of the personally signed resignation of the DO leaving the corporation;
 - a copy of the Resolution of the Board bearing the corporate seal indicating the resignation of the DO leaving the corporation; or
 - a signed statement providing the date of death of the currently licensed DO.

Both items need to be received by the DRE in the same package in order to keep the corporation continuously licensed with the DRE. No fee is required to be submitted with the package when a new officer is completing the balance of the corporation's license period upon the departure of the DO.

If the two documents are properly completed and received together, the effective substitution date will be the date the package was received by the DRE.

Additional broker-officers

How to change corporation information

How to substitute designated officers

If the two documents are not properly completed and are received piecemeal, the corporation's license, along with any branch offices, will be immediately cancelled and the working status of all employed sales agents will be terminated.

However, if the corporation wishes to add a new broker-officer to be the designated broker and allow the current DO to remain as a mere additional broker-officer, the following need to be submitted to the DRE:

- a completed *Corporation License Application* [See RE 201];
- a license fee; and
- a personally signed statement from the current DO indicating they will remain with the corporation as an additional broker-officer.

Branch office licenses will then be reissued to match the term of the new DO.

How to renew a corporation license

To renew an officer license, either as a DO or a broker-officer, the following are to be submitted to the DRE:

- an *Officer Renewal Application* [See RE 207];
- a *Continuing Education Course Verification* form, if applicable [See RE 251]; and
- the renewal fee.

If licensed only as an officer without maintaining an individual broker license, the officer will need to complete the same education required of an individual broker and submit evidence of its completion to the DRE. [See RE 251]

However, if currently also licensed as an individual broker, so long as the individual broker license is kept current by completing the required continuing education courses every four years, no evidence of the completion of these courses needs to be submitted with the officer license renewal application.

Editor's note — The Continuing Education Course Verification form only needs to be submitted when a person who is licensed only as a corporation officer needs to:

- *renew the existing corporation license;*
- *apply for a new corporation license; or*
- *apply for an individual broker license. [See RE 251]*

If a broker has a corporation license as a DO through their corporation, but are not currently licensed as an individual broker and wish to have it reinstated, they are to fill out the individual *Broker Exam/License Application*, and write in the top right-hand side, "Second License" and pay \$300 to have the individual broker license reinstated. [See RE 436]

In order to cancel a corporation license, a letter signed by all licensed broker-officers is to be submitted to the DRE stating the corporation is no longer conducting business which requires a real estate license.

Upon acceptance of the cancellation by the DRE, the working status of all the sales agents licensed with the corporation will be terminated and all branch offices cancelled.

To simply cancel an additional broker-officer, not the DO or corporation, the broker-officer needs to submit a personally signed letter of cancellation. Alternatively, the corporation can submit a Resolution of the Board stating the severance.

To reactivate an expired corporation license, the following needs to be submitted to the DRE:

- a completed *Corporation License Application* [See RE 201];
- a *Certificate of Status* from the Secretary of State; and
- the late fee.

To reactivate a cancelled corporation, the following needs to be submitted to the DRE:

- a completed *Corporation Change Application*, if being reactivated by the previously licensed designated broker [See RE 204A]; or
- a completed *Corporation Change Applications* and *Corporation License Application*, if being reactivated by a new designated broker. [See RE 201 and RE 204A]

A broker may employ a licensee as an office manager to carry out their supervisory responsibility to review documents and maintain files. In addition to reviewing documents, the responsibilities of the appointed office manager include:

- the oversight and supervision of day-to-day operations of all licensed activities in the real estate branch or division;
- supervising the on-the-job activities of employed licensees; and
- managing clerical staff employed in the branch office or division.

The real estate licensee who is appointed by a broker as their office manager also assumes obligations for any sanctions and disciplinary actions by the California Department of Real Estate (DRE) for the office manager's failure to properly supervise the activities of licensees and administrative employees.

Cancelling a corporation or broker-officer

Reactivating an expired/cancelled corporation

Office Management Chapter 6 Summary

Licensees who may be appointed as an office manager cannot include individuals who:

- hold a restricted DRE license;
- have been debarred by the DRE; or
- are salespersons with less than two years of full-time real estate experience within the past five years prior to the appointment.

While the broker may employ the services of an office manager, the broker retains the overall supervisorial responsibility over their office. Thus, the broker, as the ultimate authority with responsibility for employees, needs to periodically review the actions of the office manager, and in turn, each employee.

A corporation can be licensed as a real estate broker through a designated officer (DO) who qualifies the corporation to hold a license. The DO:

- needs to be licensed as an individual broker with the DRE or have qualified for a broker license by recently passing the broker exam; and
- hold an actual officer title in the corporation.

The corporation license issued to a corporation's DO allows them to conduct licensed activities on behalf of the corporation. Here, the DO is responsible for the supervision and control of the activities requiring a real estate license that are conducted on behalf of the corporation by its broker-officers. However, by resolution of the board of directors, the DO may assign supervisory responsibility over salespersons licensed to the corporation to an additional licensed broker-officer or broker-officers.

**Office
Management
Chapter 6
Key Terms**

designated officer	pg. 73
office manager	pg. 70



Agency: authority to represent others

Agency Chapter 1



Click to watch

After reading this chapter, you will be able to:

- understand the variations of the agency relationship;
- determine how agency relationships are created and the primary duties owed; and
- discuss why real estate licensing is necessary to protect the licensees and their clients.

agency

California Department of Real Estate (DRE)

principal

Learning Objectives

Key Terms

An **agent** is described as “One who is authorized to act for or in place of another; a representative...”¹

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.

Agency in real estate related transactions includes relationships between:

- *brokers* and members of the public (clients or third parties); and

Introduction to agency

agent

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

¹ Black's Law Dictionary, Ninth Edition (2009)

**California
Department of Real
Estate (DRE)**

A government agency which oversees, regulates, administers and enforces California real estate law as practiced by licensees.

What is an agent?

principal

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



Real estate jargon

- 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.

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.²

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 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)*.

² Calif. Civil Code §2295

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*. [See Agency Chapter 4]

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.

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.

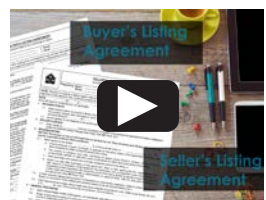
A licensee needs to conduct themselves at or above the minimum acceptable levels of competency to avoid liability to the client or disciplinary action by the DRE.

An agency relationship is created in a real estate transaction when a *principal* employs a broker to act on their behalf.³

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.”⁴ [See **RPI** Forms 102 and 103]



Creation of the agency relationship



³ CC §2307

⁴ *Phillippe v. Shapell Industries, Inc.* (1987) 43 C3d 1247

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.

**Agency
Chapter 1
Summary**

An agent is an individual who represents another in dealings with third persons. The representation of others undertaken by a real estate broker or agent is called agency. Agency in real estate related transactions includes relationships between brokers and members of the public, and licensed sales agents and their brokers.

The primary duties a broker owes their client include evaluating the financial impact, legal consequences, tax aspects and exposure to risk of loss inherent in all transactions.

The agency relationship is created when a client employs a broker to act on their behalf. This relationship is best undertaken with a signed written employment agreement containing a fee provision.

The California Department of Real Estate (DRE) was created to oversee licensing and establish a minimum level of professional competency in real estate transactions.

**Agency
Chapter 1
Key Terms**

agency pg. 81
California Department of Real Estate (DRE) pg. 82
principal pg. 82



The agency law disclosure

Agency Chapter 2



Click to watch

After reading this chapter, you will be able to:

- understand the origin and necessity of the statutorily-mandated Agency Law Disclosure;
- know the roles and obligations of all parties involved in a real estate transaction; and
- identify when the Agency Law Disclosure is required.

agency confirmation provision

Agency Law Disclosure

buyer's agent

exclusive agent

fiduciary duty

seller's agent

Learning Objectives

Key Terms

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.

Legislated order

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. [See **RPI** Forms 305, 305-1 and 550-2]

agency confirmation provision

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



[Click to watch](#)

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 Form 305 accompanying this chapter; 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]

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 chapter.

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.

Thus, 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:

- 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.¹

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]

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.

¹ Calif. Civil Code §§2079.13(k), 2079.14

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

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.

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.

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**. [See Agency Chapter 4]

buyer's agent

An agent representing the buyer. Also known as a selling agent. [See **RPI** Form 103]

seller's agent

An agent representing the seller. Also known as a listing agent. [See **RPI** Form 102]

exclusive agent

An agent who is acting exclusively on behalf of only one party in a transaction.

² CC §2079.16

Form 305

Agency Law
Disclosure

Page 1 of 2



Click to watch

	AGENCY LAW DISCLOSURE Disclosure Regarding Real Estate Agency Relationships For Negotiating the Sale or Exchange of Real Estate
Prepared by: Agent _____ Broker _____	Phone _____ Email _____
<p>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.]</p> <p>DATE: _____, 20____ at _____, California.</p> <p>TO THE SELLER AND THE BUYER:</p> <ol style="list-style-type: none"> 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: <ol style="list-style-type: none"> 2.1 To the Seller: <ol style="list-style-type: none"> a. A fiduciary duty of utmost care, integrity, honesty and loyalty in dealings with the Seller. 2.2 To the Buyer and the Seller: <ol style="list-style-type: none"> 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: <ol style="list-style-type: none"> 3.1 To the Buyer: <ol style="list-style-type: none"> a. A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Buyer. 3.2 To the Buyer and the Seller: <ol style="list-style-type: none"> 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. <ol style="list-style-type: none"> 4.1 In a dual agency situation, the Agent has the following affirmative obligations to both the Seller and the Buyer: <ol style="list-style-type: none"> 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 _____ (Signature of Salesperson or Broker-Associate, if any) _____ Date _____ (Seller's Broker) _____ Date _____ (Signature of Salesperson or Broker-Associate, if any) _____ Date _____	(Buyer's Signature) _____ Date _____ (Buyer's Signature) _____ Date _____ (Seller's Signature) _____ Date _____ (Seller's Signature) _____ Date _____

----- PAGE 1 OF 2 ----- FORM 305 -----

Editor's note — This chapter is discussed primarily in the context of an agent representing a buyer or seller. Though not mandated by statute, use of the disclosure in leasing situations is also recommended as it helps to clarify the duties of the licensees involved.

**The parties,
their brokers
and duties
owed**

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.

----- PAGE 2 OF 2 ----- FORM 305 -----

2079.13. As used in Sections 2079.14 to 2079.24, inclusive, the following terms have the following meanings:

- "Agent" means a person acting under provisions of Title 9 (commencing with Section 2295) in a real property transaction, and includes a person who is licensed as a real estate broker under Chapter 3 (commencing with Section 10130) of Part 1 of Division 4 of the Business and Professions Code, and under whose license a listing is executed or an offer to purchase is obtained. The agent in the real property transaction bears responsibility for that agent's salespersons or broker associates who perform as agents of the agent. When a salesperson or broker associate owes a duty to any principal, or to any buyer or seller who is not a principal, in a real property transaction, that duty is equivalent to the duty owed to that party by the broker for whom the salesperson or broker associate functions.
- "Buyer" means a transferee in a real property transaction, and includes a person who executes an offer to purchase real property from a seller through an agent, or who seeks the services of an agent in more than a casual, transitory, or preliminary manner, with the object of entering into a real property transaction. "Buyer" includes vendee or lessee of real property.
- "Commercial real property" means all real property in the state, except (1) single-family residential real property, (2) dwelling units made subject to Chapter 2 (commencing with Section 1940) of Title 5, (3) a mobilehome, as defined in Section 798.3, (4) vacant land, or (5) a recreational vehicle, as defined in Section 799.29.
- "Dual agent" means an agent acting, either directly or through a salesperson or broker associate, as agent for both the seller and the buyer in a real property transaction.
- "Listing agreement" means a written contract between a seller of real property and an agent, by which the agent has been authorized to sell the real property or to find or obtain a buyer, including rendering other services for which a real estate license is required to the seller pursuant to the terms of the agreement.
- "Seller's agent" means a person who has obtained a listing of real property to act as an agent for compensation.
- "Listing price" is the amount expressed in dollars specified in the listing for which the seller is willing to sell the real property through the seller's agent.
- "Offering price" is the amount expressed in dollars specified in an offer to purchase for which the buyer is willing to buy the real property.
- "Offer to purchase" means a written contract executed by a buyer acting through a buyer's agent that becomes the contract for the sale of the real property upon acceptance by the seller.
- "Real property" means any estate specified by subdivision (1) or (2) of Section 761 in property, and includes (1) single-family residential property, (2) multiunit residential property with more than four dwelling units, (3) commercial real property, (4) vacant land, (5) a ground lease coupled with improvements, or (6) a manufactured home as defined in Section 18007 of the Health and Safety Code, or a mobilehome as defined in Section 18008 of the Health and Safety Code, when offered for sale or sold through an agent pursuant to the authority contained in Section 10131.6 of the Business and Professions Code.
- "Real property transaction" means a transaction for the sale of real property in which an agent is retained by a buyer, seller, or both a buyer and seller to act in that transaction, and includes a listing or an offer to purchase.
- "Sell," "sale," or "sold" refers to a transaction for the transfer of real property from the seller to the buyer and includes exchanges of real property between the seller and buyer, transactions for the creation of a real property sales contract within the meaning of Section 2985, and transactions for the creation of a leasehold exceeding one year's duration.
- "Seller" means the transferor in a real property transaction and includes an owner who lists real property with an agent, whether or not a transfer results, or who receives an offer to purchase real property of which he or she is the owner from an agent on behalf of another. "Seller" includes both a vendor and a lessor of real property.
- "Buyer's agent" means an agent who represents a buyer in a real property transaction.

§2079.14. A seller's agent and buyer's agent shall provide the seller and buyer in a real property transaction with a copy of the disclosure form specified in Section 2079.16, and shall obtain a signed acknowledgment of receipt from that seller and buyer, except as provided in Section 2079.15, as follows:

- The seller's agent, if any, shall provide the disclosure form to the seller prior to entering into the listing agreement.
- The buyer's agent shall provide the disclosure form to the buyer as soon as practicable prior to execution of the buyer's offer to purchase. If the offer to purchase is not prepared by the buyer's agent, the buyer's agent shall present the disclosure form to the buyer not later than the next business day after receiving the offer to purchase from the buyer.

§2079.15. In any circumstance in which the seller or buyer refuses to sign an acknowledgment of receipt pursuant to Section 2079.14, the agent shall set forth, sign, and date a written declaration of the facts of the refusal.

§2079.17. (a) As soon as practicable, the buyer's agent shall disclose to the buyer and seller whether the agent is acting in the real property transaction as the buyer's agent, or as a dual agent representing both the buyer and the seller. This relationship shall be confirmed in the contract to purchase and sell real property or in a separate writing executed or acknowledged by the seller, the buyer, and the buyer's agent prior to or coincident with execution of that contract by the buyer and the seller, respectively.

- As soon as practicable, the seller's agent shall disclose to the seller whether the seller's agent is acting in the real property transaction as the seller's agent, or as a dual agent representing both the buyer and seller. This relationship shall be confirmed in the contract to purchase and sell real property or in a separate writing executed or acknowledged by the seller and the seller's agent prior to or coincident with the execution of that contract by the seller.
- The confirmation required by subdivisions (a) and (b) shall be in the following form:

[Do not fill out] _____ is the broker of (check one):
(Name of Seller's Agent, Brokerage firm and license number)
☐ the seller; or
☐ both the buyer and seller. (dual agent)
_____ is (check one):
(Name of Seller's Agent and license number)
☐ is the Seller's Agent. (salesperson or broker associate)
☐ is both the Buyer's and Seller's Agent. (dual agent)

[Do not fill out] _____ is the broker of (check one):
(Name of Buyer's Agent, Brokerage firm and license number)
☐ the buyer; or
☐ both the buyer and seller. (dual agent)
_____ is (check one):
(Name of Buyer's Agent and license number)
☐ the Buyer's Agent. (salesperson or broker associate)
☐ both the Buyer's and Seller's Agent. (dual agent)

- The disclosures and confirmation required by this section shall be in addition to the disclosure required by Section 2079.14. An agent's duty to provide disclosure and confirmation of representation in this section may be performed by a real estate salesperson or broker associate affiliated with that broker.

§2079.19. The payment of compensation or the obligation to pay compensation to an agent by the seller or buyer is not necessarily determinative of a particular agency relationship between an agent and the seller or buyer. A listing agent and a selling agent may agree to share any compensation or commission paid, or any right to any compensation or commission for which an obligation arises as the result of a real estate transaction, and the terms of any such agreement shall not necessarily be determinative of a particular relationship.

§2079.20. Nothing in this article prevents an agent from selecting, as a condition of the agent's employment, a specific form of agency relationship not specifically prohibited by this article if the requirements of Section 2079.14 and Section 2079.17 are complied with.

§2079.21. (a) A dual agent may not, without the express permission of the seller, disclose to the buyer any confidential information obtained from the seller.

- A dual agent may not, without the express permission of the buyer, disclose to the seller any confidential information obtained from the buyer.
- "Confidential information" means facts relating to the client's financial position, motivations, bargaining position, or other personal information that may impact price, such as the seller is willing to accept a price less than the listing price or the buyer is willing to pay a price greater than the price offered.
- This section does not alter in any way the duty or responsibility of a dual agent to any principal with respect to confidential information other than price.

§2079.22. Nothing in this article precludes a seller's agent from also being a buyer's agent. If a seller or buyer in a transaction chooses to not be represented by an agent, that does not, of itself, make that agent a dual agent.

§2079.23. A contract between the principal and agent may be modified or altered to change the agency relationship at any time before the performance of the act which is the object of the agency with the written consent of the parties to the agency relationship.

§2079.24. Nothing in this article shall be construed to either diminish the duty of disclosure owed buyers and sellers by agents and their associate licensees, subagents, and employees or to relieve agents and their associate licensees, subagents, and employees from liability for their conduct in connection with acts governed by this article or for any breach of a fiduciary duty or a duty of disclosure.

FORM 305 01-19 ©2019 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517

Form 305**Agency Law Disclosure****Page 2 of 2**

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.

Agencies confirmed

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.³

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.⁴

Use of the Agency Law Disclosure

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.

³ CC §2079.17(d)

⁴ **L. Byron Culver & Associates v. Jaoudi Industrial & Trading Corporation** (1991) 1 CA4th 300

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.⁵

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.

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.⁶

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

What is targeted?



Agency rules for a seller's listing

⁵ CC §2079.13(m)

⁶ CC §2079.14(a)



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.⁷

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.⁸

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.⁹

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.

Agency rules for a buyer's agent

Similarly, 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.¹⁰

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]*

The buyer's agent perfects their fee

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*

⁷ **Huijers v. DeMarrais** (1992) 11 CA4th 676

⁸ CC §52079.13(k), 2079.13(m), 2079.14

⁹ CC §2079.14

¹⁰ CC §2079.13

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*. [See Agency Chapter 4]

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.

A seller may accept a purchase agreement offer or enter into a counteroffer but refuse to sign an Agency Law Disclosure. If the seller refuses to return a signed copy of the Agency Law Disclosure, the broker or their agent needs to document the refusal to preserve their right to receive a fee from the seller.¹¹

No particular method of documenting the refusal is given by legislation or regulations. However, the facts of the refusal are to be placed in writing, dated and signed by the broker or agent.

Documentation of the facts surrounding any refusal to sign a timely presented Agency Law Disclosure include:

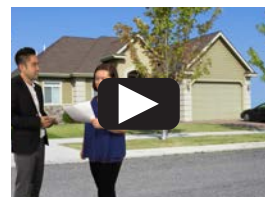
- preparation of a memorandum stating the facts surrounding the refusal;
- mailing a copy of the memorandum to all parties together with a copy of the Agency Law Disclosure; and
- retaining a copy in the broker's records. [See **RPI** Form 525]

If a party claims they were never handed the Agency Law Disclosure, the broker's written documentation, created at the time of the refusal, dispels such a claim. The written documentation would also preserve the fee.



[Click to watch](#)

Documenting a refusal to sign



[Click to watch](#)

¹¹ CC §2079.15

Agency Chapter 2 Summary

The Agency Law Disclosure was created by the California legislature to familiarize brokers, agents and their principals with the uniform industry jargon. It also reveals the duties owed by licensees in the sale or lease for more than one year of real estate in targeted transactions involving:

- 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.

The disclosure describes the various agency roles licensees undertake on behalf of their principals and other parties in a real estate related transaction.

A separate agency confirmation provision is included in purchase agreements and counteroffers. It advises the buyer and seller of any agency relationships each broker has with the parties in the transaction.

If the seller refuses to sign copy of the Agency Law Disclosure, the broker or agent needs to document the refusal to preserve their right to receive a fee.

Agency Chapter 2 Key Terms

agency confirmation provision	pg. 86
Agency Law Disclosure	pg. 86
buyer's agent	pg. 87
exclusive agent	pg. 87
fiduciary duty	pg. 89
seller's agent	pg. 87



Agency Chapter 3



Click to watch

Agency confirmation provision

After reading this chapter, you will be able to:

- identify the arrangements in which an agency confirmation provision is mandated; and
- properly use the agency confirmation provision in transactions that require it.

agency confirmation provision
associate licensee

double-end dual agent

Learning Objectives

Key Terms

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.¹ [See *Agency Chapter 2*]

This relationship is disclosed in the **agency confirmation provision** located in all written negotiations to purchase or lease, and lease agreements.² [See *Figure 1*]

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

Mandated for purchase agreements

agency confirmation provision

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

¹ Calif. Civil Code §2079.17(d)

² CC §2079.17

does not include the seller's broker's agency in the agency confirmation and broker identification provisions in the purchase agreement form.³ [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. [See *Agency Chapter 2*]

The Agency Law Disclosure is an explanation of the duties owed to each party in a transaction by the broker and agents involved.⁴

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 chapter 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.

associate licensee

A sales agent employed by a broker.

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.⁵

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**.⁶ [See **RPI Form 506**]

³ CC §2079.17(a)

⁴ CC §2079.17(d)

⁵ CC §2079.13(a), 2079.13(b)

⁶ Calif. Business and Professions Code §10132

Buyer's/ Selling Broker: _____ Broker's DRE #: _____ Buyer's Agent: _____ Agent's DRE #: _____ Signature: _____ Is the agent of: <input type="checkbox"/> Buyer exclusively. <input type="checkbox"/> Both Seller and Buyer. Address: _____ Phone: _____ Cell: _____ Email: _____	Seller's/ Listing Broker: _____ Broker's DRE #: _____ Seller's Agent: _____ Agent's DRE #: _____ Signature: _____ Is the agent of: <input type="checkbox"/> Seller exclusively. <input type="checkbox"/> Both Seller and Buyer. Address: _____ Phone: _____ Cell: _____ Email: _____
---	--

Figure 1

Excerpt from
Form 150Purchase
Agreement

A buyer's agent, previously referred to as a *selling agent* in the Agency Law Disclosure, by definition is a legal hybrid with four distinct personalities. Each of the four is a different type of agency relationship a broker can have with a buyer. The common thread among the legal types is *direct contact* with the buyer.⁷

**Just who is
the “selling
agent”?**

By legal definition, a buyer's agency includes the following four types of broker relationships with buyers:

1. The *seller's broker*, also known as the listing broker, when acting as the seller's exclusive agent, has direct contact with the buyer when no broker is acting on behalf of the buyer. [See Figures 2 and 4]
2. Another broker collaborating with the seller's broker on behalf of the seller to locate a buyer, acting not as an employee of the seller's broker but independently as a subagent of the seller. [See Figure 5]
3. Buyer's brokers locating property on behalf of a buyer, often referred to as *fee-splitting (cooperating) brokers*. [See Figure 3]
4. Brokers locating buyers for an unlisted property, such as a For Sale by Owner (FSBO) transaction in which the seller will not employ the broker and the broker does not represent the buyer.⁸

For example, a broker who is employed by a buyer to act on behalf of the buyer to locate *qualifying properties* is said to have *listed the buyer* or been retained by their buyer.

The **buyer's broker** confirms their agency in the purchase agreement as “the agent of the buyer exclusively” — even though no oral **fee arrangements**, much less a written exclusive right-to-buy listing, may exist with the buyer. [See Figure 1]

The **buyer's broker** might find their agency confirmation complicated by also having a listing with the seller of the property their buyer is making an offer on. Thus, the broker becomes a **dual agent**. [See Figure 1 and 4; see Agency Chapter 4]

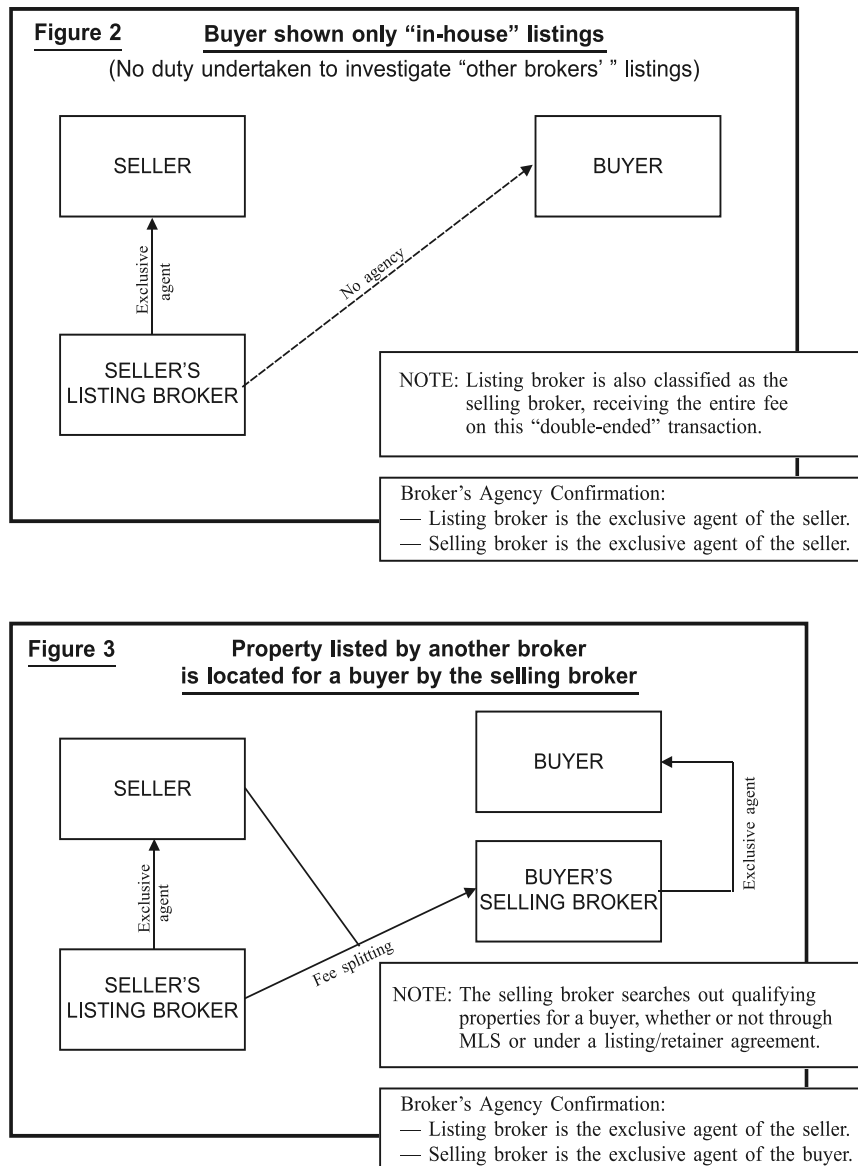
dual agent

A broker who represents both parties in a real estate transaction. [See RPI Form 117]

⁷ CC §2079.13(o)

⁸ CC §2079.13(o)

Figure 2 & 3



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.

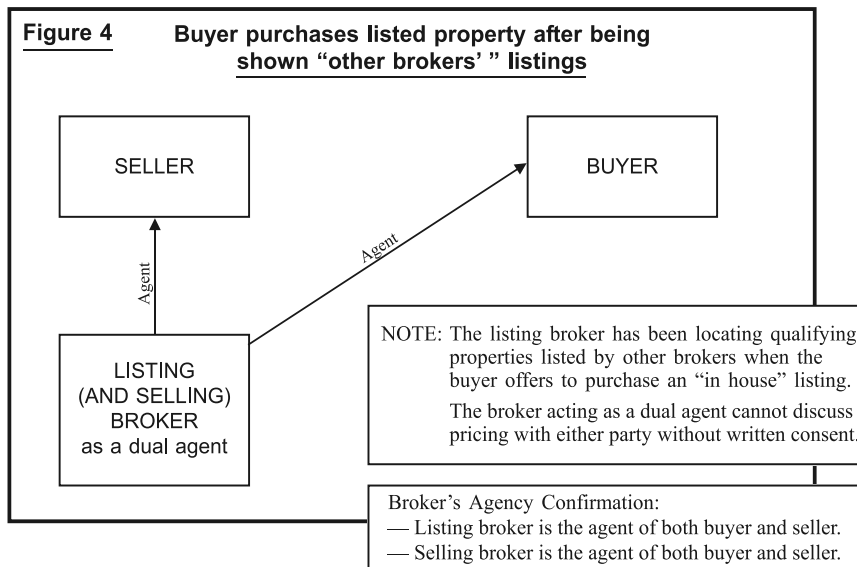
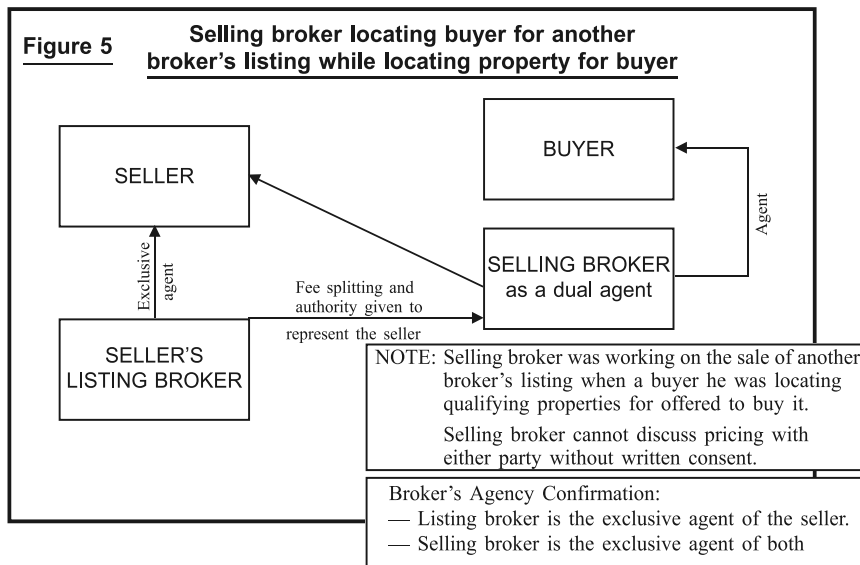


Figure 4 & 5



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.

Double- ending codified

The seller's broker or their agents are occasionally the only persons acting as agents in a transaction and working directly with a buyer. As the seller's agent, they do not owe a *fiduciary duty* to the buyer.

If they do act to become the buyer's agent, the listing broker becomes a *dual agent*. As a dual agent, the agent agrees to locate the most suitable property available for the buyer to purchase in the entire MLS inventory, not limited to the seller's property.

However, if the seller's broker and their agents do not expose the buyer to properties other than their "in-house" listings, they do not become the buyer's agent by their conduct. Thus, they are not dual agents. [See Figure 2]

Alternatively, a broker is said to have "double-ended" a deal when only one broker is involved and is paid a fee. When a transaction is **double-ended**, no cooperating buyer's broker is involved with whom they split the fee.

In this instance, no dual agency is created. Thus, the seller's broker includes the standard agency law disclosure and confirms their agency as the "exclusive agent of the seller." [See Figure 1]

double-end

When the seller's agent receives the entire fee in the real estate transaction, there being no buyer's agent for fee splitting.

Agency Chapter 3 Summary

The agency confirmation provision is contained in all purchase agreements for the sale, exchange or long-term lease of targeted properties such as a one-to-four unit residential property, commercial property or mobile home. The provision lays out the agency relationships of brokers and their agents to their principals and third parties to the transaction.

By statutory definition, an agent retained by a client is always a broker. However, the broker is usually represented by licensed sales agents employed by the broker to provide services agreed to by the broker. The agent employed by a broker is acting on their broker's behalf when providing brokerage services for the client, and is thus an agent of the broker.

A transaction is double-ended when the seller's agent receives the entire fee as no buyer's agent exists to split the fee with.

Agency Chapter 3 Key Terms

agency confirmation provision	pg. 95
associate licensee	pg. 96
double-end	pg. 100
dual agent	pg. 97



Agency Chapter 4



Click to watch

After reading this chapter, you will be able to:

- differentiate between agency and fee sharing;
- identify situations in which a dual agency or subagency is established and managed; and
- understand how conflicts of interest are managed.

conflict of interest
dual agent

multiple listing service (MLS)
subagent

Learning Objectives

Key Terms

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.¹

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.

Agency and fee sharing concepts

subagent

An individual who has been delegated agency duties by the primary agent of the client, not the client themselves.

¹ Calif. Civil Code §2079.19

Subagent vs. fee-sharing buyer's broker



Click to watch

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

multiple listing service (MLS)

An association of real estate agents pooling and publishing the availability of their listing properties.



Click to watch

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.

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.²

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.

Dual agency as an authorized practice

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.³

² CC §2307

³ CC §2079.13(e)

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.⁴

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).⁵

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.⁶

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.

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]

dual agency

The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction. [See **RPI** Form 117]

Dual agency and conflict of interest

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. [See **RPI** Form 527]

⁴ CC §2079.17

⁵ Calif. Business and Professions Code §10176(d)

⁶ **L. Byron Culver & Associates v. Jaoudi Industrial & Trading Corporation** (1991) 1 CA4th 300



 Click to watch

Both clients are entitled to advice

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.

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.⁷

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



 Click to watch

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.

⁷ CC §2079.21

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.⁸

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.

⁸ *Price v. Eisan* (1961) 194 CA2d 363

Agency Chapter 4 Summary

A provision in a listing agreement may authorize the seller's broker to create a subagency between their seller and another broker. Under the subagency provision, the seller's broker may act on behalf of the seller to employ another brokerage office to also act on behalf of the seller to market the property.

A dual agent is a broker who is simultaneously representing the best interests of each of the opposing parties in a transaction. Dual agency needs to be disclosed to the parties involved at the time the conflict arises. Failure to disclose a dual agency relationship can result in the loss of the brokerage fee, liability for money losses incurred by the clients, and disciplinary action by the California Department of Real Estate (DRE) on a complaint.

A conflict of interest exists when a broker or their agent has a competing professional or personal bias that may hinder their ability to fulfill the fiduciary duties to give advice and act on behalf of the client.

Confidential pricing information needs to remain the undisclosed knowledge of the dual agent, unless they are authorized by a client to release the information to the other party.

The conflicts that exist in a broker's dual representation rule out aggressive negotiations to obtain the best business advantage for either party. Thus, the principals of a dual agent do not receive the full range of benefits they would obtain from an exclusive agent.

Agency Chapter 4 Key Terms

conflict of interest	pg. 103
dual agent	pg. 103
multiple listing service (MLS)	pg. 102
subagent	pg. 101



A broker's use of supervisors

Agency Chapter 5

After reading this chapter, you will be able to:

- understand the supervisory responsibility a broker owes to the agents they employ; and
- delegate certain activities in real estate transactions to an office manager or transaction coordinator.

office manager
supervisory scheme

transaction coordinator

Learning Objectives

Key Terms

A sales agent employed by a broker is the *agent of the broker*. In turn, the broker is the agent of the client.

As an agent representing the broker, a real estate sales agent is authorized to prepare:

- listings;
- sales documents;
- disclosure sheets; and
- other documents on behalf of the broker.

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:

- transactions requiring a real estate license;
- documents having a material effect upon the rights or obligations of a party to the transaction;

Delegated supervision, not agency

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

office manager

A licensee hired by a broker to fulfill the supervisory responsibility of reviewing documents and maintaining office files. [See **RPI** Form 510]

- the filing, storage and maintenance of documents;
- the handling of trust funds [See *Trust Funds* Chapter 1];
- advertisement of services that require a license;
- sales agent's knowledge of anti-discrimination laws; and
- reports of the activities of the sales agents.¹

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.

¹ Department of Real Estate Regulation §2725

Form 510**Office Manager
Employment
Agreement****Page 1 of 2****OFFICE MANAGER EMPLOYMENT AGREEMENT**

NOTE: This form is used by a broker when employing a licensed broker or sales person as an office manager for their brokerage operations, to establish their duties as the office manager and the fee schedule for their earnings.

DATE: _____, 20____, at _____, California.

Broker hereby employs Licensee as the Office Manager of Broker's real estate office located at _____

1. OFFICE MANAGER AGREES TO:

- 1.1 Maintain a real estate license in the State of California and act as Office Manager for Broker.
- 1.2 Provide managerial/supervisory service under the direction of the Broker or the Designated Officer in Broker's employ.
- 1.3 Diligently perform duties assigned and immediately deposit and account to Broker for all cash or checks received by Office Manager or employees assigned to him.
- 1.4 Develop a working relationship with each licensee employed at this office.
- 1.5 Assist in the implementation of Broker's policy manual and any other directions given by Broker.
- 1.6 Review all correspondence and documents made or received by Broker or his agents.
- 1.7 Organize and participate in any educational programs or meetings specified by Broker.
- 1.8 Assure the existence of a full inspection and disclosure of the conditions of any property to be sold, bought, leased or encumbered by Broker's clients.
- 1.9 Obligate Broker to no agreement without Broker's prior consent.
- 1.10 Expose Broker to no liability to any third party without Broker's prior consent.
- 1.11 Join and pay fees for Office Manager's membership in any professional organization in which Broker is a member.
- 1.12 Divulge to no one the business or names of clientele, lists or descriptions of forms, trade secrets or business practices of Broker during or after the term of this agreement.
- 1.13 ☐ Also be employed by Broker as an Independent Contractor. Concurrent herewith, Office Manager and Broker have entered into and signed a separate Independent Contractor's employment agreement. [See **RPI** Form 506]
 - a. Any conflicts in the terms of these agreements shall be controlled by this agreement.

2. BROKER AGREES TO:

- 2.1 Create the necessary resolutions to adopt this agreement.
- 2.2 Maintain a license as a real estate broker in the State of California.
- 2.3 Maintain an office with proper facilities to operate a real estate brokerage business.
- 2.4 Maintain membership in the following professional organization(s):
 - ☐ Multiple Listing Service
 - ☐ Local branch of the California Association of Realtors and National Association of Realtors
 - ☐ _____
- 2.5 Maintain listings.
- 2.6 Provide advertising approved by Broker.
- 2.7 Provide worker's compensation insurance for Office Manager.
- 2.8 Maintain the following insurance coverage for Office Manager:
 - ☐ Errors and Omissions ☐ Health ☐ Dental ☐ Life
 - ☐ _____
- 2.9 Indemnify Office Manager for the expense of any legal action arising out of the proper performance of Office Manager's duties.
- 2.10 Pay Office Manager as specified in the Office Manager's fee schedule, section 3 of this agreement.
- 2.11 Withhold from the Office Manager's compensation all appropriate state and federal income taxes, state disability insurance, and social security taxes.
- 2.12 Other _____

3. OFFICE MANAGER'S FEE SCHEDULE:

- 3.1 The Office Manager is to be compensated under this agreement solely for his administrative efforts.

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.

----- PAGE TWO OF TWO - FORM 510 -----

3.2 Broker shall pay Office Manager monthly, on the tenth business day following the end of each calendar month of employment, _____% of Broker's share of gross fees, after deducting any portion earned by Broker's agents, other Brokers and any Franchisor, received in the brokerage business during the preceding calendar month.

3.3 The fee schedule may be changed by Broker on 30 days prior written notice to Office Manager.

3.4 On termination, Office Manager will be paid on a pro rata basis for any period of employment he has not been compensated.

4. **TERMINATION:**

4.1 This agreement shall continue until termination by mutual written agreement, or 30 days after either party serves written Notice of Termination, or either party, for cause, serves written Notice of Termination.

4.2 For one year after termination, Office Manager will not interfere with Broker's continuing relationship with his clients and employees, nor induce or attempt to induce any sales staff to discontinue representing Broker for the purpose of representing another broker.

4.3 For one year after termination and within 25 miles of the office, Office Manager is not to become employed with any real estate brokerage business, nor employ or become employed with any real estate licensee who was employed by Broker during the six months prior to termination.

5. **GENERAL PROVISIONS:**

5.1 Broker reserves the exclusive right to determine whether any dispute involving the Broker and third parties and arising from Office Manager's performance of assigned duties shall be prosecuted, defended or settled.

5.2 Before any party to this agreement files an action on a dispute arising out of this agreement which remains unresolved after 30 days of informal negotiations, the parties agree to enter into non-binding mediation administered by a neutral dispute resolution organization and undertake a good faith effort during mediation to settle the dispute.

5.3 **ARBITRATION:** Any dispute between Office Manager and Broker or any other licensee employed by Broker which cannot be resolved by the Broker or State Labor Commission shall be arbitrated under the rules of the American Arbitration Association.

5.4 _____

5.5 ☐ See addendum for additional terms. [See RPI Form 250]

OFFICE MANAGER: I agree to render services on the terms stated above. Date: _____, 20____ Name: _____ Social Security Number: _____ Signature: _____ Address: _____ Phone: _____ Cell: _____ Email: _____	BROKER: We agree to employ Designated Officer on the terms stated above. Date: _____, 20____ CalBRE #: _____ Broker: _____ Officer's Name: _____ Title: _____ Signature: _____ Address: _____ Phone: _____ Cell: _____ Email: _____
---	--

FORM 510 08-15 ©2015 RPI - Realty Publications, Inc. P.O.Box 5707, RIVERSIDE, CA 92517

Form 510

Office Manager
Employment
Agreement

Page 2 of 2

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 Form 510 accompanying this chapter]

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 *supervisory responsibility*. Thus, the broker is to ultimately review the acts of the office manager, transaction coordinator, and in turn, each sales agent.²

The actions of a sales agent or broker in the employ of a broker are considered the acts of the employing broker.³

Sales agent employment agreement

A real estate broker is to have a *written employment agreement* with each of their sales agents and brokers employed to act under their license.

The agent employment agreement, usually an independent contractor employment form, provides for:

- the supervision of the agent's activities;
- fulfillment by the sales agent of the duties owed by the broker to clients and the public; and
- the sales agent's compensation. [See **RPI** Form 506]

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.⁴

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;

² DRE Reg. 2725

³ Calif. Civil Code §2079.13(b)

⁴ Bus & P C §10177(h)

- 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.⁵

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.⁶

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.

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.⁷

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.⁸

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.⁹

Office manager and transaction coordinator liability

transaction coordinator

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

⁵ Bus & P.C. §10131.01

⁶ DRE Reg. §2724

⁷ DRE Reg. §2724

⁸ **Walters v. Marler** (1978) 83 CA3d 1

⁹ **Barry v. Raskov** (1991) 232 CA3d 447

Agency
Chapter 5
Key Terms

A broker who employs licensed sales agents is required by the California Department of Real Estate (DRE) to reasonably supervise their agents' activities.

To carry out these supervisory responsibilities, the broker may employ others, such as an office manager or transaction coordinator.

Though the broker may employ an office manager or transaction coordinator, the broker holds the final supervisory responsibility for the actions of the sales agents they employ.

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 cannot be delegated to others.

Agency
Chapter 5
Key Terms

office manager	pg. 108
supervisory scheme	pg. 107
transaction coordinator	pg. 111



Opinions with erroneous conclusions

Agency Chapter 6

After reading this chapter, you will be able to:

- distinguish between honestly held opinions, assurances and guarantees;
- recognize situations in which opinions can become assurances or guarantees;
- shield yourself from exposure to liabilities stemming from a client's reliance on an opinion;
- differentiate between estimates, projections, and forecasts; and
- manage clients' expectations of future events or conditions based on opinions, estimates, projections and forecasts.

affirmative fraud

estimate

fact

fiduciary duty

forecast

guarantee

negative fraud

opinion

projection

Learning Objectives

Key Terms

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"

When an opinion becomes a guarantee

opinion

A statement by an agent concerning an event or condition which has not yet occurred based on readily available facts.

or “projection,” denoting their statement is an **opinion** about an uncertain future event; or

- 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 buyer¹;
- 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 transaction²;

¹ *Ford v. Cournale* (1973) 36 CA3d 172

² *Pacesetter Homes, Inc. v. Brodtkin* (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 buyer³; 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.⁴

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.⁵

An opinion based on facts

³ *Borba v. Thomas* (1977) 70 CA3d 144

⁴ *Cooper v. Jevne* (1976) 56 CA3d 860

⁵ *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.⁶

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.

⁶ Pacesetter Homes, Inc., *supra*

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.⁷

Consider a prospective buyer who asks the seller's agent to point out the boundaries for the lot on which the home is located. The seller's agent states the boundaries are represented by a fence surrounding the property. The seller's agent does not provide the buyer with the *metes and bounds* description or instruct the buyer to investigate the boundaries.

The seller's agent does not indicate the source of the information upon which they based their boundary opinion. The agent also does not qualify their statement with words such as "the boundaries in this subdivision *are usually* where the fence has been placed." Further, the seller's agent does not say, "in my opinion" or "I believe" to indicate any uncertainty about the location of the boundaries. The agent's statement of the boundary location was absolute — the fence surrounding the property is the boundary.

The buyer indicates they intend to build a pool on their acquisition of the property. The seller's agent does not respond to the buyer's statement about the intent to build a pool. The seller's agent has no actual knowledge of easements

Opinions in lieu of investigations

⁷ Foreman & Clark Corporation v. Fallon (1971) 3 C3d 875

or zoning ordinances which could *adversely affect* implementation of the buyer's intended future use of the property. This information is readily available in the public record or from public agencies on a phone call.

Without further investigation, a purchase agreement is entered into. In preparation of the purchase agreement, the seller's agent does not include a contingency provision to provide the buyer with an opportunity to verify the location of the boundaries, or to confirm their ability to obtain a permit to build a pool as a condition for closing escrow.

Prior to closing, the title company is not asked nor is a surveyor brought in to establish the boundaries. Neither the local planning department nor a pool contractor are consulted about the ability to build a pool.

In actual fact, the location of the rear fence is several feet beyond the property line. The misplaced fence gives the rear yard the appearance of having sufficient room to accommodate a pool, which it does not. Also, an easement for water lines and a sewer line runs across the entire rear of the property. The seller's agent has no actual knowledge of the easements.

Here, the buyer acted in reliance on the seller's agent's (and seller's) opinion about the location of the boundaries. As a result, liability for the boundary discrepancy is imposed on the seller's agent for their failure to *conditionalize their statement* about the location of the boundaries. Without qualifying their statement, the agent's comments became a misrepresentation about the actual location of the boundaries.

Lack of actual knowledge

In the previous example, the seller's agent has no liability exposure for their failure to disclose the easements due to the agent's lack of actual knowledge of the easements, even though the information was readily available on request. The seller's agent did not owe the buyer a duty to advise the buyer of the need to check title for any easements or restrictions which might interfere with the construction of a pool.

The seller's agent did conduct a visual inspection of the property and observed nothing which indicated the existence of an easement. Further, the agent knew nothing about any such easement and had no duty to investigate the condition of title or zoning since they are public records and go beyond observations resulting from a limited visual inspection.

Conversely, since the buyer made an inquiry about the boundaries of the property and announced their intention to install a pool, the subject matter of these inquiries became **material facts**. When a seller's agent responds to an inquiry by a prospective buyer without conditionalizing their statement, the buyer may rely on the information. The buyer may thus acquire the property without further confirmation of the accuracy or truthfulness of the agent's statements.

The seller's agent needed to include a **further-approval contingency provision** in the purchase agreement due to the buyer's inquiry. Then, the buyer would have been required as a condition of closing to further

investigate. Thus, if the results of the due diligence investigation into the feasibility of constructing a pool (and the location of the boundaries) were not satisfactory to the buyer (or waived), the buyer could have cancelled the transaction.

Without the inquiry from the buyer, the seller's agent need not volunteer their opinion about the location of the boundaries. Thus, without the inquiry, the agent would not have gone beyond the *minimum required disclosures* about the physical condition of the property. Once the agent responded to the buyer's request, a contingency provision for further approval of the condition included in the purchase agreement would have avoided the dispute.

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 agency 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.

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.⁸

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

Opinions of the buyer's broker

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.

Assurance of suitability without a contingency

⁸ Borba, *supra*

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.⁹

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**

⁹ Ford, *supra*

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 *specialty 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.¹⁰

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**.

**Inducing
reliance by
assurances**

¹⁰ *Cohen v. S & S Construction Co.*, (1983) 151 CA3d 941

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**.¹¹

negative fraud
Deceitfully withholding or failing to disclose information to someone.

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.

Predicting the conduct of others

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.

¹¹ Cooper, *supra*

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 *especially 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.¹²

Estimates as projections or forecasts

estimate

Prediction of future amounts which have not yet actually occurred.

Nearly every transaction offers agents the opportunity to provide **estimates** for their clients or the other principals involved. Estimates include:

- 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

¹² Borba, *supra*

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.

Opinions voiced by agents about an income property’s future performance are either **projections** or **forecasts**.

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 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;

Distinguish projection from 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.

- 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.

**Agency
Chapter 6
Summary**

Statements made by an agent to their client are expressed as either an opinion about an uncertain future event, or as an assurance the events and conditions will occur, becoming a guarantee. The difference between the wording used by an agent to express either an opinion or a guarantee exposes the agent to liability when the buyer acts in reliance on the information and the event or condition fails to occur.

In an opinion, the event or condition expressed is not a factual representation. An opinion does not create any liability if the event does not occur, so long as the agent’s opinion is a belief honestly held by the agent. However, a special condition or circumstance may exist which imposes liability.

Due to an agent’s experience or special training in a particular aspect of a property or type of transaction, agents may find their opinion is given extra weight by a buyer. Thus, an agent’s wording of their opinion needs to express that the opinion is only their belief on the matter.

To prevent an opinion from becoming an assurance, the buyer’s broker needs to recommend the client investigate the terms of the opinion independently. Coupling an opinion with advice that no further investigative action is necessary elevates the opinion to the level of a guarantee.

**Agency
Chapter 6
Key Terms**

affirmative fraud	pg. 122
estimate	pg. 124
fact	pg. 114
fiduciary duty	pg. 119
forecast	pg. 125
guarantee	pg. 122
opinion	pg. 114
negative fraud	pg. 123
projection.....	pg. 125



Fair Housing Chapter 1



[Click to watch](#)

After reading this chapter, you will be able to:

- recognize discriminatory practices prohibited under the Federal Fair Housing Act (FFHA);
- avoid penalties and liability for losses resulting from the practice of unlawful housing discrimination; and
- understand the need for brokers and agents to be committed to fair and equitable housing practices as defined by the FFHA.

aggrieved person

blockbusting

Federal Fair Housing Act (FFHA)

residence

steering

Learning Objectives

Key Terms

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.¹

A **residence** 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.²

Introduction to fair housing

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.

¹ 42 United States Code §93601 et seq.

² 42 USC §93602(b)

residence

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.³

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.⁴

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.⁵

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.⁶

Individuals with the Human Immunodeficiency Virus (HIV) are also protected as handicapped.⁷ [See *Fair Housing* Chapter 12]

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).⁸

Refusal to sell or rent

A broker is prohibited from discriminating in the negotiations and handling of an offer on the sale or rental of a residence.⁹ [See *Fair Housing* Chapter 5 and Chapter 6]

Consider a broker hired by an apartment owner to perform property management activities. One of the broker's duties is to locate tenants to fill vacancies.

³ 42 USC §3605

⁴ 42 USC §3602(k)

⁵ 42 USC §3602(h)

⁶ **United States v. Southern Management Corporation** (4th Cir. 1992) 955 F2d 914

⁷ 24 Code of Federal Regulations §100.201

⁸ 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.

⁹ 42 USC §3604(a)

A prospective tenant from a minority group contacts the broker. The broker informs the prospective tenant of the monthly rent. When the prospective tenant asks the broker for an application, the broker informs the tenant a nonrefundable fee is charged to process the application. The prospective tenant fills out the application and pays the fee.

Later, a non-minority prospective tenant inquires about the rental of the same unit. The broker quotes the non-minority tenant a lower monthly rental rate and does not charge a processing fee. The apartment is then rented to the non-minority tenant.

Here, the broker's actions are a violation of the FFHA. The higher rates and application charge imposed on the minority tenant are *racially motivated*. Based on the tenant's minority status, the broker misrepresented the rental terms on which the apartment was available and used different procedures and qualification standards for processing the tenant's application.¹⁰

Prohibited discrimination by a broker or their agent is to be avoided in the *terms, conditions or privileges* of the sale or rental of a dwelling. Further, a broker may not discriminate when providing *services and facilities* involving a residence.¹¹

For example, a minority buyer responds to an advertisement concerning the sale of a residence in a new housing development.

The broker shows the buyer the residence. The prospective buyer informs the broker they are interested in purchasing the property. The broker states they cannot sell the home to the prospective buyer since it would become more difficult to sell the remaining homes in the development.

The broker states the developer is willing to build an identical house at the same price in another part of town, an activity called **steering**.

Here, the broker has discriminated against the prospective buyer by refusing to sell the house in a particular location to the buyer due to the buyer's minority status.¹²

Steering involves restricting a person from seeking to buy or rent a residential property in a community, neighborhood or development and redirecting them to other housing. The result is the perpetuation of segregated housing patterns.¹³

Other prohibited activities of a broker which demonstrate an *intent to discriminate* include:

- using *less favorable provisions* in lease or purchase agreements, such as in rental charges and closing requirements;
- *delaying or failing* to perform maintenance or repairs;

Different terms, conditions, privileges, services and facilities

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.



Click to watch

¹⁰ **United States v. Balistrieri** (7th Cir. 1992) 981 F2d 916

¹¹ 42 USC §3604(b)

¹² **United States v. Pelzer Realty Company, Inc.** (5th Cir. 1973) 484 F2d 438

¹³ 24 CFR §100.70; 42 USC §3604(d)



- limiting an individual's use of privileges, services or facilities; or
- refusing or failing to provide services or facilities due to a person's refusal to provide sex.¹⁴

Further, a broker and their agent may not make or release any advertisement that indicates a *preference, limitation or discrimination* in the sale or rental of a residential unit.¹⁵ [See *Fair Housing* Chapter 11]

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.

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* occurs when agents make negative representations about a change in the ethnic makeup of a neighborhood and the economic consequences resulting from the change.¹⁶ [See *Fair Housing* Chapter 7]

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.¹⁷

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.¹⁸

Thus, if a broker is the agent for any of the parties to a sale or rental transaction, the FFHA applies.

¹⁴ 24 CFR §100.65(b)

¹⁵ 42 USC §3604(c)

¹⁶ 42 USC §3604(e)

¹⁷ 24 CFR 100.85(c)

¹⁸ 42 USC §3603(c)

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.¹⁹

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.²⁰

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.²¹ [See *Fair Housing* Chapter 6]

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.²² [See *Fair Housing* Chapter 6]

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.²³

After an investigation and informal negotiations, the Secretary will have the parties mediate an agreement to resolve the dispute.²⁴

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.²⁵

Failure to comply with the FFHA

aggrieved person

Any person who claims to have been injured by a discriminatory housing practice.



Click to watch

¹⁹ 42 USC §3603(b)(1)

²⁰ 42 USC §3603(b)(2)

²¹ 42 USC §3607(a)

²² 42 USC §3607(b)

²³ 42 USC §3610(a)

²⁴ 42 USC §3610(b)

²⁵ 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.²⁶

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).²⁷

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.²⁸

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.²⁹

²⁶ 42 USC §3612(g)(3)

²⁷ 42 USC §3612(g)(5)

²⁸ 42 USC §3613(c)(1)

²⁹ 42 USC §3614(d)

The Federal Fair Housing Act (FFHA) prohibits discrimination in:

- the sale, rental or advertising of a residence;
- offering and performing broker services;
- making and purchasing real estate-related mortgages; and
- appraising real estate.

Under the FFHA, a broker or agent cannot discriminate in their practice against a person based on their race, color, national origin, religion, sex, familial status or handicap.

Certain exemptions to the FFHA discrimination rules exist, such as for religious organizations, private clubs and senior housing.

Any aggrieved person who claims to have been injured by a discriminatory housing practice may file a complaint with the Secretary of Housing and Urban Development (HUD). The parties will enter into mediation to achieve a resolution. If mediation fails, the complaint will be resolved by an administrative law judge or, if a party to the complaint chooses, in a civil action.

aggrieved person	pg. 131
blockbusting	pg. 130
Federal Fair Housing Act (FFHA)	pg. 127
residence	pg. 128
steering	pg. 129

Fair Housing

Chapter 1

Summary

Fair Housing

Chapter 1

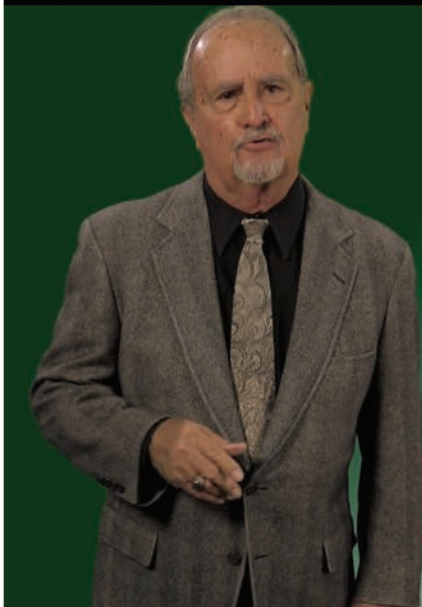
Key Terms

LEARN THE 25 MARKET FACTORS

pushing and pulling California real estate

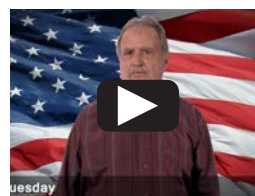
Enroll in our 45-hour package **901: Economic Trends in California Real Estate** to get all the renewal hours you need, PLUS an up-to-date report on the latest trends so you're prepared for tomorrow's market.

Enroll now





Fair Housing Chapter 2



Click to watch

After reading this chapter, you will be able to:

- recognize the protections against race-based discrimination in real estate transactions under the Civil Rights Acts of 1866 and 1870.

The Civil Rights Acts of 1866 and 1870

public housing

Learning Objectives

Key Terms

All citizens of the United States have the right to acquire, lease, sell, hold and encumber real estate and personal property, regardless of race.¹

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.²

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*. [See *Fair Housing* Chapter 1]

The Civil Rights Acts of 1866 and 1870 apply to race discrimination on *all types of real estate*, not just residential real estate.

Property rights cannot be based on race

The Civil Rights Acts of 1866 and 1870

Federal prohibitions against racial discrimination on all types of real estate.

¹ 42 United States Code §1982

² 42 USC §1981(a)

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

public housing
Subsidized housing typically reserved for low-income families, the elderly, and persons with disabilities.

For example, a city housing authority is to construct low-income **public housing**.

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.³

³ Resident Advisory Board v. Rizzo (1977) 564 F.2d 126

Under 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. This protection applies to residential and commercial real estate.

Further, the Act provides all persons the right to make and enforce contracts regardless of race.

The Civil Rights Acts of 1866 and 1870.....pg. 135
public housingpg. 136

Fair Housing Chapter 2 Summary

Fair Housing Chapter 2 Key Terms



Want an exclusive
behind-the-scenes look at
firsttuesday's new
Video Renewal Course™?

Click here for a sneak
peek at your next renewal.



Americans with Disabilities Act



Fair Housing Chapter 3

After reading this chapter, you will be able to:

- identify a qualified person with a disability;
- prevent unlawful discrimination against people with disabilities;
- identify the kinds of commercial real estate subject to accessibility rules under the Americans with Disabilities Act (ADA); and
- adequately accommodate people with disabilities in commercial facilities and places of public accommodation.

**Americans with
Disabilities Act (ADA)**
commercial facility

public accommodation

Learning Objectives

Key Terms

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.¹

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.²

Providing access to commercial real estate

Americans with Disabilities Act (ADA)

Federal regulations prohibiting an employer from discriminating against a qualified person based on a disability.

¹ 42 United States Code §12112

² 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.³

ADA **employees** are all representatives of the broker, including:

- broker-associates;
- sales agents;
- managers;
- administrative personnel; and
- call center employees.

ADA **disabilities** include:

- a physical or mental impairment that limits one or more of a person's **major life activities**;
- a person having a record of such an impairment; or
- a person regarded as having such an impairment.⁴

Major life activities include, but are not limited to:

- performing manual tasks;
- caring for oneself;
- seeing or hearing; and
- walking or standing.⁵

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.

Public accommodations and commercial facilities

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**.⁶

³ 42 USC §12111(5)(A)

⁴ 42 USC §12102(2)

⁵ 42 USC §12102(2)(A)

⁶ 42 USC §§12132; 12182(a)

Further, real estate used to provide *public accommodation* and *commercial facilities* need to be designed, constructed and altered in compliance with the ADA.⁷

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.⁸

Any person who owns or operates a place of public accommodation or a commercial facility may not *discriminate* on the basis of a disability.⁹

Discrimination includes:

- use of eligibility requirements that screen out individuals with disabilities;
- failure to make reasonable modifications in policy, practices or procedures necessary to provide accommodations;
- failure to take the steps necessary to ensure a person with a disability is not excluded, denied services, segregated or treated differently in the accommodations offered;
- failure to remove architectural and communication barriers which are structural in nature and where such removal is readily achievable; and

public accommodation

Property owned, leased or operated by a private entity whose operation affects commerce.

commercial facility

Property owned, leased or operated by a private entity whose operation affects commerce.

⁷ 28 Code of Federal Regulations §36.101

⁸ 42 USC §12181(2)

⁹ 42 USC §12182(a)

- with respect to a facility that can be altered, failing to make alterations which provide accessibility to persons with disabilities.¹⁰

A landlord who owns a place of public accommodation is subject to the ADA. A tenant who operates a place of public accommodation is similarly subject to the ADA. The landlord and tenant agree who is responsible for complying with the ADA in a lease provision.¹¹

Removal of architectural and communication barriers

A place of public accommodation is required to provide necessary aids to ensure effective communication with individuals with disabilities. This includes aids such as *telecommunication devices (TDD)* and closed-caption decoders. This rule is subject to a reasonableness standard. Thus, compliance is not required if it would place an *undue burden* or significant difficulty or expense on the public accommodation.¹²

For example, a public accommodation is not required to use TDDs for the deaf for receiving or making telephone calls incidental to operations.¹³

However, places of public accommodation providing lodging in which televisions are placed in five or more guest rooms need to provide closed-caption decoders for the hearing impaired on request.¹⁴

A place of public accommodation need to remove architectural barriers which limit access for disabled persons.

Examples of the removal of **architectural barriers** include:

- installing ramps;
- making curb cuts for wheelchair access;
- rearranging furniture; and
- widening doors.¹⁵

¹⁰ 42 USC §12182(b)(2)(A); 12183

¹¹ 28 CFR §36.201

¹² 28 CFR §36.303

¹³ 28 CFR §36.303(d)

¹⁴ 28 CFR §36.303(e)

¹⁵ 28 CFR §36.304(b)

The Americans with Disabilities Act (ADA) prohibits discrimination against individuals with disabilities. Disabilities are defined as a physical or mental impairment that limits one or more of a person's major life activities.

An employer may not discriminate against a person with a disability who can perform a job with or without reasonable accommodation by the employer.

Further, a person with a disability cannot be discriminated against in the offering of public services or in places of public accommodation or commercial facilities.

Failure to make such places accessible to disabled individuals is considered discriminatory. Remedies to such access-based discrimination include the removal of communication barriers, such as those for the hearing or sight impaired, and architectural barriers, such as those for the mobility impaired.

Americans with Disabilities Act (ADA)	pg. 139
commercial facility	pg. 141
public accommodation	pg. 141

Fair Housing Chapter 3 Summary

Fair Housing Chapter 3 Key Terms



CAN'T DECIDE WHAT TO WATCH?
firsttuesday has you covered

Stream your continuing education
with California's first DRE-approved
Video Renewal Course™

Enroll Now



Fair Housing Chapter 4



Click to watch

After reading this chapter, you will be able to:

- prevent unlawful discrimination against protected groups under California's Unruh Civil Rights Act;
- distinguish between reasonable and arbitrary discrimination; and
- understand the criteria exempting senior citizen housing facilities from age-based discrimination laws.

protected group

Unruh Civil Rights Act

senior citizen housing

Learning Objectives

Key Terms

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.

The Unruh Civil Rights Act

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.

senior citizen housing

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

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.¹

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.²

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.³

Reasonable vs. arbitrary discrimination

The state's civil rights and fair housing laws prohibit a broker from practicing any outlawed discrimination when locating tenants for a residential or commercial property. [See *Fair Housing* Chapter 6]

However, discriminatory standards which are *reasonably related* to the operation of the income property and apply equally to all members of the public are valid. This includes distinguishing criteria to ensure a prospective tenant is financially able to pay the rent (creditworthy) and will not damage

¹ Calif. Civil Code §§51, 51.2, 51.3

² *O'Connor v. Village Green Owners Association* (1983) 33 C3d 790

³ CC §51.5

(waste) or put the property to an improper use (nuisance). Standards which are applied equally to all individuals and do not discriminate against **protected groups** are more likely to be considered reasonable.

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.⁴

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.⁵

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.⁶

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.⁷ [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.⁸

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.

protected groups

A class of people who receive special protections against discrimination due to their distinguishing factors.

Housing for older persons



[Click to watch](#)

Qualifying for senior citizen housing federally

⁴ 42 United States Code §3607(b)

⁵ CC §51.3(b)(4)

⁶ CC §51.2(a); 51.4

⁷ 24 Code of Federal Regulations §100.303

⁸ 24 CFR §100.303(a)(3)

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.⁹

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.¹⁰

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.¹¹

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.¹²

Penalties for discrimination

A broker who discriminates is liable for damages of no less than \$4,000, and no more than three times the amount of the tenant's actual money losses, plus any attorney fees.¹³

⁹ 24 CFR §100.305(d)

¹⁰ 24 CFR §100.305(e)(1)

¹¹ CC §551.3(b)(2), 51.3(b)(3)

¹² CC §798.76

¹³ CC §52(a)

Fair Housing Chapter 4 Summary

California's Unruh Civil Rights Act prohibits discrimination by anyone in the business of providing housing or any commercial real estate facility. Brokers, housing developers, apartment owners, condominium owners and single family residence (SFR) owners are considered to be in the business of providing housing.

Residential developments and facilities consisting of at least 35 units may exercise age-based discrimination when the housing offered for

sale or lease is intended to be solely occupied by persons 62 years of age or 55 years of age or older, depending on the type of community established within the project.

protected group pg. 147
senior citizen housing pg. 146
Unruh Civil Rights Act pg. 145

Fair Housing
Chapter 4
Key Terms



Need to expand your real estate income?

Become a California Mortgage Loan Originator
to take advantage of record-low rates and
the refinance boom.

Get started



Fair housing for disabled persons

Fair Housing Chapter 5

After reading this chapter, you will be able to:

- ensure disabled tenants are provided equal access to residential rental units; and
- identify residential rental and leasing practices that are considered discriminatory against disabled people.

disabled person

Learning Objectives

Key Term

In the management of residential rental properties in California, individuals with disabilities are to be given full and equal access to housing accommodations offered for rent.¹

Editor's note – An exception exists when only one room is rented in a single family residence (SFR).²

A **disabled person** for residential rental purposes is defined as anyone who:

- has a *physical or mental impairment* that significantly limits major life activities;
- has a record of a disability; or
- is regarded as being disabled.³

Consider a *blind tenant* with a guide dog who seeks to rent a unit in an apartment building. The landlord refuses to rent an apartment to the blind tenant, claiming the guide dog violates the building's *pet restriction*.

California-style access for disabled tenants

disabled person

Anyone who has a physical or mental impairment which significantly limits major life activities, has a record of disability, or is regarded as being disabled.

¹ Calif. Civil Code §54.1(b)(1)

² CC §54.1(b)(2)

³ CC §54(b); Calif. Government Code §12926

The blind tenant claims the landlord may not deny housing due to the guide dog as this is a discriminatory practice based on their disability.

Is the landlord's refusal to permit a guide dog as policy an improper discriminatory practice?

Yes! A landlord may not refuse to rent residential property to a blind tenant due to the tenant's guide dog. The refusal to rent to a disabled tenant on these grounds is *unlawful discrimination*. This protection is also provided to deaf and other disabled persons who use specially trained dogs to assist them.⁴

Also, the landlord may not charge an additional security deposit for the disabled tenant's guide dog.⁵

However, a landlord with a pet restriction policy is not required to rent an apartment to a disabled tenant if the dog is not *specially trained* to assist the tenant. The landlord may impose reasonable regulations on the presence of the dog and hold the tenant liable for any property damage caused by the dog.⁶

Now consider a disabled tenant who is dependent on their spouse for *financial support*. The disabled tenant and their spouse seek to rent an apartment. The tenant and their spouse both sign the lease agreement. The spouse's income meets the landlord's *minimum income requirement* to rent.

The landlord refuses to rent the couple an apartment, claiming the disabled tenant's income does not meet minimum income requirements.

Here, the landlord may not deny housing to the couple based on the disabled tenant's financial dependency on their spouse as the *combined income* of the couple meets minimum income requirements. Thus, the landlord's refusal to rent an apartment to the couple based on the tenant's dependence on their spouse's income is unlawful discrimination.⁷

Accommodations for disabled persons

To meet the special needs of disabled tenants, a landlord is not required to modify their residential rental property.⁸

However, the landlord is to *allow* the tenant to make **reasonable modifications** to the rented property to meet their special needs and make it suitable for their occupancy. As a condition for allowance, the landlord may require the tenant to *restore* the property to its original condition when the tenancy is terminated.⁹

Likewise, a *mobilehome park* may not prohibit a tenant from installing ramps, handrails, or other accommodations for the disabled, as long as the required permits are obtained.¹⁰

⁴ CC §54.1(b)(6)

⁵ CC §54.2

⁶ CC §54.1(b)(5)

⁷ CC §54.1(b)(7)

⁸ CC §54.1(b)(4)

⁹ Gov C §12927(c)(1)

¹⁰ CC §§798.29, 6, 799.11

For new construction of residential properties containing four-or-more units in a building, California anti-discrimination rules require the builder to provide access for disabled persons. *Required adaptations* include:

- wheelchair ramps; and
- kitchens and bathrooms designed to allow access to disabled tenants.

Lack of access for the disabled when constructing a four-or-more unit residential structure is *unlawful discrimination*.¹¹

A disabled person being discriminated against may seek a court ordered injunction against the discriminatory activity. The injunction may be sought by:

- the person being discriminated against;
- the city attorney;
- district attorney; or
- the Attorney General.¹²

Liability is imposed on a property owner who unlawfully discriminates against a disabled person for money losses incurred by the disabled person due to the unlawful refusal to rent. In addition to money losses, treble the amount of actual money losses may be awarded as *punitive damages*, if malice is involved, plus attorney fees.

The minimum monetary award for discrimination against a disabled person is \$1,000.¹³

¹¹ Gov C §12955.1

¹² CC §555, 55.1

¹³ CC §54.3

California law prohibits discrimination against disabled persons when renting or leasing residential real estate, unless no more than one room is rented in a single family residence (SFR).

Landlords are not required to modify a property for a disabled tenant. However, the landlord needs to allow the tenant to make reasonable modifications. The landlord may require the tenant to restore the property to its original condition when the tenancy is terminated.

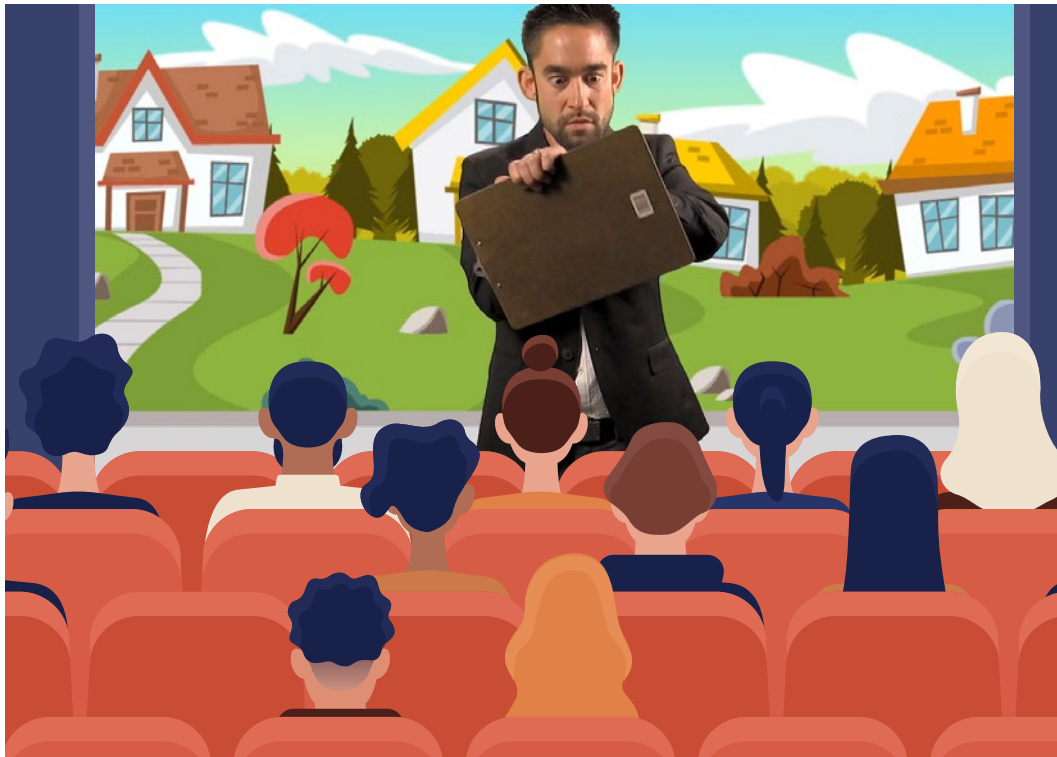
New residential properties consisting of four or more units need to allow access for disabled persons, including wheelchair ramps and accessible kitchens and bathrooms.

disabled personpg. 151

Remedies

Fair Housing Chapter 5 Summary

Fair Housing Chapter 5 Key Term



Knock out your CE with the only cinematic license renewal in California

Renew your license with **firsttuesday's**
new **Video Renewal Course™** for just \$119.50

Enroll now



California Fair Employment and Housing Act

Fair Housing Chapter 6

Discriminatory practices include:
 making an inquiry into the race, sex, disability, etc.
 publishing ads or notices which indicate a preference, prohibition, or restriction
 prohibited discrimination or arranging real estate and financing
 refusal to represent or negotiate in a real estate transaction
 any other practice that denies housing to a member of a protected class



[Click to watch](#)

After reading this chapter, you will be able to:

- identify the social characteristics protected from housing discrimination by California law;
- understand which practices are considered discriminatory; and
- recognize the agencies that enforce housing anti-discrimination rules in California.

Department of Fair Employment and Housing

senior citizen housing

Learning Objectives

Key Terms

Consider a minority tenant who seeks to rent an apartment. The landlord states they will not rent an apartment to a tenant until a credit check has been completed. The landlord declines to accept a deposit from the tenant until their credit has been cleared.

Later the same day, a non-minority tenant seeks to rent the same apartment. The landlord agrees to rent the apartment to the non-minority tenant without first requiring a credit check. The landlord immediately accepts a check from the tenant as a deposit on the apartment.

The minority tenant is then informed the apartment has been rented to another individual.

The minority tenant files a complaint against the landlord, claiming the landlord discriminated against them by refusing to rent an apartment to them based on their race. The landlord claims no discrimination occurred since they are entitled to require a credit check of prospective tenants.

Was the landlord's conduct discriminatory?

Discriminatory practices, exemptions and remedies

Yes! Requiring a credit check of minority tenants, but not non-minority tenants, is an unlawful discriminatory practice. The minority tenant is entitled to an award for money collectible from the landlord.¹

Prohibited factors

California law prohibits discrimination in the sale or rental of housing accommodations based on the distinguishing factors of:

- race;
- color;
- religion;
- sex;
- sexual orientation;
- marital status;
- national origin;
- ancestry;
- familial status; or
- disability.

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.²

Department of Fair Employment and Housing

The state agency designated to protect Californians from discrimination in housing, employment and public accommodation.

The **Department of Fair Employment and Housing (Department)** and the **Fair Employment and Housing Council (Council)** are the California government agencies which enforce anti-discrimination law.³

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 seeks to resolve the situation through discussions with the individual against whom the complaint is made.⁴

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

¹ *Stearns v. Fair Employment Practice Commission* (1971) 6 C3d 205

² Calif. Government Code §12955

³ Gov C §§12901, 12903, 12930, 12935

⁴ Gov C §12980

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.⁵

Familial status in anti-discrimination law refers to a situation in which children under the age of 18 live with a parent or guardian.⁶

Until *familial status* was added to the anti-discrimination laws in 1992, it was legal to exclude minors under the age of 18 from housing accommodations. However, policies excluding children under the age of 18 are now classified as unlawful discrimination, unless the property qualifies as **senior citizen housing**.⁷

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.⁸

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.⁹

Unlawful discrimination based on familial status

Religious exemption

senior citizen housing

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

⁵ Gov C §12981

⁶ Gov C §12955.2

⁷ Gov C §12955.9

⁸ Gov C §12955.4

⁹ *Smith v. Fair Employment and Housing Commission* (1996) 12 C4th 1143

Fair Housing Chapter 6 Summary

California law prohibits discrimination in the sale or rental of housing accommodations based on race, color, religion, sex, sexual orientation, marital status, national origin, ancestry, familial status or disability.

Discriminatory practices include:

- inquiring about an individual's race, sex, disability, or other prohibited factors;
- indicating a preference or limitation based on a prohibited factor;
- discriminating against a prohibited factor when arranging mortgages or financing;
- refusal to represent an individual based on a prohibited factor; and
- any other practice that denies housing or financing to an individual based on a prohibited factor.

The Department of Fair Employment (Department) and Housing and the Fair Employment and Housing Council (Council) are the agencies of the California state government which enforce anti-discrimination law.

Fair Housing Chapter 6 Key Terms

Department of Fair Employment and Housingpg. 156
senior citizen housing.....pg. 157



Fair Housing Chapter 7



DRE regulation of discrimination

After reading this chapter, you will be able to:

- identify which practices the California Department of Real Estate (DRE) prohibits as discriminatory;
- observe the social characteristics protected from discrimination by DRE anti-discrimination rules; and
- recognize and avoid cases of implicit discrimination.

blockbusting
discriminatory practices

implicit discrimination
protected group

Learning Objectives

Key Terms

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.¹

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;

Guidelines for broker conduct

discriminatory practices
Unequal treatment given to members of a protected class of individuals.

¹ Department of Real Estate Regulation §2780

- 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.²

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.³

Blockbusting and implicit discrimination

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.

implicit discrimination

Actions which are not openly discriminatory but yield discriminatory results.

Regulations also prohibit the old practice of **blockbusting**, also known as *panic selling*.⁴

Blockbusting is an attempt to influence sales or rentals of real estate by exploiting the prejudices of property owners in a neighborhood. This prohibited activity occurs when agents make negative representations about a change in the ethnic makeup of a neighborhood and the economic consequences resulting from the change.

Such blatantly discriminatory practices are not as common now as they once were. However, the focus now has shifted to more subtle forms of discrimination — **implicit discrimination**. *Implicit discriminatory practices* are those which are not openly discriminatory, but result in discriminatory effects.

Brokers and their agents need to be careful in their dealings in order to avoid actions with inadvertent discriminatory effects.

² DRE Reg. §52780 et seq.

³ 73 Ops. Cal. Atty. Gen. 58 (1990)

⁴ DRE Reg. §2781

Consider a seller whose agent receives an offer to purchase a listed property. The offer was received from a member of a **protected group**.

The price offered in the purchase agreement is greater than the listed price. However, the financing is structured as an installment sale calling for the seller to carry back a trust deed note in a no-downpayment, cash-back transaction without additional collateral.

The seller's agent, who is not a member of a protected group, informs the buyer the seller is not interested in a carryback note or the kickback of cash to the buyer.

Later, the property is sold for less than the listed price in an all cash transaction. The buyer is an individual who is not a member of a protected group.

The prospective buyer sues the seller's agent for unlawful discrimination against a member of a protected group, claiming the seller's agent unfairly prevented the buyer from obtaining housing since the seller's agent failed to submit the buyer's offer to the seller.

The seller's agent claims they did not discriminate against the prospective buyer since the carryback financing arrangement in the offer in lieu of cash made the offer less desirable than an offer for all cash.

Was the seller's agent guilty of discriminatory practices?

No! The seller's agent's behavior presented no unlawful discrimination. The only discrimination practiced by the seller's agent was over the distinction between two offers with dramatically dissimilar financial consequences for the seller.

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, and federal fair housing law. [See *Fair Housing* Chapters 1, 4 and 6]

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.

No discrimination on offers with dissimilar terms

protected group

A class of people who receive special protections against discrimination due to their distinguishing factors.

Broker's duty to employees

Fair Housing
Chapter 7
Summary

The California Department of Real Estate (DRE) maintains regulations prohibiting real estate brokers and their agents from discriminating against anyone based on race, color, sex, religion, ancestry, disability, marital status or national origin. The DRE also prohibits blockbusting and agent-induced panic selling.

As blatantly discriminatory practices are now far less common than in the past, the DRE has shifted its focus to implicit discrimination. Implicit discrimination is a practice which is not openly discriminatory, but has discriminatory effects.

Brokers are responsible for their own compliance with anti-discrimination regulations as well as their agents.

Fair Housing
Chapter 7
Key Terms

blockbusting	pg. 160
discriminatory practices	pg. 159
implicit discrimination	pg. 160
protected group	pg. 161



Fair Housing Chapter 8



After reading this chapter, you will be able to:

- recognize the protected classes under the Equal Credit Opportunity Act (ECOA);
- identify who is subject to the rules of the ECOA and what activities are prohibited; and
- distinguish the exemptions from anti-discrimination rules under the ECOA.

credit reporting agency

Equal Credit Opportunity Act (ECOA)

Learning Objectives

Key Terms

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*.

The lender claims the denial of the mortgage to the unmarried couple is motivated by a legitimate business consideration. The lender states the

Federal fair lending rules

Equal Credit Opportunity Act (ECOA)

A federal law which prohibits discriminatory and unfair lending practices.

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**.¹

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*.²

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 individually³;
- discouraging loan applicants based on their race, color, sex, etc.⁴; and
- making inquiries into the marital status of loan applicants.⁵

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.⁶

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.⁷

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.

¹ *Markham v. Colonial Mortgage Service Co. Associates, Inc.* (1979) 605 F2d 566

² 15 United States Code §1691a(e)

³ *Anderson v. United Finance Company* (1982) 666 F2d 1274

⁴ 12 Code of Federal Regulations §1002.5(b)

⁵ 12 CFR §1002.5(d)

⁶ 12 CFR §1002.5(d)

⁷ 15 USC §1691(a)(2)

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.⁸

Consider a California-regulated institutional lender who regularly arranges alternative forms of financing. The lender consistently informs non-minority loan applicants of their financing options when they deny a loan application.

The lender's failure to diligently provide the same assistance for minority loan applicants subjects the lender to liability for the minority applicant's money losses caused by the discrimination. Here, the unlawful discrimination is based on the lender's selective release of information based on status.⁹

Different treatment is discrimination



Click to watch

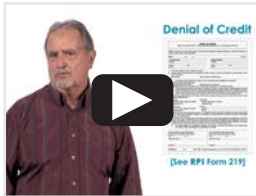
Same assistance for minorities

⁸ *Barber v. Rancho Mortgage & Investment Corp.* (1994) 26 CA4th 1819

⁹ *Barber, supra*

Form 219

Denial of Credit



Click to watch

DENIAL OF CREDIT <small>(California Civil Code §1785.20; 12 Code of Federal Regulations §202.9; 15 United States Code §1681m)</small>	
NOTE: This form is used by a loan broker or lender when processing a mortgage application, to inform the borrower of adverse action taken on their application.	
DATE: _____, 20____, at _____, California.	
TO APPLICANT: Address _____ Phone _____ Fax _____ Email _____	FROM LENDER: Address _____ Phone _____ Fax _____ Email _____
<ol style="list-style-type: none"> 1. This notice regards your loan application number _____. 2. Adverse action has been taken on the application based in whole or in part on information in a credit report or other source as follows: <div style="margin-left: 20px;"> <input type="checkbox"/> loan denied. <input type="checkbox"/> loan offered on different terms. </div> 2.1 The adverse action was taken by Lender, not the Credit Bureau that supplied the credit report. 3. Reason(s) adverse action was taken: <div style="margin-left: 20px;"> <input type="checkbox"/> delinquent payment of debts. <input type="checkbox"/> derogatory trade references. <input type="checkbox"/> inadequate references to establish credit. <input type="checkbox"/> references not responsive to verification requests. </div> 3.1 If the reason(s) adverse action was taken is not stated in Section 3 or was only given orally, Applicant may, within 60 days of the date on this notice, request a separate statement of specific reasons for the adverse action from Lender identified above which Lender will deliver to Applicant within 30 days of Lender's receipt of request. Only Lender can give specific reasons for the adverse action, not the Credit Bureau that supplied the report. 4. Applicant may, within 60 days of the date on this notice, request a free copy of their credit report from the Credit Bureau(s) identified below: <div style="margin-left: 20px; display: flex; justify-content: space-between;"> <div> <input type="checkbox"/> Equifax PO BOX 740241, Atlanta, GA 30374 1-800-685-1111 </div> <div> <input type="checkbox"/> Experian PO BOX 2002, Allen, TX 75013 1-888-397-3742 </div> </div> <div style="margin-left: 20px; margin-top: 5px;"> <input type="checkbox"/> TransUnion PO BOX 1000, Chester, PA, 19022 1-800-888-4213 </div> <div style="margin-left: 20px; margin-top: 5px;"> <input type="checkbox"/> Name: _____ Address: _____ Phone: _____ </div> 5. Applicant has the right to dispute the accuracy or completeness of any information contained in the credit report issued by the Credit Bureau identified in Section 4 by submitting a written statement describing the nature of the dispute directly to the Credit Bureau. 6. The federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. <div style="margin-left: 20px;"> 6.1 The federal agency that administers compliance with this law concerning this creditor is the Federal Trade Commission, Equal Credit Opportunity, Washington, DC 20580. </div> 	
I have received a copy of this notice. <input type="checkbox"/> See Signature Page Addendum. [RPI Form 251] Date: _____, 20____ Applicant's name: _____ Signature: _____	I have received a copy of this notice. <input type="checkbox"/> See Signature Page Addendum. [RPI Form 251] Date: _____, 20____ Applicant's name: _____ Signature: _____
FORM 219 03-11 ©2017 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517	

Discrimination by age and public assistance

Some exceptions to the anti-discrimination rules exist.

For example, a lender may lawfully consider a loan applicant's age when determining the applicant's creditworthiness. A lender may also consider whether the applicant receives income from a public assistance program, if such an inquiry is for the purpose of determining the amount and likely continuance of income levels from public assistance.¹⁰

¹⁰ 15 USC §1691(b)(2)

Editor's note — Allowing lenders to consider an applicant's age or receipt of income from a public assistance program as an exception in determining the applicant's creditworthiness effectively removes these two factors from the anti-discrimination protection previously discussed.

While a lender may not refuse to accept applications or impose different loan terms based on an applicant's age or receipt of public assistance income, the lender can lawfully deny a loan based on these factors simply by stating the applicant is not creditworthy.

Further, lenders may consider an applicant's **immigration status** when considering a loan application. Immigration status is used by the lender to determine whether the applicant is a permanent resident of the United States.¹¹

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.¹² [See **RPI** Form 219 accompanying this chapter]

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.¹³

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.¹⁴

Denial of credit and notification

credit reporting agency

A private agency which collects and reports information regarding an individual's credit history.

¹¹ 12 CFR §1002.6(b)(7)

¹² 15 USC §1691(d)

¹³ Calif. Civil Code §1785.10

¹⁴ 15 USC §1691e

Fair Housing Chapter 8 Summary

The Equal Credit Opportunity Act (ECOA) prohibits discrimination in lending based on race, color, religion, national origin, sex, marital status or age. The ECOA applies to institutional lenders, loan brokers, and others who regularly make or arrange loans.

Discrimination is rarely practiced overtly. Unlawful discrimination includes applying different standards to minority and non-minority borrowers, and providing more assistance to non-minority borrowers than to minority borrowers.

Exceptions to anti-discrimination rules exist, such as a lender's consideration of an applicant's age, public assistance program income, or immigration status when determining creditworthiness.

If the lender denies a loan application, it needs to deliver a statement to the applicant listing the specific reasons for the denial, or deliver a notice to the applicant advising them of their right, upon request, to obtain a statement listing the reasons for denial.

Fair Housing Chapter 8 Key Terms

credit reporting agency.....	pg. 167
Equal Credit Opportunity Act (ECOA)	pg. 163



The Housing Financial Discrimination Act of 1977

After reading this chapter, you will be able to:

- understand the California state law prohibiting discriminatory lending practices; and
- identify the practices in lending and mortgage brokering which are considered discriminatory.

redlining

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**.¹

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.²

¹ Calif. Health and Safety Code §35801(b)

² Health & S C §35802

Fair Housing Chapter 9



[Click to watch](#)

Learning Objectives

Key Term

California's fair lending laws

Increased availability of mortgages



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.³

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.⁴

Discrimination in certain communities

redlining

Failure to provide financing in certain communities based on the demographics of that community.

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.⁵

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.⁶

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.⁷

However, a lender can consider neighborhood conditions when making a mortgage under certain circumstances. When doing so, the lender needs to

³ Health & S C §35805(d)

⁴ Health & S C §35811

⁵ Health & S C §35810, 35812

⁶ Health & S C §35801(e)(4)

⁷ Health & S C §35801

demonstrate a mortgage denial is based on neighborhood conditions which render the mortgage unsafe and unsound as a matter of good business practice.⁸

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.⁹

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).¹⁰

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.¹¹

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.¹²

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.¹³

Notice of a mortgage applicant's rights



[Click to watch](#)

Administrative remedies

⁸ Health & SC §35810(a)

⁹ Health & SC §35813

¹⁰ Health & SC §35830

¹¹ Health & SC §35805

¹² Health & SC §35800 et seq.

¹³ *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.¹⁴

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.¹⁵

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 \$1,000.¹⁶

Lender liability

Consider a minority buyer of real estate who submits a mortgage application to a mortgage broker for a purchase-assist mortgage.

The mortgage broker fails to take the necessary steps to arrange a mortgage for the minority buyer, and denies the application. Concurrently, the mortgage broker makes similar financing for a non-minority buyer whose credit record is worse than the minority buyer.

The minority buyer seeks money losses from the mortgage broker for race discrimination.

The minority buyer claims the mortgage broker's denial of their mortgage application is discriminatory since the mortgage broker arranged mortgages for a less qualified non-minority buyer.

The mortgage broker claims they did not discriminate against the minority buyer since the buyer did not qualify for the mortgage.

Is the mortgage broker liable for money losses for discrimination?

Yes! The mortgage broker's failure to arrange a mortgage for the minority buyer, while at the same time arranging mortgages for less qualified non-minority buyers, is discriminatory.¹⁷

¹⁴ Health & S C §35821

¹⁵ Health & S C §35822

¹⁶ Health & S C §35822(a), 35822(b)

¹⁷ *Green v. Rancho Santa Margarita Mortgage Company* (1994) 28 CA4th 686

California state law prohibits discriminatory lending practices. This is done to achieve and maintain a healthy state economy and an efficient real estate market.

Lenders need to make financing available to all qualified creditworthy applicants seeking to buy, build, repair, improve or refinance an existing mortgage on a one-to-four unit residence, owner-occupied or not. The financing available to a borrower cannot be based on the applicant's race, color, religion, sex, marital status, sexual orientation, source of income, genetic information, disability, national origin, or ancestry.

The practice of denying mortgages and under-appraising properties in minority communities based on demographics is called redlining and is prohibited by law. Redlining discourages homeownership in minority communities and thus has adverse effects on the economic and social health of those communities. Denial can be based on neighborhood conditions, but not neighborhood demographic characteristics.

State regulated lenders need to publicly post notices informing applicants of their right to pursue recourse should the lender practice unlawful discrimination.

redlining pg. 170

Fair Housing Chapter 9 Summary

Fair Housing Chapter 9 Key Term



Need an easier way to inform clients and answer their real estate related questions?

Use our printable Client Q&A flyers as reference guides to respond to common inquiries, from questions about disclosure requirements to closing the sale of a home.

Improve your marketing



Fair Housing Chapter 10



 [Click to watch](#)

After reading this chapter, you will be able to:

- identify the goals of the federal Home Mortgage Disclosure Act (HMDA);
- identify which lenders and mortgage types the HMDA applies to; and
- find and interpret the data required for HMDA disclosure statements.

debt-to-income (DTI) ratio

Home Mortgage Disclosure Act (HMDA)

Learning Objectives

Key Terms

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.¹

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.²

Mortgage originations include:

- purchase-assist financing;
- construction for a new home;
- improvement of the borrower's home; or
- the refinance of an existing mortgage.

Lenders release mortgage data

Home Mortgage Disclosure Act (HMDA)

A federal law mandating data collection on mortgage originations and applications of lenders who meet threshold requirements.

¹ Department of Housing and Urban Development Mortgage Letter 94-22

² 12 United States Code §§2802, 2803; Calif. Health and Safety Code §35816

Federal disclosure requirements

Lenders with total assets of more than \$45 million, and for-profit mortgage brokers who have originated 25 close-end mortgages in each of the last two years or 100 open-end lines of credit in each of the last two years, need to compile origination data and make it available to the public.

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.³

The data is grouped according to census tracts to determine the lender's activity within the tract.⁴

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.⁵

The data is compiled by the **Federal Financial Institutions Examination Council** into a *disclosure statement* sent to the lender.⁶

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.⁷

On request from any member of the public, the lender needs to make available a copy of the disclosure statement data.⁸

California state regulated lenders

Lenders who regularly originate residential mortgages who do not report to a federal or state regulatory agency need to compile data on the number and dollar amount of mortgage originations for each fiscal year. This includes both actual originations and completed mortgage applications.⁹

State regulated lenders who fall into this category include:

- insurers;
- mortgage bankers;

³ 12 Code of Federal Regulations §1003.4(a)

⁴ 12 USC §2803(j)(2)(C)

⁵ HUD Mortgagee Letter 94-22

⁶ 12 CFR §1003.5(b)

⁷ 12 USC §52803(a)(2), 2803(c)

⁸ 12 USC §2803(a)(1)

⁹ 21 Calif. Code of Regulations §7118(a)

- investment bankers; and
- credit unions that do not make federally related mortgages.

The data is first categorized by geographical area, then by census tract. For each census tract, mortgage originations are grouped according to:

- FHA and Veterans Administration (VA) mortgage originations on owner-occupied, one-to-four unit dwellings;
- conventional purchase-assist mortgage originations on owner-occupied, one-to-four unit dwellings;
- home improvement mortgage originations on owner-occupied, one-to-four unit dwellings; and
- home improvement mortgage originations on occupied, one-to-four unit dwellings not occupied by the owner.¹⁰

California regulated lenders exempt from mortgage origination disclosures are:

- lenders whose originations of purchase-assist mortgages totaled less than 10% of the lender's mortgage volume during the current reporting year; and
- licensed real estate brokers who negotiate or arrange purchase-assist and home improvement mortgages.¹¹

Federally regulated lenders are subject to investigation and penalties by federal authorities.¹²

While disclosure of home mortgage statistics helps to identify lending patterns, mortgage statistics alone are not sufficient to determine whether a lender is unlawfully practicing *redlining* or other discriminatory practices.

The mortgage statistic disclosures may be relevant when considered in conjunction with other evidence. This includes the *credit histories* of denied mortgage applicants and their **debt-to-income (DTI) ratios**.¹³

Monitoring federally regulated lenders

debt-to-income (DTI) ratio

The percentage of monthly gross income that goes towards paying debt.

¹⁰ 21 CCR §7118(b)(2)

¹¹ 21 CCR §7121

¹² 12 USC §2803(h)

¹³ HUD Mortgagee Letter 94-22

Fair Housing Chapter 10 Summary

The federal Home Mortgage Disclosure Act (HMDA) prevents lending discrimination and unlawful redlining practices on residential or home improvement mortgages. The HMDA requires lenders to disclose information on their mortgage originations to the public.

State and federally regulated banks need to maintain data on the type of mortgages they originate, the amount, the occupancy status of the real estate, the action taken by the lender on the application, and demographic information about the applicant.

This data is categorized by mortgage type, geographical area and census tract. It is then compiled into a disclosure statement which lenders need to post publically. These disclosures help identify lending patterns and prevent lending discrimination.

Fair Housing Chapter 10 Key Terms

debt-to-income (DTI) ratio	pg. 177
Home Mortgage Disclosure Act (HMDA)	pg. 175



HUD advertising guidelines for sales and rentals

Fair Housing Chapter 11



After reading this chapter, you will be able to:

- recognize the types of advertising considered discriminatory under the Federal Fair Housing Act (FFHA);
- use the Department of Housing and Urban Development (HUD) guidelines to avoid discriminatory preferences in advertising; and
- understand the consequences of failing to follow HUD advertising guidelines.

dwelling

Federal Fair Housing Act (FFHA)

Learning Objectives

Key Terms

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)**.¹ [See *Fair Housing Chapter 1*]

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*.²

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.

Avoiding discrimination in advertising

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.

dwelling

A building or personal property occupied or designed to be occupied as a residence by one or more families.

¹ 42 United States Code §3604(c)

² 42 USC §§3603, 3604

Marketing real estate for sale or rent



Click to watch

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.

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:

- White private home;
- perfect for newlyweds;
- Jewish (or Christian) home;
- country club nearby;
- Black home;
- ideal bachelor pad;
- walking distance from 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. [See *Fair Housing* Chapter 4]

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.

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.

HUD issues guidelines that require real estate brokers selling or renting SFRs to display a *fair housing poster*.³

The fair housing poster is available at any HUD office.⁴

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.⁵

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.⁶

The fair housing posters 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.⁷

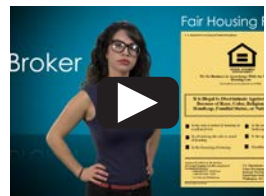
Even though it is required, a broker will not be subject to any penalties for failing to display the **fair housing poster**. However, failure to display the fair housing poster is initially considered sufficient evidence in a lawsuit to show that a broker practiced discriminatory housing practices.⁸

Practice in an enclave



[Click to watch](#)

The HUD fair housing poster



[Click to watch](#)

Failure to follow HUD guidelines

³ 24 CFR §§110.1, 110.10

⁴ 24 CFR §110.20

⁵ 24 CFR §110.10(a)

⁶ 24 CFR §§110.10(a)(2)(ii), 110.10(a)(3)

⁷ 24 CFR §110.15

⁸ 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.

Fair Housing Chapter 11 Summary

Printing or publishing the sale or rental of a dwelling indicating a discriminatory preference is a violation of the Federal Fair Housing Act (FFHA). This includes the selective use of words and phrases in the advertising of real estate. This rule applies to brokers and agents, developers and landlords.

The Department of Housing and Urban Development (HUD) provides guidelines controlling advertisements for dwellings. HUD also publishes a fair housing poster which is to be displayed, when offering a dwelling for rent or sale, in the place of business of brokers, agents, developers and landlords and the dwelling offered, except for single family homes other than those offered by developers.

Licensees following HUD advertising and poster guidelines are in a better position to defend themselves against a fair housing lawsuit.

Fair Housing Chapter 11 Key Terms

dwelling	pg. 179
Federal Fair Housing Act (FFHA)	pg. 179



Prior occupant's use, affliction and death

Fair Housing Chapter 12



Click to watch

After reading this chapter, you will be able to:

- determine when to disclose a prior death on a property; and
- assess whether a history of death on a property might affect the buyer's valuation or desire to own the property.

material fact

Transfer Disclosure Statement (TDS)

Learning Objectives

Key Terms

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. All other mandatory property and transaction disclosures are made.

The buyer does not inquire about any deaths which may have occurred on the property. The buyer then 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?

When and when not to disclose

Transfer Disclosure Statement (TDS)

A mandatory disclosure prepared by a seller and given to prospective buyers setting forth any property defects known or suspected to exist by the seller, generically called a condition of property disclosure. [See **RPI Form 304**]

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 **AIDS**.¹

*Editor's note — Deaths on the property which occurred **within three years** of the offer are to be disclosed.*

Disclosure on inquiry



 [Click to watch](#)

Regardless of whether a death occurred within three years of the buyer's 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.²

For example, consider a buyer who asks the seller's agent if any deaths have ever occurred on the property.

Here, the seller's agent needs to disclose their knowledge of the existence of any deaths which occurred on the real estate, no matter when the death occurred.³

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.⁴

Further, a buyer's inquiry 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 if 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

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 and, thus, needs to be disclosed.

¹ Calif. Civil Code §1710.2(a)

² CC §1710.2(d)

³ CC §1710.2(d)

⁴ CC §1710.2(d)

- whether the agent or others will further investigate any deaths on the property.

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.⁵

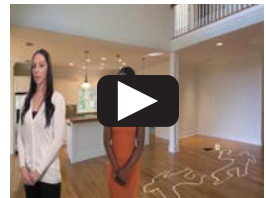
Consider a buyer's agent who is aware a death occurred on the real estate *within three years* of the buyer's purchase offer.

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.

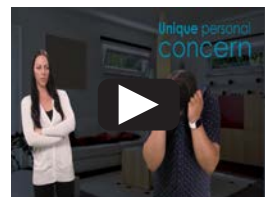
The buyer claims their agent breached their agency duty by failing to disclose the death since it inflicted an intangible harm on the buyer, preventing them from enjoying the real estate.

Deaths affecting market value



[Click to watch](#)

Desirability based on events within three years



[Click to watch](#)

⁵ **Reed v. King** (1983) 145 CA3d 261

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.

**Fair Housing
Chapter 12
Summary**

Generally, seller’s agents are not required 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 HIV or AIDS. If a death on the property for some reason adversely affects the market price of the property, it needs to be disclosed.

However, on direct inquiry by the buyer or the buyer’s agent about deaths on the property, the seller’s agent needs to disclose their knowledge of any deaths on the real estate, no matter when they occurred. An intentional concealment of a death after a buyer makes a direct inquiry is a breach of the seller’s agent’s general duty and the buyer’s agent’s agency duty.

An inquiry by the buyer into deaths on a property indicates a death on the premises is material fact which might affect the buyer’s use and enjoyment of the property. This imposes an affirmative duty on the buyer’s agent to investigate or recommend an investigation into any deaths before an offer is made.

**Fair Housing
Chapter 12
Key Terms**

material fact pg. 184
Transfer Disclosure Statement (TDS) pg. 183



Trust funds overview



After reading this chapter, you will be able to:

- identify the general laws and regulations governing broker-held trust funds;
- manage, receive, deposit, hold and disburse trust funds; and
- understand trust fund recordkeeping and accounting procedures.

conversion
general account
owner's statement

subaccount ledger
trust funds

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 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 Chapter 1



[Click to watch](#)

Learning Objectives

Key Terms

Introduction to 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.

Trusts 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.

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.¹

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**.

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.

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.²

Managing the trust funds



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.

conversion

The unlawful appropriation of another's property, as in the conversion of trust funds.

¹ Calif. Business and Professions Code §10145

² *Apollo Estates, Inc. v. Department of Real Estate* (1985) 174 CA3d 625

Managing a mortgage brokerage trust account

Alternatively, consider a broker who maintains a brokerage trust account. The trust account contains mortgage payments received by the broker while servicing mortgages on behalf of trust deed investors.

The broker pledges the trust account to secure a personal loan from the same bank which holds the trust account.

The broker defaults on the loan, and the bank seizes the trust account funds.

An investor seeks to recover their trust account funds from the bank, claiming the bank's seizure of the funds is a *conversion* since trust funds cannot be taken to satisfy the broker's personal debt.

The bank claims the seizure of the trust account is not a conversion since it exercised its right to an offset under the security agreement.

Is the investor entitled to recover their portion of the trust funds?

Yes! The trust funds belong to the investor and need to be returned. The bank's right to an offset for the broker's personal debt to the bank does not extend to seizure of funds held for others in the broker's trust account.³

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.

owner's statement

An accounting on the status, expenditure and location of negotiable trust funds provided to the owner of those 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**.

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

³ *Chazen v. Centennial Bank* (1998) 61 CA4th 532

- in a *trust account* maintained by the broker at a bank or other state-recognized depository.⁴

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.⁵

For example, when a broker negotiates the purchase or lease of real estate, they usually 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, if:

- 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.⁶

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. [See Figure 1, **RPI** Form 150 §1]

After a buyer's offer is accepted, the broker may continue to hold the buyer's check for the good faith money undeposited if 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, if the broker is the payee and does not want to deposit and disburse the funds from their trust account to escrow.⁷

Holding checks undeposited



[Click to watch](#)

⁴ Bus & P C §10145; Department of Real Estate Regulation §2832(a)

⁵ Bus & P C §10145(c)

⁶ DRE Reg. §2832(c)

⁷ DRE Reg. §2832

Figure 1

Excerpt from
Form 150Purchase
Agreement

FACTS:	
1.	Received from _____, as the Buyer(s),
1.1	the sum of \$ _____, evidenced by <input type="checkbox"/> personal check, or <input type="checkbox"/> _____,
	payable to _____, for deposit only on acceptance of this offer.
1.2	Deposit to be applied toward Buyer's obligations under this agreement to purchase property
1.3	situated in the City of _____, County of _____, California,
1.4	referred to as _____,
1.5	including personal property, <input type="checkbox"/> see attached Personal Property Inventory. [See RPI Form 256]
1.6	The interest acquired will be fee simple, unless <input type="checkbox"/> leasehold or <input type="checkbox"/> _____.

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.⁸

⁸ Mullen v. Department of Real Estate (1988) 204 CA3d 295

Funds belonging to others which a broker and their agents handle when acting as agents in a transaction are called trust funds. Trust funds include rents, security deposits, good faith deposits, advance fees, mortgage payments, and any other personal property of value.

The safekeeping of trust funds is ensured by the imposition of recordkeeping and accounting requirements on brokers when they receive, transfer or disburse trust funds.

Trust funds come in many forms, including checks, precious metals/stones, stocks/bonds, collectibles, promissory notes and any other item or evidence of value handed to the broker or the broker's employee while acting as an agent in a real estate transaction.

Trust funds are illegally commingled when a broker deposits the funds into an account other than a dedicated trust fund account. A broker's use of trust funds for any reason other than those expressly authorized by the owner of the funds constitutes a conversion of the client's funds to the broker's own use.

Cash and checks held as trust funds need to be deposited into the broker's trust account, held undeposited as instructed, or endorsed and handed to others entitled to the funds.

A broker needs to regularly account to the owner on the status, expenditure and location of the negotiable trust funds held by the broker. Similarly, brokers need to know who owns and controls the funds held in their trust account, identified through the use of subaccount ledgers.

conversion	pg. 189
general account	pg. 189
owner's statement.....	pg. 190
subaccount ledger.....	pg. 189
trust funds	pg. 187

Trust Funds Chapter 1 Summary

Trust Funds Chapter 1 Key Terms



Add marketing flyers to your
personal library with our
NEW FARM Letter download!

We've packaged 100+ of our most popular and frequently requested FARM Letters in one easy download. Our FARM Letters cover a variety of real estate topics, and are available in Microsoft Word and PDF formats.

Improve your marketing



Advance fees are trust funds

Trust Funds Chapter 2

After reading this chapter, you will be able to:

- properly handle the receipt of advance fees;
- adhere to accounting procedures for advance fees prescribed by the California Department of Real Estate (DRE); and
- understand how to obtain DRE approval for advance fees.

advance fee

good faith deposit

Learning Objectives

Key Terms

Consider a seller's broker employed under an *exclusive right-to-sell listing agreement*. The listing states the broker will receive a fee set as a percentage of the purchase price and contingent on locating a buyer. The fee is earned and payable on delivery of a signed offer to purchase the property on the price and terms of payment stated in the listing agreement or accepted by the seller. [See **RPI** Form 102]

The broker locates a buyer. The buyer makes an offer to buy the real estate. However, the *purchase agreement* fee provision calls for the seller's payment of the broker's fee at the close of escrow, not on acceptance as provided in the listing agreement.

The buyer's check for the **good faith deposit** is made payable to the seller's broker to apply toward the purchase price. On acceptance, the funds are deposited into the broker's trust account.

The broker's fee on the transaction is less than the amount of the buyer's *good faith deposit* held in the broker's trust account. The broker, without authorization from the buyer and the seller, withdraws the amount of their

Deposits retain trust status until disbursed as instructed

good faith deposit

A money deposit made by a buyer to evidence their good faith intent to buy when making an offer to acquire property. Also known as earnest money.

brokerage fee prior to closing the transaction. The broker claims the funds are the seller's and withdrawal is permitted under the terms of the seller's listing agreement.

Can the broker advance themselves the fee by a withdrawal from the buyer's deposit held in their trust account prior to closing?

No! The broker is not entitled to their brokerage fee until the sale closes, as stated in the purchase agreement. The funds the broker withdrew from the trust account in advance of closing were still the buyer's funds. The buyer's funds were thus controlled by the terms of the buyer's purchase agreement, not the seller's listing agreement with the broker.

On withdrawal of the buyer's funds, the broker unlawfully *commingled* trust funds with their separate funds.¹

Advance fee trust fund accounting

advance fee

A fee paid in advance of any services rendered.

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.

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.
[See *Trust Funds* Chapter 1]

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.²

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*.³

If an agreed-to service disbursed from the account is made for advertisement, the verified accounting will include:

- a copy of the advertisement;

¹ *Bell v. Watson* (1957) 148 CA2d 684

² Department of Real Estate Regulation §2972

³ DRE Reg. §2972(f)

- the name of the publication in which the advertisement appeared; and
- the number of ads published and the dates they appeared.⁴

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.⁵

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.⁶

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.⁷

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.⁸

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.⁹

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.¹⁰

Approval of advance fee agreements

⁴ DRE Reg. §2972(g)

⁵ DRE Reg. §2972(h)

⁶ Calif. Business and Professions Code §10146

⁷ DRE Reg. §2970

⁸ Bus & P C §10085

⁹ DRE Reg. §2970(b)

¹⁰ DRE Reg. §§2970(b)(4), 2970(b)(5)

Trust Funds
Chapter 2
Summary

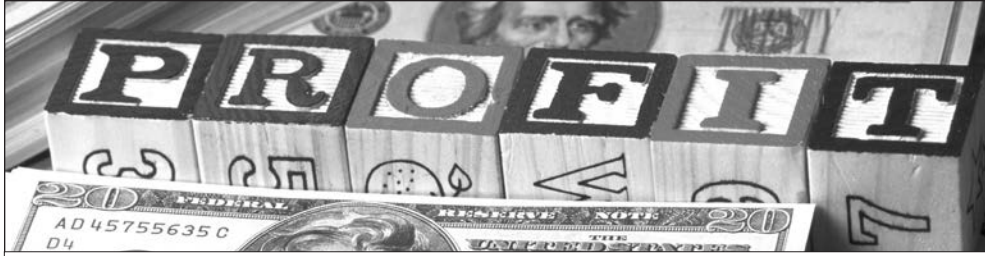
Advance fees are funds received from a client for the payment of broker fees before they are earned. Advance fees are to be handled as trust funds and deposited into the broker's trust account. The broker may not withdraw their fee from the funds before the conditions for having earned the fee has been fully performed.

Statutorily-mandated accounting and reporting procedures apply to advance fees received by brokers and their agents. Advance fee accounting includes a description of services to be rendered, amounts allocated to providing services, fees, overhead costs and profits, and any advertising to be paid for by the advanced funds.

Any solicitations, advertising, and agreements used by a broker to collect an advance fee will be submitted to the Commissioner of the California Department of Real Estate (DRE) a minimum of 10 days prior to use.

Trust Funds
Chapter 2
Key Terms

advance fee	pg. 196
good faith deposit	pg. 195



Advance costs are trust funds

Trust Funds Chapter 3

After reading this chapter, you will be able to:

- properly handle funds advanced by a client to cover the cost of marketing a property;
- correctly account for and report the disbursement of advance funds to cover marketing costs; and
- analyze and prepare a Marketing Package Cost Sheet.

advance cost sheet

embezzlement

Learning Objectives

Key Terms

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.¹

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. [See Form 107 accompanying this chapter]

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.

Funds handed to the broker for marketing costs

advance cost sheet


An itemization of the costs incurred to properly market a property for sale which are to be paid by the owner. [See **RPI** Form 107]

¹ Calif. Business and Professions Code §10146

Form 107

Listing Package
Cost Sheet

Page 1 of 2

	MARKETING PACKAGE COST SHEET Due Diligence Checklist
Prepared by: Agent _____ Broker _____	Phone _____ Email _____

NOTE: This form is used by a seller's agent as an addendum when entering into the employment of an owner who lists a property for sale, to disclose the itemized costs the owner can expect to incur during the marketing and sale of the property as anticipated by the employment agreement.

DATE: _____, 20____, at _____, California.
Items left blank or unchecked are not applicable.

1. FACTS:

1.1 This is an addendum to an employment agreement referred to as a Seller's Listing Agreement [See **RPI** Form 102]
 1.2 ☐ of same date, or dated _____, 20____, at _____, California,
 1.3 entered into by _____, as the Broker,
 and _____, as the Seller,
 1.4 regarding real estate referred to as _____,
 1.5 for a period beginning on _____, 20____, and expiring on _____, 20____.

2. BROKER'S DISCLOSURE AND PERFORMANCE:

2.1 The items listed below with estimated costs constitute a disclosure of the reports and activities Seller can reasonably expect will be required to either bring about or close a transaction under the employment agreement, and if acquired early, will assist Broker to provide prospective buyers with property information Broker anticipates he will need to effectively perform under the employment agreement.

a. Natural hazard disclosure report [See RPI Form 314].	\$ _____
b. Local ordinance compliance certificate	\$ _____
c. Structural pest control report and <input type="checkbox"/> clearance	\$ _____
d. Smoke detector and water heater anchor installation.	\$ _____
e. Home inspection report	\$ _____
f. Homeowners' Association (HOA) documents charge	\$ _____
g. Lead-based paint report [See RPI Form 313]	\$ _____
h. Mello-Roos assessment notice	\$ _____
i. Listing (transaction) coordinator's fee.	\$ _____
j. Well-water quality and quantity report.	\$ _____
k. Septic/sewer report.	\$ _____
l. Soil report	\$ _____
m. Survey of property (civil engineer)	\$ _____
n. Appraisal report	\$ _____
o. Architectural (floor) plans	\$ _____
p. Title report: <input type="checkbox"/> property profile, <input type="checkbox"/> preliminary report, <input type="checkbox"/> abstract	\$ _____
q. MLS and market session input fees	\$ _____
r. Sign deposit or purchase, installation and removal	\$ _____
s. Advertising in newspapers, magazines, radio or television	\$ _____
t. Information flyers and postage (handout or mailing).	\$ _____
u. Open house — food and spirits	\$ _____
v. Photos or video of the property	\$ _____
w. Credit report on prospective buyer	\$ _____
x. Travel expenses	\$ _____
y. Other _____	\$ _____
z. Other _____	\$ _____
2.2 TOTAL ESTIMATED COSTS	\$ 0.00

2.3 ☐ Broker is hereby authorized and instructed to incur on behalf of Seller the cost estimated above.

----- PAGE 1 OF 2 — FORM 107 -----

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. Again, if any funds remain, they will be returned to the client with the final accounting.²

The **statement of account** for the trust funds will include the following information:

² Bus & PC §10146

----- PAGE 2 OF 2 --- FORM 107 -----

3. PAYMENT OF COSTS:

3.1 ☐ Seller agrees to pay, on presentation of a billing, those costs estimated above and incurred by Broker.

3.2 ☐ Broker agrees to incur the expenses of the estimated costs set out and authorized in §2.3 during the first 21 days of the employment and to timely pay the charges. Seller agrees to reimburse Broker for the costs Broker incurs, IF:

a. Seller closes a transaction which is the subject of the employment agreement;

b. Seller terminates the employment agreement by cancellation or by conduct before it expires; or

c. Seller retains another Broker on the expiration of the employment agreement to pursue a transaction which is the subject of the employment agreement with Broker.

3.3 ☐ Costs paid by Seller under this addendum shall be credited toward any contingency fee earned by Broker upon closing a transaction which is the subject of the employment agreement.

3.4 Seller herewith hands Broker a deposit of \$_____ as an advance for the payment of costs incurred by Broker on behalf of Seller as estimated above.

4. TRUST ACCOUNT: (To be filled out only if a deposit is entered at §3.4 above.)

4.1 Broker will place the advance cost deposit received under §3.4 above into his trust account maintained with _____ at their _____ branch.

4.2 Broker is authorized and instructed to disburse from the trust account those amounts required to pay and satisfy the obligations incurred as agreed.

4.3 Within 10 days after each calendar ☐ month, or ☐ quarter, and upon termination of this agreement, Broker will deliver to Seller a statement of account for all funds withdrawn from the advance cost deposit handed Broker under §3.4 above.

4.4 Each statement of account delivered by Broker shall include no less than the following information:

a. The amount of the advance cost deposit received.

b. The amount of funds disbursed from the advance cost deposit.

c. An itemization and description of the obligation paid on each disbursement.

d. The current remaining balance of the advance cost deposit.

e. An attached copy of any advertisements paid from the advance cost deposit since the last recorded accounting.

f. _____

4.5 On termination of this agreement, Broker will return to Seller all remaining trust funds.

<p>I agree to the terms stated above.</p> <p>Date: _____, 20 _____</p> <p>Broker's name: _____</p> <p>CalBRE#: _____</p> <p>By: _____</p> <p>Phone: _____ Cell: _____</p> <p>Email: _____</p>	<p>I agree to the terms stated above.</p> <p>Date: _____, 20 _____</p> <p>Seller's name: _____</p> <p>Seller's name: _____</p> <p>Seller's Signature: _____</p> <p>Seller's Signature: _____</p> <p>Phone: _____ Cell: _____</p> <p>Email: _____</p>
--	---

FORM 107 04-16 ©2016 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517

Form 107**Marketing
Package Cost
Sheet****Page 2 of 2**

- 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.³

³ Bus & P C §10148

embezzlement

The dishonest act of converting a client's assets for personal use.

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**.⁴

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.⁵

Analyzing the marketing package cost sheet

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, if 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.

When filling out the sheet, the client is given choices as to *when* and *how* they will pay the stated costs.

⁴ *Burch v. Argus Properties, Inc.* (1979) 92 CA3d 128

⁵ Bus & P C §10145

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.

A seller of real estate will frequently need to incur costs to assist the broker to obtain reports and properly market the property. To cover these costs, sellers may advance funds directly to the broker for the broker’s further disbursement. Advanced funds received by a broker or their agents are classified as trust funds, subject to accounting and reporting requirements.

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 fees the client may owe to the broker. A broker will also keep all accounting records for a minimum of three years.

Itemized advance cost sheets are used to provide clients with a detailed list of all costs the broker incurs. These costs are related primarily to documenting the integrity of the client’s property, not to pay for broker services.

advance cost sheet

embezzlement

pg. 199

pg. 202

Trust Funds

Chapter 3

Summary

Trust Funds

Chapter 3

Key Terms



★ NOW SHOWING ★

PROFESSOR BILL SELLER'S AGENT BUYER'S AGENT

**VIDEO RENEWAL
COURSE™**

LOVE MOVIES?

LOVE MOVIES?

Knock out your CE
with the only cinematic
license renewal in
California

[Enroll now](#)



Trust account management

Trust Funds Chapter 4

After reading this chapter, you will be able to:

- manage trust funds in an interest-bearing account on behalf of the owner of the funds;
- properly authorize agents to make withdrawals from a trust account on behalf of the broker-trustee;
- differentiate between proper and improper commingling of trust funds and personal or business funds; and
- prepare an interest-bearing trust agreement.

**commingling
signer**

trust account

Learning Objectives

Key Terms

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.

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*.¹

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

The withdrawal of trust funds

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.

¹ Calif. Business and Professions Code §10145

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.²

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.³

signer

An employee who has written authorization from the broker to withdraw or disburse funds from the trust account.

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.

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.⁴

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.⁵

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.

Interest-bearing 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.

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.⁶

² Bus & P C §10145(a)(1)

³ Department of Real Estate Regulation §2834(a); Bus & P C §10145(a)(2)(c)

⁴ DRE Reg. §2834(b)

⁵ DRE Reg. §2834(c)

⁶ 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.⁷

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.⁸ [See Form 535 accompanying this chapter]

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.⁹

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.¹⁰

The improper commingling of trust funds exposes the broker to a complaint and revocation or suspension of their license.¹¹

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]

Improper commingling

commingling

The mixing of personal funds with client or third-party funds held in trust.

⁷ Bus & P C §10145(d)

⁸ Bus & P C §10145(d)(4)

⁹ **Stillman Pond, Inc. v. Watson** (1953) 115 CA2d 440

¹⁰ DRE Reg. §2835

¹¹ Bus & P C §10176(e)

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.¹²

Maintaining trust account integrity

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.¹³

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

¹² *Brown v. Gordon* (1966) 240 CA2d 659

¹³ DRE Reg. §2834(c)

INTEREST-BEARING TRUST ACCOUNT AGREEMENT	
<p>NOTE: This form is used by a broker or their agent when handed funds for deposit into a trust account held by the broker which account the owner requests be interest bearing, to identify the depository and terms for the interest-bearing trust account.</p>	
<p>DATE: _____, 20____, at _____, California. <i>Items left blank or unchecked are not applicable.</i></p>	
<p>This agreement regarding the handling of trust funds is between _____, as the Broker, and _____, as the Depositor.</p>	
<p>1. Depositor hereby requests Broker to hold under this agreement those trust funds in the amount of \$_____ handed to Broker by Depositor on execution of this agreement.</p>	
<p>1.1 The funds are held in trust to be disbursed for the purpose of completing Depositor's performance under an agreement entitled _____, dated _____, 20____, entered into by Depositor and _____.</p>	
<p>2. Broker is hereby authorized and instructed to deposit the trust funds into an interest-bearing trust account with _____, as the Depository, being a bank, thrift, credit union or industrial loan company whose accounts are insured by the Federal Deposit Insurance Company (FDIC). The address of the branch or location of the Depository is _____.</p>	
<p>2.1 The trust account to be in the name of Broker, as trustee for <input type="checkbox"/> Depositor, or <input type="checkbox"/> _____.</p>	
<p>2.2 All funds in the trust account to be covered by FDIC insurance or other insurance by an agency of the United States.</p>	
<p>2.3 The type of interest-bearing account to be <input type="checkbox"/> passbook, or <input type="checkbox"/> time certificate, or <input type="checkbox"/> _____.</p>	
<p>2.4 The annual rate of interest accruing on the account to be _____%.</p>	
<p>2.5 Interest accruing on the deposit to be compounded <input type="checkbox"/> daily, <input type="checkbox"/> monthly, or <input type="checkbox"/> quarterly.</p>	
<p>2.6 A service charge <input type="checkbox"/> is, or <input type="checkbox"/> is not, imposed on the account by the Depository.</p>	
<p>a. If a service charge is imposed, it is to be deducted and paid from interest accruing on the account.</p>	
<p>2.7 Interest earned on the trust funds is to be paid to <input type="checkbox"/> Depositor, or <input type="checkbox"/> _____, on (event) _____.</p>	
<p>a. Under no circumstances may the interest be paid, directly or indirectly, to Broker or a licensed person employed by Broker.</p>	
<p>2.8 Withdrawal of the trust funds from the account prior to _____ days after deposit with the depository, or without _____ days prior notice, shall subject the funds to a penalty of \$_____ for early withdrawal.</p>	
<p>3. The trust account shall hold no other funds belonging to Broker or held by Broker for others as trust funds.</p>	
<p>4. The trust account number is _____.</p>	
<p>4.1 Broker is authorized and instructed to enter the account number on this agreement when it is known to Broker, and notify Depositor and other party named at §2.7 of the account number by promptly handing them a copy of this agreement containing the account number or sending a copy by regular USPS mail service.</p>	
<p>5. Should these trust funds accepted by Broker be for use in a real estate related transaction (purchase, lease, or loan), the other parties to the transaction must consent to this agreement by signing the third party approval provision below.</p>	
<p>I agree to the terms stated above. Date: _____, 20____ Broker: _____ Broker's CalBRE #: _____ Agent: _____ Agent's CalBRE #: _____ Signature: _____</p>	<p>I agree to the terms stated above. Date: _____, 20____ Depositor's Name: _____ Social Security #: _____ Signature: _____</p> <p>I have read and approve this agreement. Date: _____, 20____ Third Party's Name: _____ Signature: _____</p>
<p>FORM 535 09-15 ©2015 RPI – Realty Publications, Inc. P.O.Box 5707, RIVERSIDE, CA 92517</p>	

Form 535

Interest-Bearing Trust Account Agreement

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.¹⁴

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.

¹⁴ Calif. Commercial Code §4406

Trust Funds
Chapter 4
Summary

Funds a broker receives from a client in trust during the course of a transaction will be deposited into a non-interest bearing trust account at a bank or other state-recognized depository. Once trust funds are placed in a trust account, they may only be withdrawn or disbursed as authorized by the owner or any third party who has an interest in them. Trust funds may be placed in an interest-bearing trust account on the owner's request and at the broker's discretion. The broker cannot receive any of the earned interest.

A broker may authorize another licensed broker, sales agent or adequately bonded or insured unlicensed employee to withdraw or disburse funds. However, this delegation does not relieve the broker from liability for any loss or misuse of the trust funds.

A broker has improperly commingled funds when they mix the client's funds held in trust with their own personal or business account. Converting trust funds is grounds for revocation or suspension of the broker's license.

Trust Funds
Chapter 4
Key Terms

commingling	pg. 207
signer	pg. 206
trust account	pg. 205



Trust fund accounting

Trust Funds Chapter 5

After reading this chapter, you will be able to:

- maintain trust fund records as required by law; and
- regularly confirm and reconcile trust account balances.

**general ledger
overage**

subaccount ledger

Learning Objectives

Key Terms

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.¹

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.²

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.

Trust account bookkeeping

general ledger

Bookkeeping records of funds in an overall trust account.

¹ Department of Real Estate Regulation §2831(a)

² DRE Reg. §2831(c)

subaccount ledger

An accounting document or file identifying the owner of trust funds and the amount held for the owner.

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.³

Undeposited trust funds

Separate handling rules apply to funds not deposited in a trust account. The broker is to maintain a **trust fund ledger** separate from the trust account identifying:

- the location of any trust funds received but not deposited in the trust account; and
- the date the funds were returned or forwarded, such as a check, cashier's check, cash or promissory note that is not deposited in the broker's trust account.

For example, a broker receives a good faith deposit check from a buyer. The check is made payable to escrow. As the check is not made payable to the broker, the broker cannot deposit the check into their trust account. Thus, the broker makes no entry in their **trust account record** regarding the check made payable to escrow. However, the broker makes an entry in their **trust funds ledger** on the date the check is received.

For safekeeping, the broker places the check in the transaction file with all the other documents regarding the transaction.

The offer is timely accepted and the broker delivers the check to escrow. The broker again makes an entry in the trust funds ledger on the date the check is delivered to escrow.

Does the broker need to keep a record of their handling of a check made payable to escrow?

Yes! The check represents *trust funds* temporarily entrusted to the broker by the buyer who signed and handed the offer to the broker. Thus, as trust funds, the check will be accounted for by the broker in their trust fund ledger, not their trust account records.⁴

³ DRE Reg. §2831.1

⁴ DRE Reg. §2831(a)(6)

A broker is not required to keep records of checks made payable to others for services, such as escrow, credit reports and appraisal services, if the total amount of all such checks for any one transaction does not exceed \$1,000.⁵

However, on request from the California Department of Real Estate (DRE), or the maker of the check exempt from entry in the trust fund ledger, the broker is to account for the receipt and distribution of the checks.⁶

All records of trust funds are retained by the broker for **three years** after the closing or cancellation of the transaction involving the trust funds.⁷

Lack of proper accounting records is grounds for suspension or revocation of the broker's license.⁸

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.⁹

Occasionally due to error, the amount of all funds held in a trust account exceeds the amount of trust funds held in all the subaccounts for individuals. This condition is known as an **overage**.

An *overage* occurs when the broker cannot determine the owner of the excess funds. The excess, however, is not the result of the broker's *commingled funds*.

The overage generally arises due to *mathematical errors*. These math errors typically occur in the entry of deposits or withdrawals, bank records, or failure to identify the owner of the funds when deposited or withdrawn and entered in the trust account records.

Unexplained excess funds in a trust account are still *trust funds*, even though the ownership of the funds cannot be determined.

Monthly reconciliation

Ownership of an unexplained overage

overage

A surplus amount in a trust account exceeding the amount of trust funds held in all the subaccounts for individuals.

⁵ DRE Reg. §2831(e)

⁶ DRE Reg. §2831(e)

⁷ Calif. Business and Professions Code §10148(a)

⁸ **Apollo Estates, Inc. v. Department of Real Estate** (1985) 174 CA3d 625

⁹ DRE Reg. §2831.2

An unexplained overage may not be withdrawn for the broker's business or personal use. Further, an unexplained overage may not be used to offset shortages on individual subaccounts in the trust account.

Excess funds are not the broker's funds as the broker cannot demonstrate they have instructions to withdraw them. Unexplained trust account overages remain in the trust account, or may be placed in a separate trust fund account established to hold unexplained overages.

Figure 1

State Bank Account Number 123456789 Trust Account General Ledger 10/1/2013 to 10/5/2013								
<u>Date Rec.</u>	<u>Chk./Dep. Date</u>	<u>Chk. No.</u>	<u>Deposit/Pay to</u>	<u>Client</u>	<u>Source</u>	<u>Clear</u>	<u>Amount</u>	<u>Balance</u>
								Beginning Balance \$ 0.00
10/1/13	10/1/13	N/A	Initial Deposit	Broker	Broker	Yes	\$100.00	\$100.00
10/1/13	10/1/13	N/A	Appraisal, credit report fee for loan	BR 1	BR 1	Yes	\$300.00	\$400.00
10/1/13	10/1/13	N/A	Advance costs	SE 1	SE 1	Yes	\$500.00	\$900.00
10/3/13	10/1/13	N/A	Appraisal, credit report and property inspection	BY 1	BY 1	Yes	\$500.00	\$1,400.00
N/A	10/3/13	1173	TRW Credit Reporting Service	BR 1	N/A	No	\$25.00	\$1,375.00
N/A	10/3/13	1174	Appraiser service	BR 1	N/A	No	- \$275.00	\$1,100.00
N/A	10/5/13	1175	Appraiser service	BY 1	N/A	No	- \$275.00	\$825.00
N/A	10/5/13	1176	Home inspection service	BY 1	N/A	No	- \$200.00	\$625.00
N/A	10/5/13	1177	TRW Credit Reporting Service	BY 1	N/A	No	-\$25.00	\$600.00
N/A	10/5/13	1178	Local paper	SE 1	N/A	No	- \$250.00	\$350.00
N/A	10/5/13	1179	Local caterer	SE 1	N/A	No	- \$100.00	\$250.00

Ultimately, the excess funds *escheat* to the state, unless the ownership of the unexplained overage is determined within three years of the discovery of the overage.¹⁰

Consider a broker who opens their trust account with a maximum \$100 deposit from their own funds to cover bank service charges. This deposit is

Sample transaction

¹⁰ Calif. Code of Civil Procedure §§1500 et seq.

State Bank Account Number 123456789 Trust Account Subaccount Ledger						
Date Rec. Date Dep.	Chk. No.	Deposit/Pay to Additional Description	Source Cleared	Amount	Running Balance	
Subaccount 1						
		Client: BROKER – Broker				
		> > > Client Balance As Of . . .		10/1/2013	\$	0.00
10/1/13	N/A	Initial Deposit	Broker			
10/1/13			Yes	\$ 100.00	\$	100.00
Subaccount 2						
		Client: Borrower 1 – BR1				
		> > > Client Balance As Of . . .		10/1/2013	\$	0.00
10/1/13	N/A	Appraisal and credit report	BR1			
10/1/13		fee for loan on	Yes	\$ 300.00	\$	300.00
		124 University, Riverside				
N/A	1173	TRW Credit Reporting	N/A			
10/3/13		Service Statement	No	\$ (25.00)	\$	275.00
		10/2/01				
N/A	1174	Appraiser Service	N/A			
10/3/13		Invoice #7654	No	\$ (275.00)	\$	0.00
Subaccount 3						
		Client No: Seller 1 – SE1				
		> > > Client Balance As Of . . .		10/1/2013	\$	0.00
10/1/13	N/A	Advance costs to sell property	SE1			
10/1/13		125 Main Street, Riverside	Yes	\$ 500.00		\$500.00
N/A	1178	Local paper	N/A			
10/5/13		statement dated 10/3/13	No	\$ (250.00)	\$	250.00
N/A	1179	Local caterer	N/A			
10/5/13		statement dated 10/3/13	No	\$ (100.00)	\$	150.00
Subaccount 4						
		Client: Buyer 1 – BY1				
		> > > Client Balance As Of . . .		10/1/2013	\$	0.00
10/3/13	N/A	Advance costs for purchase	BY1			
10/3/13		of property located at	No	\$ 500.00	\$	500.00
		123 university, Riverside				
N/A	1175	Appraiser Service	N/A			
10/5/13		for property located at	No	\$ (275.00)	\$	225.00
		123 university, Riverside				
N/A	1176	Home inspector Service	N/A			
10/5/13		Invoice #7654	No	\$ (200.00)	\$	25.00
N/A	1177	TRW Credit Reporting Service	N/A			
10/5/13		Invoice #1123	No	\$ (25.00)	\$	0.00

Figure 2

entered by the broker on their overall trust account general ledger and on the broker's subaccount as *appropriately commingled funds*. [See Figures 1 and 2]

Borrower One retains the broker to arrange financing. The broker receives \$300 from Borrower One to cover costs incurred for:

- placing the mortgage;
- appraisal costs; and
- credit report costs.

State Bank – 123456789 Statement for Borrower's Account No. Borrower – BR1					
<u>Date Rec.</u>	<u>Check No.</u>	<u>Deposit/Pay to</u>	<u>Source</u>	<u>Amount</u>	<u>Amount</u>
<u>Date Dep.</u>		<u>Additional Description</u>	<u>Cleared</u>		<u>Balance</u>
10/1/13	N/A	Appraisal and credit report	BR 1		
10/1/13		loan fee for	Yes	\$ 300.00	\$ 300.00
		124 University, Riverside			
N/A	1173	TRW Credit Reporting Service	N/A		
10/3/13		Statement 10/2/13	No	\$ (25.00)	\$ 275.00
N/A	1174	Appraiser service	N/A		
10/3/13		Invoice #7654	No	\$ (275.00)	\$ 0.00

Figure 3

These funds are deposited in the broker's trust account. The broker enters information on the deposit to Borrower One's subaccount under an account number assigned to Borrower One by the broker. [See Figure 3]

The entry is also recorded in the general ledger for the trust account. The general ledger is the balance of all the individual subaccounts.

Seller One enters into an *exclusive seller's listing agreement* with the broker and advances the broker \$500 to cover costs to be incurred by the broker to obtain reports for better marketing the seller's real estate. The broker deposits the \$500 in their trust account. The information is then entered in a subaccount ledger under an account number assigned to Seller One by the broker. The balance is then entered in the general ledger.

Buyer One makes a purchase offer, and hands the broker a \$1,000 check for a good faith deposit. Buyer One also advances the broker \$500 to cover the cost of a property inspection, credit report and appraisal required by the lender to finance the purchase.

The buyer makes an offer

The broker is instructed by Buyer One not to negotiate the \$1,000 good faith deposit check until the offer is accepted. The \$1,000 check is held undeposited, but is entered on the broker's ledger for undeposited trust funds. [See **RPI** Form 536 accompanying this chapter]

The \$500 is deposited in the broker's trust account and entered in a subaccount ledger under an account number assigned to Buyer One by the broker, and entered on the trust account general ledger.

The overall balance of the broker's trust account is now \$1,400. The balances of the subaccounts within the trust account are:

- \$100 in Account 1, representing the broker's initial deposit in the account to cover account fees;
- \$300 in Account 2, representing the funds received by the broker from Borrower One;
- \$500 in Account 3, representing the funds received by the broker from Seller One; and
- \$500 in Account 4, representing the \$500 received by the broker from Buyer One (the \$1,000 check held undeposited by the broker as instructed by Buyer One is not part of the balance of the broker's trust account).

The broker then pays out \$25 for a credit report and \$275 for an appraisal for Borrower One in Subaccount 2.

These disbursements are entered on both Borrower One's subaccount ledger and the general ledger.

The information from the subaccount ledger for Account 2 will be used to generate Borrower One's monthly statement from the broker. [See Figure 3]

Acceptance

Buyer One's purchase offer is accepted by the owner of the real estate. The broker delivers Buyer One's check for the \$1,000 good faith deposit to escrow (as payee or by endorsement). The broker records the transfer of the check on the broker's separate ledger for undeposited trust funds. [See **RPI** Form 536]

From the trust account, the broker also disburses \$275 for an appraisal of the property, \$200 for an inspection of the property and \$25 for a credit report on Buyer One.

These disbursements are entered by the broker on Buyer One's subaccount ledger, and the trust account general ledger.

On behalf of Seller One, the broker disburses \$250 for advertising and \$100 for catering at an open house. These disbursements are also entered on the subaccount ledger and the general ledger.

All three transactions close without further disbursements.

Trust account balances

A \$250 balance now exists in the broker's trust account. The balances of the subaccounts are:

- \$100 in Subaccount 1, the broker's initial deposit of their own funds to open the trust account;
- \$0 in Subaccount 2, as the funds received from Borrower One were completely exhausted;

- \$150 in Subaccount 3, representing the remainder of the funds received by the broker from Seller One; and
- \$0 in Subaccount 4, as the funds received from Buyer One were completely exhausted.

Any funds remaining in the subaccounts after the transactions have closed are not the property of the broker and are returned to their owner. In tandem with the funds, the broker provides the owner an accounting of the subaccount.

For every trust account a broker maintains, the broker maintains a general ledger for the overall trust account. The broker also maintains a separate subaccount ledger for each owner of the trust funds.

Further, the broker maintains a separate trust fund record with a ledger of any trust funds the broker receives which are not deposited in the trust account. All records of trust funds are retained by the broker for three years.

Brokers are to reconcile the general ledger for the trust account against the separate subaccount ledgers each month when deposits or withdrawals are made.

Unexplained excess funds called overages are still trust funds. Excess funds are to remain in the trust account or be placed in a separate trust account specifically for unexplained excesses, and escheat to the state if they are unclaimed after three years.

general ledger	pg. 211
overage	pg. 213
subaccount ledger	pg. 212

Trust Funds Chapter 5 Summary

Trust Funds Chapter 5 Key Terms



WATCH AND EARN

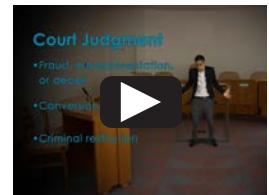
with **firsttuesday's** **Video Renewal Course**

California's first and only DRE-approved video-based
license renewal experience

[Enroll now](#)



Trust Funds Chapter 6



Click to watch

After reading this chapter, you will be able to:

- interpret the penalties of misusing trust funds; and
- understand when individuals can satisfy a judgment against a broker through the Real Estate Recovery Account.

embezzlement

restitution

punitive damages

Learning Objectives

Key Terms

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. [See *Trust Funds* Chapter 2]

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**.¹

Commingling, conversion and restitution

¹ Calif. Business and Professions Code §10146

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

restitution

A money award given to restore an injured party to the condition they held before being damaged.

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.²

The Commissioner may also include a claim for **restitution** on behalf of clients injured by the broker's misuse of trust funds.³

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.⁴

Commingling of trust funds is grounds for suspension or revocation of the broker's license.⁵

Civil liability

A broker who misuses trust funds needs to **reimburse** the owner of the funds the amount wrongfully used.⁶

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.⁷

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.

² Bus & P C §10081.5

³ Bus & P C §10081(b)

⁴ Bus & P C §10081.5

⁵ Bus & P C §10176(e)

⁶ Calif. Civil Code §3281

⁷ **Savage v. Mayer** (1949) 33 C2d 548

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.⁸

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.⁹

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*.¹⁰

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.¹¹

In instances where actual money losses are small, punitive money awards are occasionally awarded as a *deterrent* against future fraudulent activity.¹²

Punitive damages

punitive damages

Monies awarded in excess of actual money losses in order to deter unlawful actions.

⁸ **Ward v. Taggart** (1959) 51 C2d 736

⁹ CC §3294

¹⁰ CC §1573

¹¹ **Haigler v. Donnelly** (1941) 18 C2d 674

¹² **Esparza v. Specht** (1976) 55 CA3d 1

The Real Estate Recovery Account

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:

- the broker is *insolvent*; and
- the losses are *directly related* to the broker's conduct.

The client's recovery is limited to \$50,000 per transaction. The recovery is further limited to the actual losses on the transaction which resulted from the broker's fraud.¹³

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 if 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

¹³ Bus & P C §§10471 et seq.

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.¹⁴

Also, no attorney fees award can be recovered from the Recovery Account since attorney fees are not direct losses.¹⁵

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.¹⁶

Income taxes to the extent due are paid on all income, from whatever source. This includes income derived from illegal activities such as *embezzlement*.¹⁷

Thus, brokers who convert trust funds expose themselves to tax penalties if they fail to report the converted funds as income and pay the appropriate taxes on the *illegal income*.¹⁸

Further, embezzled money needs to be reported as income even if 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*.¹⁹

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.²⁰

A broker who uses funds in any way not authorized by the owner may be held guilty of **embezzlement**.²¹

Whether the broker is merely “borrowing” the funds and intends to return them is of no import. The broker is still guilty of embezzlement.²²

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.

Income tax

Embezzlement

embezzlement

The dishonest act of converting a client's assets for personal use.

¹⁴ *Circle Oaks Sales Co. v. Real Estate Commissioner* (1971) 16 CA3d 682

¹⁵ *Acebo v. Real Estate Education, Research and Recovery Fund* (1984) 155 CA3d 907

¹⁶ *Nordahl v. Franzalia* (1975) 48 CA3d 657

¹⁷ *James v. United States* (1961) 366 US 213

¹⁸ Calif. Revenue and Taxation Code §19701

¹⁹ *Buff v. Commissioner of Internal Revenue* (1974) 496 F2d 847

²⁰ Rev & TC §17282

²¹ Calif. Penal Code §506

²² Pen C §513

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.²³

²³ *People v. Parker* (1965) 235 CA2d 100

**Trust Funds
Chapter 6
Summary**

A broker who misuses trust funds is subject to a variety of penalties and consequences, including civil liability, disciplinary action by the California Department of Real Estate (DRE), income tax liability and criminal sanctions for embezzlement.

A broker who misuses trust funds needs to reimburse the owner of the funds for the amount wrongfully misused. The client is also entitled to recover any profits the broker derived from the funds as well as punitive damages. If a client's losses are directly related to the broker's conduct and the broker is insolvent, the client may satisfy the judgment through the Real Estate Recovery Account.

**Trust Funds
Chapter 6
Key Terms**

embezzlement	pg. 225
punitive damages	pg. 223
restitution	pg. 222



Ethics Chapter 1



After reading this chapter, you will be able to:

- recognize the types of arrangements, situations and relationships that can give rise to conflicts of interest in real estate transactions;
- disclose the kinds of relationships and interests presenting a potential conflict of interest; and
- mitigate potential conflicts resulting from familial and investment relationships.

**affiliated business
arrangement (ABA)
conflict of interest**

**dual agency
net listing agreement**

Learning Objectives

Key Terms

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.

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**]

Professional relationships compromised

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.

affiliated business arrangement (ABA)

A business arrangement in which a broker may lawfully profit from referring a client to a service provider the broker owns; requiring the broker to make a disclosure of their ownership interest to the client. [See **RPI** Forms 205 and 519]

Situations involving a conflict



Click to watch

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]

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.

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* [See *Agency* Chapter 4]; 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.

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.¹

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.

A seller's broker needs to disclose their acquisition of any direct or indirect interest in the seller's property. The broker needs to also 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 Figure 1, **RPI** Form 527 §3.6]

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.

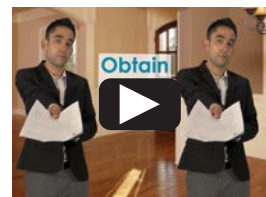
The broker does not disclose to the seller that the buyer is their brother-in-law.

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.

To disclose or not to disclose?

Relative's participation in a transaction



Click to watch

¹ Calif. Business and Professions Code §10177(o)

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.

dual agency

The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction.

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.² [See Agency Chapter 4; See Figure 1, **RPI** Form 527]

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.³

Conflict under a net listing

net listing agreement

A type of listing in which the agent's fee is set as all sums received exceeding a net price established by the owner.

Consider a seller who, acting on a broker's advice as to the estimated value of their real estate, retains the broker to find a buyer for the property. [See **RPI** Form 318]

The broker and seller enter into a **net listing agreement**.

Under the *net listing*, the seller agrees to take a fixed sum of money as the net proceeds for their equity if the property sells. The net listing further provides for the broker to receive all further sums paid on the price as their brokerage fee.

The broker arranges a sale of the property to their daughter and son-in-law. The seller is not informed of the broker's relationship with the buyers. On the close of the transaction, the broker receives their fully disclosed brokerage fee as the net proceeds remaining from the sale in excess of the net listing price.

On discovery of the broker's relationship with the buyer, the seller demands a return of the brokerage fee. The seller claims the broker's kinship with the buyer created an undisclosed conflict of interest which violated the fiduciary duty the broker owed to the seller. The broker claims the seller cannot recover the brokerage fee no matter who the buyer was since the seller only bargained to receive a fixed amount on the sale of their property under the net listing agreement.

² Bus & P C §10176(d)

³ **Whitehead v. Gordon** (1970) 2 CA3d 659

CONFLICT OF INTEREST Kinship, Position or Undue Influence
<p>NOTE: This form is used by an agent or broker when a conflicting situation arises between the agent or broker and another principal or third-party to the transaction, to disclose relationships or positions held by the broker, their agents or family members which may appear to be in conflict with the agency duties owed the client.</p>
<p>DATE: _____, 20____, at _____, California. Items left blank or unchecked are not applicable.</p>
<p>FACTS:</p> <p>1. This disclosure is made in connection with the following agreement:</p> <div style="display: flex; justify-content: space-between;"> <input type="checkbox"/> Listing (Employment) Agreement <input type="checkbox"/> purchase Agreement </div> <p><input type="checkbox"/> Escrow Instructions <input type="checkbox"/> _____</p> <p>1.1 <input type="checkbox"/> of the same date, or dated _____, 20____, at _____, California,</p> <p>1.2 entered into by _____, as the _____, and</p> <p>1.3 _____, as the _____,</p> <p>1.4 regarding real estate referred to as _____,</p> <p>2. The client(s) represented by the undersigned Broker with regard to the above referenced agreement is/are identified as the _____.</p>
<p>DISCLOSURE OF CONFLICT OF INTEREST:</p> <p>3. Broker provides the following information as a disclosure to the client of relationships or positions held by Broker or his Agents, and their family members, in investments, business activities or real estate interests which present circumstances that might, if not disclosed, appear to be in conflict with the agency duty owed the client to care for and protect the interests of the client.</p>
<p>Check the following items and enter information on facts which are believed might create a conflict of interest for Broker or his Agents in performing their agency duties on behalf of the client.</p>
<p>3.1 <input type="checkbox"/> Real Estate Property type: _____ Address: _____ Interest held: _____ Activity creating conflict: _____</p> <p>3.2 <input type="checkbox"/> Government agency Agency name: _____ Position held: _____ Activity creating conflict: _____</p> <p>3.3 <input type="checkbox"/> Business position Business name: _____ Goods or services provided: _____ Position held: _____ Activity creating conflict: _____</p> <p>3.4 <input type="checkbox"/> Business Investment Company name: _____ Type of trade or business: _____ Interest held: _____ Activity creating conflict: _____</p> <p>3.5 <input type="checkbox"/> Representation of others in transaction Name of person also owed agency duties: _____ Activity creating conflict: _____</p> <p>3.6 <input type="checkbox"/> Kinship and employee relationships Name of individual(s): _____ Relationship with Broker or employee: _____ Activity creating conflict: _____</p> <p>4. Other disclosures of direct or indirect compensation or economic benefits may have previously been made, such as exists for additional compensation and controlled business arrangements. [See RPI Forms 119 and 519]</p>
<p>----- PAGE 1 OF 2 --- FORM 527 -----</p>

Figure 1

Form 527

Conflict of Interest

Whenever a broker is employed under any type of listing, the broker has an obligation to **voluntarily disclose** to their seller any special relationship they may have with the buyer and obtain the seller's consent before proceeding. Thus, the seller can recover the brokerage fee they paid to the broker. ⁴

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.

**A relative
owns the
property sold**

⁴ *Sierra Pacific Industries v. Carter* (1980) 104 CA3d 579

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.

Taking a fee when acting as a principal



Click to watch

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.⁵

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).

⁵ **Robinson v. Murphy** (1979) 96 CA3d 763

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.⁶

A potential conflict of interest also exists when a broker *manages multiple LLCs* which own like-type properties in the same market area.

Consider a broker entrusted with managing two investment groups which own similar apartment projects located within the same market. The two projects thus compete for the same prospective tenants. The broker is paid a management fee by each investment group based on a percentage of the rents received.

When contacted by a prospective tenant, the broker is initially faced with the dilemma of which apartment building to refer the tenant to and thus which investment group will benefit from the tenant's occupancy.

A similar conflict of interest results from parallel transactions by multiple LLCs managed by the same broker are actively competing to sell or buy property within the same marketplace.

A potential conflict of interest of this nature needs to be disclosed to the investors before they agree to participate as members in an LLC the broker manages. This disclosure is contained in **RPI Form 371, Investment Circular** provision 6d, which states:

- The Manager has numerous other business responsibilities and ownership interest which will demand some or most of their time during the LLC's ownership of the property. The Manager's other interests include ownership of projects comparable to the property purchased in this transaction. To the extent their time is required on other business and ownership management decisions, they will not be involved in monitoring or marketing of the LLC's property. [See **RPI Form 371**]

With this disclosure, the **broker's allegiance** to multiple projects and investment groups is transparent and can be taken into consideration by all investors at the time they receive the Investment Circular from the Broker – before investing and consenting to the risk.

Conflicts in a real estate syndication

⁶ **Prichard v. Reitz** (1986) 178 CA3d 465

Ethics
Chapter 1
Summary

A broker’s positive or negative bias toward the opposing party, or an indirectly involved third party in a transaction, needs to be disclosed and consented to by the client. This bias is known as a conflict of interest.

A conflict of interest is disclosed at the time the conflict arises. Timely disclosure allows the client to take the bias held by the broker into consideration during negotiations.

A licensee acting solely as a principal on their own behalf when buying or selling property need not disclose the existence of their real estate license.

A potential conflict of interest also exists when a broker manages multiple LLCs which own like-type properties in the same market area. A similar conflict exists when parallel transactions by multiple LLCs managed by the same broker are actively competing to sell or buy property within the same marketplace.

Ethics
Chapter 1
Key Terms

affiliated business arrangement (ABA) pg. 228
conflict of interest pg. 227
dual agency pg. 230
net listing agreement pg. 230



Counteroffers to promote clarity

After reading this chapter, you will be able to:

- avoid the ethical implications of defacing signed documents; and
- prepare and analyze a counteroffer form.

counteroffer

defacing

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**.

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.

Ethics Chapter 2

Learning Objectives

Key Terms

Defacing a previously signed document

defacing

When a document is modified on its face, usually by striking copy and interlineation, after it is signed by one or both parties.

Counteroffers: prepared for clarity

counteroffer

An alternative response to an offer received consisting of terms different from those of the offer rejected. [See **RPI** Form 180]

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.

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 Form 180 accompanying this chapter]

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.¹

Analyzing the counteroffer form

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:

1. 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

2. By preparing an entirely *new offer* on a newly prepared purchase agreement form which is submitted as a counteroffer.

¹ Calif. Civil Code §1654

	<h2 style="margin: 0;">COUNTEROFFER</h2>
Prepared by: Agent _____ Broker _____	
Phone _____ Email _____	
<p>NOTE: This form is used by an agent when an offer or counteroffer for the purchase or lease of property is received and rejected by the client, to prepare a counteroffer on modified terms.</p>	
DATE: _____, 20____, at _____, California. <i>Items left blank or unchecked are not applicable.</i>	
FACTS:	
1. This is a counteroffer to an offer entitled: <input type="checkbox"/> Purchase agreement <input type="checkbox"/> Exchange agreement <input type="checkbox"/> Counteroffer <input type="checkbox"/> _____	
1.1 dated _____, 20____, at _____, California,	
1.2 entered into by _____, as the _____,	
1.3 regarding real estate referred to as _____	
AGREEMENT:	
2. The undersigned includes all the terms and conditions of the above referenced offer in this Counteroffer, subject to the following modifications: _____ _____ _____ _____	
2.1 <input type="checkbox"/> See attached Addendum. [RPI Form 250]	
3. This Counteroffer will be deemed revoked unless accepted in writing and delivered to the undersigned or their broker prior to the time of _____ on _____, 20____.	
Buyer's Broker: _____ By: _____ CalBRE#: _____	Seller's Broker: _____ By: _____ CalBRE#: _____
I agree to purchase this property as stated above. <input type="checkbox"/> See attached Signature Page Addendum. [RPI Form 251] Date: _____, 20____ Buyer's Name: _____	I agree to sell this property as stated above. <input type="checkbox"/> See attached Signature Page Addendum. [RPI Form 251] Date: _____, 20____ Seller's Name: _____
Signature: _____ Buyer's Name: _____	Signature: _____ Seller's Name: _____
Signature: _____ Address: _____	Signature: _____ Address: _____
Phone: _____ Cell: _____ Email: _____	Phone: _____ Cell: _____ Email: _____
FORM 180 03-11 ©2016 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517	

Form 180

Counteroffer

The counteroffer form has four sections, each with a separate purpose explained as follows:

1. *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.
2. *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.

- 3. *Time for acceptance:* The counteroffer expires at the time and on the date stated for expiration. If no specific date is given, a reasonable time to accept is permitted, unless the counteroffer is first withdrawn.
- 4. *Signatures:* The party making the counteroffer signs and dates the offer. The brokers sign the counteroffer only to acknowledge their participation in the negotiations.

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.

Ethics
Chapter 2
Summary

A broker or agent may not alter a document once it is signed, such as making change-and-initial alterations on behalf of a seller to a buyer’s purchase offer.

The altering of a signed document is improper, and often creates uncertainty as to when and who placed which terms in the agreement.

A rejection of an offer occurs either by a written rejection stating no counteroffer will be forthcoming, or by submitting an alternative offer consisting of terms different from those of the offer being rejected, called a counteroffer.

Ethics
Chapter 2
Key Terms

counteroffer	pg. 236
defacing	pg. 235



Property related disclosures

Ethics Chapter 3



After reading this chapter, you will be able to:

- assess the conditions and circumstances a broker is to disclose in a real estate transaction;
- recognize a broker's general or agency duties owed to others to inspect, confirm, and report the physical, financial, legal and regulatory conditions of a property; and
- identify circumstances when a broker can or cannot be held liable for failing to disclose property information in a real estate transaction.

**Annual Property
Operating Data sheet
(APOD)**

"as-is" clause

eminent domain

**further-approval
contingency**

material fact

public records

**Transfer Disclosure
Statement (TDS)**

Learning Objectives

Key Terms

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

Sold "as-is" is a prohibited disclaimer — property is sold "as-disclosed"

Transfer Disclosure Statement (TDS)

A mandatory disclosure prepared by a seller and given to prospective buyers setting forth any property defects known or suspected to exist by the seller, generically called a condition of property disclosure. [See **RPI** Form 304]

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)**.

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.¹ [See **RPI** Form 304; See *Fair Housing* Chapter 12]

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.²

Known material fact

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 and, thus, needs to be disclosed.

For example, consider a seller's broker who is aware the seller's residence fails to conform to building and zoning regulations. The defect, if known to a buyer, would likely affect the price they are willing to pay. Thus, the defect is a **material fact**.

The broker knows the buyer interested in making an offer is not aware of the violations and may 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**" disclaimer into the purchase agreement. The "as-is" provision states the buyer accepts the property in its current "as-is" condition.

After the buyer acquires the property, the city refuses to provide utility services to the residence due to the building and zoning 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 and zoning 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

"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."

¹ Calif. Civil Code §§1102 et seq

² CC §1102

that affect the value and marketability of the property which are known, or ought to have been known, to the seller's broker due to their mandated inspection. 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.³

Being up front with vital information has conquered the used car market, and was done solely for marketing reasons. Yet, real estate owned (REO) sales, trustee's sales, short sales, and the agents that work those deals, have made a run in the opposite direction in spite of anti-fraud legislation. However, **public policy** prohibits the sale of one-to-four unit residential property "as-is." Thus, most form publishers have eliminated the boilerplate "as-is" clauses from their purchase agreements.⁴

Editor's note – Despite legislation requiring disclosures be provided to the buyer as soon as possible, the purchase agreement published by the California Association of Realtors (CAR) fails to provide a provision for the law requiring disclosure before entering into the purchase agreement. Furthermore, provisions (14)(A) and (14)(B) of CAR's purchase agreement arbitrarily set time periods of seven days for the delayed delivery of these required reports and disclosures. Only then does the buyer discover if any intentional misrepresentation or deceit has been involved. Lack of a compliance provision in the form surely contributes to the general failure of agents to timely disclose.

Consider a buyer who makes an offer to purchase a residence. The seller's broker is aware of a large structural crack in the foundation of the residence that is not apparent on a visual inspection. The broker delivers a TDS to the buyer's agent, who in turn hands it to the buyer, stating the residence has no defective conditions. Based on the report, the buyer acquires the property. [See **RPI** Form 304]

Intentional misrepresentation

More than two years later, the buyer discovers the crack. The buyer claims the seller's broker is liable for the cost of repairing the foundation since they failed to disclose the crack. The broker claims the buyer's action is barred by the *two-year statute of limitations* for misrepresentation since they only owed the buyer the statutory duty to disclose defects which would be revealed by a visual inspection.

Is the broker liable to the buyer for intentionally misrepresenting the existence of the crack known to the broker, despite the two-year statute of limitations for negligent misrepresentations?

Yes! The buyer's claim is not time-barred under statutes requiring the broker to visually inspect and disclose observable defective property conditions. Liability is imposed on the broker for their intentional misrepresentation, by omission, of their actual knowledge of a condition of the property not readily visible when they stated defective conditions did not exist in the seller's TDS.⁵

³ **Katz v. Department of Real Estate** (1979) 96 CA3d 895

⁴ CC §1102.1

⁵ **Williams v. Bennet Realtors** (1997) 52 CA4th 857

Real estate size and boundaries will be accurately represented

further-approval contingency

A provision in an agreement calling for the further approval of an event or activity as a condition precedent to the further performance or cancellation of the transaction by the persons benefiting from the provision. [See RPI Form 185 §9 and 279 §2]

Consider a broker who is the exclusive agent of a buyer in the purchase of a one-to-four unit residential property. Without first receiving a survey or title report to verify their representations, the broker advises their buyer about the amount of acreage and the extent of an easement on the property.

The buyer enters into a purchase agreement and acquires the property in reliance on the broker's verbal representations about the size and easement on the property. A **further-approval contingency** calling for the buyer to confirm the representations is not included in the purchase agreement.

More than two years after closing, the buyer discovers the acreage and easement representations made by the broker are false. The property was worth less than the price paid.

The buyer seeks to recover the difference in property value from the broker. The broker claims the buyer's recovery is barred by a *two-year statute of limitations* for breach of a broker's agency duty to inspect and disclose defects on one-to-four unit residential property.

The buyer claims their action is not time-barred since the two-year statute of limitations only applies to *negligent misrepresentations*, not to the recovery of a loss caused by the broker's intentional misrepresentations about facts related to the property's physical condition.

Is the buyer entitled to recover their loss in property value?

Yes! The broker intentionally misrepresented the property's size and easement without first confirming what they consisted of. The two-year statute of limitation only applies to a broker who inspects the property and, as a result of the inspection, *negligently fails* to disclose facts that a reasonably diligent on-site inspection would have revealed.

Here, the broker made representations *as fact* without first verifying the information. Nor did the broker advise the buyer of their source of information and that the information was not verified. Thus, a *three-year statute of limitations* for intentional misrepresentation applies, commencing on the date the buyer discovers the falsity of the broker's representation.⁶

Square footage ought to have been known

Now consider a broker who markets real estate through the Multiple Listing Service (MLS). The property's square footage is listed in the MLS as an approximation based on unverified information. The broker conducts a visual inspection of the property.

A buyer enters into a purchase agreement for a price based on the square footage represented in the MLS, a fact known to the broker. The purchase agreement prepared by the broker includes a disclaimer stating the MLS marketing information is an approximation and advises the buyer to obtain an appraisal of the property. A *further-approval contingency* provision is not included allowing the buyer to confirm the disclosure, adjust the price or cancel the transaction.

⁶ Field v. Century 21 Klowden-Forness Realty (1998) 63 CA4th 18

The buyer closes escrow without first obtaining an appraisal of the property as advised. Later, the buyer discovers the property has significantly less square footage than approximated in the MLS marketing information. The price paid for the property exceeded the value received.

The buyer seeks to recover their lost property value from the broker. The buyer claims the broker, based on their visual inspection, ought to have known that the square footage listed in the MLS was incorrectly exaggerated.

The broker claims they are not liable for the buyer's reduction in property value since the buyer has a responsibility to determine the exact square footage and property value before closing, as advised in the purchase agreement.

Is the broker liable for the difference in property value?

Yes! Based on the visual inspection conducted by the broker, the broker *ought to have known* their representation of the square footage was an exaggeration which might be relied on by a buyer to set the price for the property.⁷

Further, buyers and sellers have no duty to comply with a broker's *advisory disclaimer*. A further-approval contingency to be satisfied by an appraisal needed to be included in the purchase agreement, not a disclaimer, since the broker knew the size was of concern to the buyer.

A broker and their agents need to accurately represent the title restrictions, potential use, and any conditions, covenants and restrictions (CC&Rs) controlling real estate to a prospective buyer or tenant.

For example, a seller's residence has a detached garage which has been converted into an apartment. The seller lists their property for sale with a broker.

The apartment is in violation of zoning ordinances. The broker does not visually inspect the property to confirm it is compliant with building codes or verify the rental activities comply with zoning ordinances known to them.

The broker induces a buyer to pay a price for the residence exceeding its *fair market value (FMV)*, representing as an incentive the existence of rental income from the apartment. The purchase agreement does not contain a further-approval contingency to confirm the rental income will be available, and if not, providing the buyer the right to cancel the agreement.

After escrow closes, the city notifies the buyer the garage apartment is being rented in violation of zoning ordinances. The buyer is forced to quit renting out the apartment, suffering a loss in value of the property.

**Knowingly
misrepresent-
ing potential
use**

⁷ *Furla v. Jon Douglas Company* (1998) 65 CA4th 1069

Here, the broker is liable for the part of the purchase price the buyer paid in excess of the FMV of the residence. The broker failed to determine the accuracy of their rental income disclosure by first determining whether zoning conditions limited the buyer's use of the property.⁸

Disclose existence of a due-on-sale clause

Consider an owner who contacts a broker to arrange an exchange of their property for other real estate the owner seeks to acquire.

The broker locates replacement property. The broker investigation uncovers the second trust deed encumbering the replacement property contains a **due-on-sale clause**. The clause states the lender can call the trust deed mortgage due and payable after the closing of a sale unless the lender consents. The due-on-sale clause is a title condition that may affect a buyer's ability to retain ownership and use of the property. However, the broker does not disclose their knowledge of the existence of the due-on-sale clause in the trust deed.

The owner agrees to take title to the replacement property subject to the existing second trust deed. No contingency existed to provide for the further approval of a beneficiary statement and trust deed conditions.

After escrow closes, the second trust deed lender discovers the transfer to the owner and calls the mortgage under the due-on-sale clause.

The owner fails to pay the mortgage balance that is now due on the second. The owner ultimately loses the property at the second trust deed lender's foreclosure sale.

Here, the broker is liable for the owner's loss of equity due to the foreclosure. The broker failed to disclose their knowledge about the existence and legal consequences of the due-on-sale clause in the second trust deed taken over by their client. The broker is thus liable for the value of the equity lost in the replacement property as established by the price set by the broker in the exchange agreement, not the property's lesser FMV.⁹

Disclosure of future use

eminent domain

The right of the government to take private property for public use. The government pays the owner the fair market value of the property taken.

A broker's duty to disclose a known potential **future use** of a property extends beyond disclosure of title and zoning conditions.

For example, consider a buyer who is interested in purchasing undeveloped property for commercial development. The property is located next to a maintenance yard owned by the state.

The seller's broker has been previously contacted by the state regarding its intent to someday acquire the property to expand the maintenance yard through **condemnation**, also known as **eminent domain**.

During purchase negotiations, the buyer asks the seller's broker if the state is interested in the property. The seller's broker informs the buyer the state has no interest in acquiring the property.

⁸ **Barder v. McClung** (1949) 93 CA2d 692

⁹ **Pepitone v. Russo** (1976) 64 CA3d 685

The buyer enters into a purchase agreement with the seller. During escrow, the buyer has plans drawn and obtains the necessary permits for development and construction on the property.

Just before escrow closes, the buyer discovers the state intends to acquire the property through *condemnation*.

The buyer proceeds to take title to the property and later grants the property to the state in a condemnation proceeding.

Here, the seller's broker is liable for the out-of-pocket losses incurred by the buyer for their lost use of the property. The broker is also liable for punitive damages for the intentional failure to disclose the state's interest in acquiring the property. The buyer relied on the broker's information regarding the state's activities when they determined whether the property was suitable for their future development plans.¹⁰

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.*

For example, 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.

Marketability disclosure

Annual Property Operating Data sheet (APOD)

A worksheet used when gathering income and expenses on the operation of an income producing property, to analyze its suitability for investment. [See **RPI** Form 352]

¹⁰ *Storage Services v. Oosterban* (1989) 214 CA3d 498

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.¹¹

Analysis of income property

A completed *APOD* is to be prepared by the owner when an agent is listing income property. As the seller's representation of the property operations, the *APOD* is to be attached to the listing agreement as an addendum signed by the seller. [See **RPI** Form 352]

In addition to income and expense information provided in the *APOD*, the broker needs to investigate and inspect the property for:

- quality of income;
- deferred maintenance;
- desirability of location; and
- any title or zoning conditions which might interfere with the buyer's intended use of the property.

Another fact affecting the value and desirability of the property is the existence of due-on-sale clauses in trust deeds of record. Similarly critical is whether the lender will call or recast the mortgage by adjusting rates and rescheduling payments so sellers and buyers have alternatives for financing the sale and purchase of a property.

A broker has a duty to investigate the accuracy of all representations they make to buyers or lenders regarding a property's physical condition, use and operating expenses. However, no investigation is needed when they disclose

¹¹ *Ford v. Courmale* (1973) 36 CA3d 172

the source of the information and the fact they have not independently investigated or confirmed the representations, but only if the broker has no reason to believe they are inaccurate.

A broker of one-to-four unit residential property is relieved of the responsibility of verifying the representations regarding property conditions they receive from others and pass on to buyers as long as the source of information is disclosed to the buyer.

The source of information is typically the seller, the seller's broker or a home inspector.¹²

For example, consider a seller's broker who hands a buyer of a one-to-four unit residential property a TDS signed by the seller. The statement includes an additional comment by the broker on observable cracks in the walls, noting the seller identified them as cosmetic. The broker does not know they are not just cosmetic.

After closing, the buyer of the property incurs repair costs due to unstable soil. The buyer claims the seller's broker is liable for the costs since they failed to independently verify the seller's claims regarding the cracks in the walls. The broker claims they are not liable since they had no duty to verify the seller's representations of property conditions unknown to the broker.

Here, the broker is not liable for the buyer's losses. The broker only has a duty to inspect and disclose material facts **observable or known** to them, not to independently verify the claims of their disclosed source.¹³

Consider a buyer who purchases a unit in a **common interest development (CID)**. The seller of the property does not disclose to either brokers or the buyer the existence of pending litigation between the homeowner's association (HOA) and the developer of the CID regarding soil subsidence in the common area.

Both the seller's broker and the buyer's broker conduct visual inspections of the property. Neither broker discovers any visible defects nor are any defects known to either of them.

After purchasing the property, the buyer learns of the litigation and the soil subsidence in the common areas. The buyer claims the brokers' failure to discover and disclose the pending litigation is a breach of their *statutory duty* to investigate and disclose the condition and marketability of the property.

Are the brokers responsible for their failure to investigate the records and disclose these material facts to the buyer?

No! The brokers of a one-to-four unit sale have no duty to investigate **public records** and disclose pending litigation or soil subsidence not known to them.

Verifying representations from others

Public record investigations

public records

Documents recorded with the county and available to the public. Includes information regarding property ownership, property tax values and pending litigation.

¹² CC §§2079 et seq.

¹³ **Robinson v. Grossman** (1997) 57 CA4th 634

Case in point

Does a seller's agent owe money losses to a buyer after they disclose the existence of past damage to a property but not whether it was repaired?

Facts: A homebuyer and their agent submit an offer to purchase a single family residence (SFR) to the seller's agent. After the purchase agreement offer is accepted, the seller's agent provides the homebuyer with a written disclosure of the property's condition, noting observable damage to a section of flooring. The seller's agent gives the homebuyer additional reports provided by the seller detailing damage to the subflooring from past drainage problems. The reports note the drainage system was repaired but the subflooring was not. The homebuyer purchases the property, and later discovers the subflooring has extensive damage which was not cured when the drainage system was repaired.

Claim: The homebuyer seeks to recover their money losses for curing the subflooring from the seller's agent, claiming the agent breached their general duty to the homebuyer since the seller's agent failed to disclose the damage to the subflooring was not repaired.

Counter claim: The seller's agent claims they did not breach their general duty owed to the buyer since the seller's agent provided the buyer with a disclosure of their visual inspection noting the damage to the flooring with supplementary reports indicating repairs were made specifically to the drainage system and not the subflooring.

Holding: A California court of appeals held the homebuyer was not entitled to recover the costs for repairs from the seller's agent since the seller's agent fulfilled their general duty owed to the buyer by completing the required visual inspection and providing reports detailing the damage observed to the subflooring and repairs were made to the drainage system. [*Peake v. Underwood* (2014) 227 CA4th 428]

Editor's note — While the seller's agent owes a special fiduciary duty to the seller who is their client, the seller's agent only owes a limited, non-client general duty to the buyer to voluntarily provide information on the listed property. Here, the "limited" refers to the minimal quantity of fundamental information about the property which needs to be presented to the buyer and their agent by the seller's agent. The information disclosed by the seller's agent only needs to 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 the buyer's intended use of the property.

Further, the brokers were unaware of the existence of either the litigation or the soil subsidence. While a broker has a duty to investigate and confirm all representations they make about a property or provide for the buyer to do so, the broker is not held accountable for representations by sellers which are outside their realm of knowledge.¹⁴

Disclosures by interim title holders

Consider a broker who acts as a *relocation agent*. As planned by the broker and seller, the broker purchases the seller's one-to-four unit residence and later resells the property to a buyer.

The broker hands the buyer the seller's TDS which the broker received from the seller. In it, the seller does not disclose the existence of *noise conditions* in the surrounding area that affect the property's value. The broker is not aware of the noise conditions and does not add them to the TDS.

¹⁴ *Padgett v. Phariss* (1997) 54 CA4th 1270

On occupying the property, the buyer discovers the undisclosed noise conditions which reduce the value of the property for less than the price paid.

The buyer seeks to recover the lost value from the broker who sold them the property. The broker claims they are not obligated to the buyer for the lost value since they were unaware of any noise conditions. The buyer claims the broker is liable since they have a duty to investigate and verify the representations made by the seller on the TDS.

Here, the broker is not liable to the buyer for the lost value resulting from undisclosed noise in the area surrounding the property. The existence of the condition was outside the realm of the broker's knowledge.¹⁵

¹⁵ *Shapiro v. Sutherland* (1998) 64 CA4th 1534

Brokers and agents are to disclose to all parties involved in a real estate transaction all significant physical aspects of a property which may affect the property's market value or a buyer's decision to purchase. Property disclosures will be made to the buyer before offers are prepared and prices agreed to. If not timely made, a buyer may cancel the transaction or close escrow and seek recovery of the costs to cure the belatedly disclosed defects.

A broker is obligated to disclose the physical condition of soil and improvements of a property, the land use and title conditions, the operating income and expenses of the property, and location hazards and the impact of the surrounding area. Further, the actual legal size and boundaries of a property need to be disclosed by a broker. A broker needs to also accurately represent the title restrictions and potential future use of real estate to a prospective buyer or tenant.

A broker marketing property as an income-producing investment owes a duty to a buyer to research whether the property produces adequate income to meet expenses.

A broker has a duty to investigate the accuracy of all representations they make to buyers regarding a property's physical condition, use and operating expenses, unless they disclose the source of their information and the fact they have not investigated or confirmed the representations.

The brokers of a one-to-four unit sale have no duty to investigate public records and disclose any pending litigation or physical condition not known to them and not observable upon visual inspection.

Ethics Chapter 3 Summary

Ethics
Chapter 3
Key Terms

Annual Property Operating Data sheet (APOD).....	pg. 245
“as-is” clause	pg. 240
eminent domain	pg. 244
further-approval contingency.....	pg. 242
material fact	pg. 240
public records	pg. 247
Transfer Disclosure Statement (TDS)	pg. 240



The borrower and mortgage broker relationship

Ethics Chapter 4

After reading this chapter, you will be able to:

- understand the need to properly represent mortgage terms and conditions to a borrower;
- avoid unethical mortgage broker behavior when soliciting employment from a borrower; and
- properly manage advance fees as trust funds received from a borrower.

advance costs

advance fees

Learning Objectives

Key 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.

The accurate representation of mortgage terms

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.¹

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.²

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.³

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.⁴

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

¹ **Wyatt v. Union Mortgage Company** (1979) 24 C3d 773

² Calif. Business and Professions Code §§10130, 10131(d), 10176(a), 10176(i)

³ **Realty Projects Inc. v. Smith** (1973) 32 CA3d 204

⁴ Bus & P C §10241

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 Form 104 accompanying this chapter]

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.⁵

Also, the broker may be fined up to \$10,000, imprisoned up to six months or both.⁶

"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.

No "free services" under a listing

⁵ Bus & P C §10177(d)

⁶ Bus & P C §10185

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.⁷

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.

Advance fees are trust funds, until earned and disbursed

advance fee

A fee paid in advance of any services rendered.

An **advance fee** is a fee received by a broker for soliciting borrowers or lenders to arrange mortgages or sell trust deed notes before brokerage services are performed and the fee earned. The advance fee arrangement also applies to real estate sales and leasing transactions.⁸

Any fees received by a broker in advance of rendering the services to be performed are *trust funds*. Thus, *advance fees* will be deposited into the broker's trust account, separate from the broker's business or personal funds.⁹ [See *Trust Funds* Chapter 2]

Further, the broker is to use a **DRE-approved advance fee form** or obtain DRE approval of a different advance fee form the broker seeks to use.¹⁰

After depositing the funds into the trust account, the broker may withdraw from the deposit and disburse a fee to themselves after:

- the broker has *completed the services* to be rendered to arrange the mortgage for the borrower;
- the broker has handed the borrower an *accounting* for the services performed arranging the mortgage; and
- *five days* have passed after the borrower has received the accounting.¹¹ [See *Trust Funds* Chapter 2]

In the interim before earning the advanced fee, the broker is to make a *full accounting* to the borrower at least every calendar quarter for the withdrawal and expenditure of any advance fees deposited in the trust account. The accounting includes the itemization of services rendered, amounts disbursed, payees, dates, etc.¹²

⁷ *Coleman v. Mora* (1968) 263 CA2d 137

⁸ Bus & P C §10026

⁹ Bus & P C §10145

¹⁰ Bus & P C §10085

¹¹ Bus & P C §10146

¹² Bus & P C §10146


Advance fees are distinguishable from **advance costs**. *Advance costs* are deposits handed to the broker to cover out-of-pocket costs incurred on behalf of the depositor while performing brokerage services, such as a mortgage appraisal for a borrower. [See *Trust Funds* Chapter 3]

For example, consider a borrower seeking to purchase commercial real estate employs a broker to help them obtain a mortgage.

The broker tells the borrower the broker fee needs to be paid in advance as compensation for their initial time spent preparing the mortgage package and negotiating with the lender.

advance costs

Deposits handed to a broker to cover out-of-pocket costs incurred on behalf of the depositor while performing brokerage services.

	LOAN BROKER LISTING Exclusive Right to Borrow
Prepared by: Agent _____ Broker _____	Phone _____ Email _____
NOTE: This form is used by an agent when entering into the employment of a buyer or an owner of a property as their sole agent for a fixed period of time, to arrange a mortgage to be secured by the property.	
DATE: _____, 20____, at _____, California. <i>Items left blank or unchecked are not applicable.</i>	
1. RETAINER COMMITMENTS:	
1.1 Owner hereby retains and grants to Broker the exclusive right to locate a lender and arrange a loan to be secured by the property described herein, for the period of this listing beginning on _____, 20____ and terminating on _____, 20____.	
1.2 Broker to use diligence in the performance of this employment. Owner to cooperate with Broker to meet the objectives of this employment.	
1.3 Owner hands \$_____ to Broker for deposit into Broker's trust account for application to Owner's obligations under the attached Listing Package Cost Sheet. [See RPI Form 107]	
2. ADDENDA to this agreement include:	
2.1 <input type="checkbox"/> Credit Application [See RPI Form 302]	
2.2 <input type="checkbox"/> Loan Purpose Statement [See RPI Form 202-2]	
2.3 <input type="checkbox"/> Acknowledgement of Changing Conditions [See RPI Form 202-1]	
2.4 <input type="checkbox"/> See Addendum for additional provisions [See RPI Form 250]	
2.5 <input type="checkbox"/> _____	
2.6 <input type="checkbox"/> _____	
2.7 <input type="checkbox"/> _____	
3. BROKERAGE FEE:	
NOTICE: The amount or rate of real estate fees is not fixed by law. They are set by each Broker individually and may be negotiable between Client and Broker.	
3.1 Owner agrees to pay Broker <input type="checkbox"/> _____% of the principal amount of the loan sought or obtained, or <input type="checkbox"/> _____, IF:	
a. Anyone procures a lender on the terms stated in this agreement, or on any other terms accepted by Owner during the period of this listing.	
b. The property is withdrawn as collateral, or title is made unmarketable as collateral by Owner during the retainer period.	
c. Owner terminates this employment of Broker during the retainer period.	
d. Within one year after termination of this agreement, Owner or their agent enter into negotiations, which later result in a transaction contemplated by this agreement, with a lender whom Broker or a cooperating broker negotiated with during the period of this listing. Broker to identify prospective lenders by written notice to the owner within 21 days after termination of this agreement.	
3.2 If this agreement terminates without Owner becoming obligated to pay Broker a fee, Owner to pay Broker the sum of \$_____ per hour of time accounted for by Broker, not to exceed \$_____.	
4. LOAN TERMS:	
4.1 Loan sought is \$_____, payable as follows:	
a. Interest at an annual rate of no more than _____%, <input type="checkbox"/> fixed, <input type="checkbox"/> ARM, type _____	
b. Payments due <input type="checkbox"/> monthly, or <input type="checkbox"/> _____, amortized over _____ years.	
c. Final/balloon payment due _____, 20____.	
d. Late charge _____	
e. Prepayment penalty _____	
f. Loan escrow with _____	
g. A lender's ALTA policy purchased by Owner in the amount of the loan.	
Title Company _____	

Form 104

Loan Broker
Listing

Page 1 of 3

Form 104

Loan Broker
Listing

Page 2 of 3

----- PAGE 2 OF 3 --- FORM 104 -----

5. REAL ESTATE SECURING THE LOAN:

5.1 Type _____
 Address _____
 Referred to as _____
 Vesting _____

5.2 The priority for the lien securing the loan sought will be ☐ first, or ☐ second.

5.3 Encumbrances of record:

a. A first loan in the amount of \$_____, payable \$_____ per month until paid, including interest at _____%, ☐ ARM, type _____, due _____, 20____, impounds being \$_____ monthly.
 Lender: _____

b. A second loan in the amount of \$_____, payable \$_____ per month, until paid, including interest at _____%, ☐ ARM, type _____, due _____, 20____.
 Lender: _____

c. Other encumbrance, bond, assessment or lien in the amount of \$_____.
 Lienholder: _____

5.4 My purchase price on _____ was \$_____. Since the purchase of the property, I have invested in repairs and improvements of approximately \$_____.

5.5 The current fair market value is \$_____.
 Property taxes for the year 20____ were \$_____.

5.6 The property is occupied by _____
 at a rental rate of \$_____ per month, under a:
☐ rental agreement; or
☐ lease agreement which expires _____, 20____.
 a. ☐ See attached Rental Income Rent Roll. [See RPI Form 352-1]

6. PERSONAL PROPERTY INCLUDED AS COLLATERAL:

6.1 Referred to as _____

6.2 Encumbered for the amount of \$_____, payable \$_____ monthly, including interest at _____%, due _____, 20____.
 Lender _____

7. GENERAL PROVISIONS:

7.1 Broker is authorized to disclose, publish, discuss, and disseminate among prospective lenders the financial information supplied by Owner or credit agencies.

7.2 Owner warrants all necessary permits have been obtained for any additions, alterations, repairs, installations or replacements to the structure or its components, except _____.
 a. ☐ See attached Condition of Property Disclosure. [See RPI Form 304]

7.3 Owner authorizes Broker to cooperate with other agents and divide with them any compensation due.

7.4 Before any party to this agreement files an action on a dispute arising out of this agreement which remains unresolved after 30 days of informal negotiations, the parties agree to enter into non-binding mediation administered by a neutral dispute resolution organization and undertake a good faith effort during mediation to settle the dispute.

----- PAGE 2 OF 3 --- FORM 104 -----

The borrower writes a check to the broker for \$1,000, indicating on the check the money is in payment for services to be rendered arranging the mortgage.

The broker deposits the client's check into their **general business account**. The broker believes the funds are theirs to spend as they sees fit.

Later, the borrower, having received no billing or accounting, demands an accounting of the funds. The broker is unable to provide the borrower with any documentation as to what services were rendered, how much time was spent or when and to whom the funds were disbursed.

----- PAGE 3 OF 3 — FORM 104 -----

7.5 The prevailing party in any action on a dispute will be entitled to attorney fees and costs, unless they file an action without first offering to enter into mediation to resolve the dispute.

7.6 This listing agreement will be governed by California law.

7.7 _____

<p>I agree to render services on the terms stated above.</p> <p>Date: _____, 20____</p> <p>Broker's Name: _____</p> <p>CalBRE #: _____ NMLS #: _____</p> <p>Agent's Name: _____</p> <p>CalBRE #: _____ NMLS #: _____</p> <p>Signature: _____</p> <p>Address: _____</p> <p>Phone: _____ Cell: _____</p> <p>Email: _____</p>	<p>I agree to employ Broker on the terms stated above.</p> <p><input type="checkbox"/> See attached Signature Page Addendum. [RPI Form 251]</p> <p>Date: _____, 20____</p> <p>Owner's Name: _____</p> <p>Signature: _____</p> <p>Owner's Name: _____</p> <p>Signature: _____</p> <p>Address: _____</p> <p>Phone: _____ Cell: _____</p> <p>Email: _____</p>
---	--

FORM 104 11-16 ©2016 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517

Form 104**Loan Broker
Listing****Page 3 of 3**

Further, the broker cannot even prove the funds were spent on services rendered on the borrower's behalf.

Here, the broker received a deposit for a fee they had not yet earned. They failed to place the deposit into their *trust account* for disbursement after the fee was earned and accounting given to the client. The broker also failed to account for time spent working on the borrower's behalf before placing the funds in their general account.¹³

A broker's failure to account to their client for advance fees paid for arranging a mortgage may result in the suspension of the broker's license. The broker may also be liable to the borrower for triple the borrower's damages for misappropriation of trust funds.¹⁴

¹³ **Nelson v. Department of Real Estate** (1984) 161 CA3d 939; Bus & P C §§10026, 10146

¹⁴ **Burch v. Argus Properties, Inc.** (1979) 92 CA3d 128

Ethics
Chapter 4
Summary

A mortgage broker needs to make a meaningful disclosure about the essential terms of a mortgage when soliciting a borrower or arranging a mortgage with a lender. This duty to disclose, and obligation to deal fairly with borrowers, commences on the broker’s first contact with prospective borrowers.

Further, a broker may not represent that a specific service is provided for “free” when that service is part of an entire transaction in which the broker will be compensated by receipt of a fee.

The mortgage broker’s duty of fair dealing also extends to discussing documents and complex mortgage terms with the borrower. The broker needs to ensure the borrower has an understanding sufficient to make a well-informed decision regarding the mortgage.

A broker arranging a mortgage who receives fees from the borrower before brokerage services are rendered treats the fees as trust funds. These trust funds may not be disbursed until they are earned and an accounting provided to the borrower. Fees advanced to a mortgage broker from a borrower are subject to rules requiring DRE approval of the advance fee agreement used, quarterly accounting to the borrower, and penalties for misuse of the trust funds.

Ethics
Chapter 4
Key Terms

advance costs pg. 255
advance fees pg. 254

Ethics Chapter 5

Kickbacks, price fixing and MLS access

After reading this chapter, you will be able to:

- recognize the unethical nature of kickbacks, referral fees and duplicative charges in real estate transactions; and
- understand the detrimental effect of price fixing.

kickback

referral fee

Learning Objectives

Key Terms

When property prices rise, **kickbacks** in real estate sales become infectious. 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

Duplicate charges for services

kickback

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

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.¹

RESPA controls brokers and third-party service providers

The mere referral-steering of a client is not a service rendered in exchange for a kickback, but is 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.²

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

¹ 12 United States Code §2607(d)

² 12 Code of Federal Regulations §1024.14(g)(vi)

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.

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.

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.³

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 broker. 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.⁴

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. However, fees prohibited by RESPA cannot be legalized by disclosure or consent of the client.⁵

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.

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.

Referral fees between brokerages

referral fee

A fee paid by one service provider to another for referring a client to them. Prohibited by the Real Estate Settlement Procedures Act (RESPA) when consumer financing funds the purchase of one-to-four unit residential property.

MLS fees fixed and competition banned

³ Calif. Business & Professions Code §10177.4; 12 USC §2607

⁴ Bus & P C §10137

⁵ Bus & P C §10176(g)

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!

Unlawful MLS price fixing

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.⁶

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.

⁶ Freeman v. San Diego Association of Realtors (9th Cir. 2003) 322 F3d 1133

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 *DRE* due to their past close liaison via past Real Estate Commissioners.

MLS-access for non-CAR members

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 1976.⁷

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 excessive and unnecessary dues or entangling themselves in a trade union’s bureaucracy, codes and arbitration rules.

⁷ *Marin County Board of Realtors, Inc. v. Palsson* (1976) 16 C3d 920

Ethics
Chapter 5
Summary

Real estate sales transactions are increasingly subject to duplicate charges for integral services, imposed on both buyers and sellers by brokers, lenders, escrow agencies and title companies during periods of rising property values. These are known as kickbacks or referral fees based on who ultimately receives them and what they do in exchange for the fee.

A referral fee is a fee paid by one service provider to another for referring a client to them. 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. 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 itself.

Subscribers to a Multiple Listing Service (MLS) do not need to be members of a trade association in order to post listings and access the MLS database.

Ethics
Chapter 5
Key Terms

kickback	pg. 259
referral fee	pg. 261



Management of exposure to liability

Risk Management Chapter 1

After reading this chapter, you will be able to:

- develop and implement a risk reduction program to minimize exposure to liability;
- identify the types of risk a brokerage service may be exposed to and what steps can be taken to mitigate them; and
- provide a scheme for the continual management of risk.

**classified risk
errors and omissions
(E&O) insurance**

**fiduciary duty
general duty
pure risk**

Learning Objectives

Key Terms

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 chapter. The risk of causing another person a loss is inherent in all activities conducted in the context of agency relationships.

The reduction of uncertainties for harm

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.

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**.

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.

Components of a risk reduction program

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.

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.

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)*

Identify activities requiring management

The uncertainties in each activity

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.

For example, one of the activities to be identified in the first step of a risk reduction program is the giving of an **opinion** in response to an inquiry regarding a property. [See *Agency* Chapter 5 and 6]

Many aspects exist in developing and giving an opinion. The failure to consider each aspect creates exposure to liability. Thus, you need a *checklist of actions* to take regarding the process for the agent's development of an opinion. [See *Agency* Chapter 6]

Activities creating risk

Excessive market conditions, manifested by the boom and bust phases of the real estate business cycle, produce *dangerous aberrations* in the conduct of agents when dealing with buyers and sellers.

The activities of negotiating purchase agreements and obtaining new listings are acceptable brokerage activities. However, risky actions are occasionally incorporated into an otherwise appropriate activity. These can expose the seller to loss and the broker to liability. Listing and escrow arrangements, while routine and customary, are also to be evaluated for risk.

For example, agents often do not advise sellers that property disclosures are mandated to be delivered to prospective buyers as soon as possible after the prospect first seeks further information about the property. Likewise, seller's agents improperly present adverse information about a property to the buyer at the last minute – well after a binding purchase agreement exists, escrow is open and the buyer has arranged financing. [See *Ethics* Chapter 2 and 3]

Nondisclosure *before entry* into a purchase agreement creates an ambiguity about the property's conditions, and thus the proper price to pay. This conduct exposes brokers to liability when the buyer experiences lost expectations of value. [See *Risk Management* Chapter 4]

Other components of an identified activity also evaluated for risk of loss include:

1. What is the source of information given to a client?
2. How credible is the source of the information?
3. When is due diligence information-gathering activity undertaken?
4. What is the proper time for releasing known information to prospects?
5. What readily available information needs to be obtained and reviewed for unknown (but knowable) property facts?
6. What other decisions may produce adverse consequences while performing the identified activity?

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.

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 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.

Even with insurance, each broker hiring agents needs to determine what level of risk is acceptable for them when undertaking a chosen brokerage activity.

For example, risks in providing information to clients and others may only result in minimal liability exposure for claims. These are *absorbable risks* the broker and their agents can take which are either uninsured or within the range of the deductible not paid by the insurer. When brokers authorize absorbable-risk conduct, an agent needs to agree to contribute to any settlement paid out by the broker on claims generated by the agent's conduct.

However, some conduct in the performance of agency duties are **pure risks** which need to be avoided since they lead to *absolute liability* as entirely unacceptable acts. *Pure risks* include:

- deceit;
- withholding known or unknown but readily available information; or
- misstating or permitting the misstatement of facts or consequences of facts which cause the person relying on the statements to suffer a financial loss.

Evaluating the uncertainty of adverse results

E and O insurance mitigates risk

errors and omissions (E&O) insurance

An insurance policy protecting brokers and agents from negligent conduct when acting as a licensee.

Avoiding acceptable levels of conflict

pure risk

Entirely unacceptable acts leading to absolute liability for the misconduct.

classified risk

Improper activity or activity leading to a lack of proper performance which may impose liability for losses the activity may cause to others.

Substandard activity, sometimes called a **classified risk**, needs to be given special emphasis. This activity generally leads to a lack of proper performance. Occasionally it is the activity itself which is considered improper and automatically imposes liability for any losses it may cause.

Each broker hiring agents will have a different level of acceptable risk they are comfortable with. Whatever that level may be, policy measures need to be adopted to provide guidelines and instructions on just what steps agents are to take when conducting a brokerage activity chosen by the broker as an acceptable risk.

For example, trust funds need to be explained so the agent can identify them. Further, agents need to understand proper handling of an agent's receipt, recording, safekeeping and delivery to the intended recipients and the agent's timely performance of each step. Trust fund procedures need to be laid out in clear, concise language to avoid risks from mishandling. DRE audits may be the biggest risk of all. [See the *Trust Funds* Chapters]

The management by the agent of a purchase agreement, deposit, disclosures and the dictating of escrow instructions needs to be detailed so the expectation of the agent about their conduct is well understood.

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*.

Risk Management Chapter 1 Summary

The risk of causing another person a loss exposes a broker and their agents to liability due to errors, omissions or misunderstandings. Brokers control these risks by maintaining a risk reduction program identifying potential risks and tracking agent compliance with risk reduction policies.

Each activity bearing risk is broken down into their individual component actions, such as conducting a visual inspection, to identify critical points at which exposure to liability can occur. This breakdown becomes the checklist of proper and improper conduct for performing that part of the activity.

There are multiple types of risk. Pure risks arise from entirely unacceptable actions and lead to absolute liability. Classified risks are based on substandard activity and may expose the broker to liability.

As a buffer against liability arising out of an error or omission, a broker maintains errors and omissions (E&O) insurance.

Continued oversight and policing limits unilateral changes, distortions and deviations by agents from conduct acceptable to the broker. Continuous oversight requires the broker's commitment of financial and human resources.

classified risk	pg. 270
errors and omissions (E&O) insurance	pg. 269
fiduciary duty	pg. 266
general duty	pg. 266
pure risk	pg. 269

Risk Management Chapter 1 Key Terms



Looking for a real estate attorney in California?

Check out **first tuesday's Real Estate Attorney Database** to find an attorney near you! Our growing list of real estate attorneys is community-built, so you can add yourself or other reputable attorneys you've worked with to the directory.

Search now



An agent's impact on their broker

Risk Management Chapter 2

After reading this chapter, you will be able to:

- understand the liabilities imposed upon a broker by the agents they employ;
- establish policies, procedures and rules for the continual management and supervision of licensed sales agents; and
- develop a business model for implementing the supervisory duties required of a broker.

business model

licensed activities

Learning Objectives

Key Terms

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.¹

A licensed real estate salesperson is limited to the status of an agent for their employing broker. An agent *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.² [See *Agency* Chapter 1]

Only when acting as a representative of their broker may the sales agent perform brokerage services which only a broker is authorized to contract for and provide to others, called **clients**.³

Further, a sales agent can only receive compensation – *fees* – for their real estate related activities from their employing broker. An agent cannot

The agent of the agent

licensed activities

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

¹ Calif. Business and Professions Code §10131

² Bus & P C §10160

³ **Grand v. Griesinger** (1958) 160 CA2d 397

receive compensation arising out of a fee generating transaction directly from anyone else, e.g., the seller or buyer, another licensee, or other provider of services in a transaction.⁴

Thus, brokers are the *agents* employed by members of the public. On the other hand, a broker's sales agents are *agents of the agent*. Sales agents render services on behalf of the broker's clients, and do so as the broker's representatives.⁵ [See Agency Chapter 1]

As a result, brokers are responsible for all the activities their agents carry out *within the course and scope* of their employment with the broker.⁶

The broker's mandated continuous supervision

When a broker employs a sales agent to act on behalf of the broker, the broker is required to exercise **reasonable supervision** over the activities performed by the agent. The broker who does not actively supervise their agents risks having their broker license suspended or revoked by the California Department of Real Estate (DRE).⁷

The employing broker's responsibility to the public includes:

- *on-the-job training* for the agent in the procedures and practice of real estate; 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 to them by the employing broker.⁸

The duties owed to the various parties in a transaction by a broker 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 affects the value and desirability of the property involved.⁹

A broker ensures their agents are diligently complying with the duties owed to clientele and others by establishing office policies, procedures, rules and systems relating to:

- *soliciting* and obtaining buyer and seller listings;
- *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;

⁴ Bus & P C §10137

⁵ Calif. Civil Code §2079.13(b)

⁶ **Gipson v. Davis Realty Company** (1963) 215 CA2d 190

⁷ Bus & P C §10177(h)

⁸ CC §2079.13(b)

⁹ CC §2079.16

- 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 [See the *Trust Funds* Chapters];
- *advertisements*, such as flyers, brochures, press releases, multiple listing service (MLS) postings, etc.;
- agent compliance with all federal and state laws relating to *unlawful discrimination* [See the *Fair Housing* Chapters]; and
- the receipt of regular *periodic reports* from agents on their performance of activities within the course and scope of their employment.¹⁰

An employing broker implements the need for supervision by developing a **business model**. With it, the broker establishes the means and manner by which listings are produced and serviced, and how purchase agreements are negotiated and closed by their agents. The development of a plan of operations logically starts with an analysis of the conduct required of an agent based on established categories of administrative and licensed activities. [See *Office Management* Chapter 1]

Categories of business and licensed activities include:

- **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.);
- **substantive 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.

Brokers typically use an **independent contractor (IC)** form when documenting the employment of agents for DRE compliance. An IC employment form is used solely for the avoidance of income tax withholding and unemployment benefits payments by real estate brokers. [See Figure 1, **RPI Form 506**]

¹⁰ Department of Real Estate Regulations §2725

Implementing supervision

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.

Liability imposed on a broker by their agents

Figure 1

Form 506

Independent
Contractor
Employment
Agreement

INDEPENDENT CONTRACTOR EMPLOYMENT AGREEMENT For Sales Agents and Broker-Associates	
NOTE: This form is used by an employing broker when entering into an agreement employing a sales agent or a broker on terms calling for the employee to be treated for tax purposes as an independent contractor, to establish the duties of the broker and agent, earned fees and how the fees due the employee will be allocated and shared.	
DATE: _____, 20____, at _____, California. <i>Items left blank or unchecked are not applicable.</i>	
1. Broker hereby employs Agent as a real estate sales agent or broker-associate, until terminated by either party, on the following stated terms.	
1.1 Agent to be treated as an independent contractor for tax purposes.	
2. AGENT agrees:	
2.1 To maintain a real estate license in the State of California.	
2.2 To provide brokerage services only on behalf of Broker.	
2.3 To follow the Broker's policy manual and any directions orally given by Broker.	
2.4 To use only those real estate forms authorized by Broker.	
2.5 To make complete and immediate disclosure to Broker of any correspondence or document made or received.	
2.6 To immediately deliver and account to Broker for funds received by Agent in the course of this employment.	
2.7 To participate in educational programs and meetings specified by Broker.	
2.8 To fully inspect the physical conditions of any property to be sold or bought for clients.	
2.9 To obligate Broker to no agreement without Broker's prior consent.	
2.10 To expose Broker to no liability to any third party without Broker's prior consent.	
2.11 To furnish their own transportation and carry a liability and property damage insurance policy in an amount satisfactory to Broker with a policy rider naming Broker as co-insured.	
2.12 To faithfully adhere to the Real Estate Law of the State of California.	
2.13 To join and pay fees for membership to professional organizations in which Broker is a member.	
2.14 To contribute to the defense and settlement of litigation arising out of transactions in which Agent was to or shared fees, in an amount equal to Agent's percentage share of the fees.	
2.15 Social Security Number _____/_____/_____	
2.16 Other _____	
3. BROKER agrees:	
3.1 To maintain a real estate Broker's license in the State of California.	
3.2 To maintain office(s) with proper facilities to operate a general real estate brokerage business.	
3.3 To maintain membership in the following professional organization(s):	
<input type="checkbox"/> Multiple Listing Service	
<input type="checkbox"/> Local Branch of the California Association of Realtors and National Association of Realtors	
<input type="checkbox"/> _____	
3.4 To maintain listings.	
3.5 To provide advertising approved by Broker.	
3.6 To provide worker's compensation insurance for Agent.	
3.7 To maintain the following insurance coverages for Agent:	
<input type="checkbox"/> Errors and Omissions <input type="checkbox"/> Life <input type="checkbox"/> Health <input type="checkbox"/> Dental	
3.8 To pay Agent as specified in the Broker's fee schedule.	
3.9 To withhold from Agent's share of fees all appropriate state and federal income taxes, state disability and unemployment insurance and social security taxes.	
3.10 To notify the DRE in writing of the employment and termination of the employee if they are being hired as a broker-associate. [See RE Form 215]	
3.11 Other _____	
4. General Provisions:	
4.1 Agent has the right to purchase any properties listed by Broker on full disclosure to the seller of the Agent's activities as a principal, and without diminution of fees to Broker.	
4.2 Broker has the right to reject any listing or retainer obtained by Agent.	
4.3 Broker to determine whether any litigation or dispute involving Broker, or their business and third parties, arising from Agent's activities, will be prosecuted, defended or settled.	
4.4 Arbitration: Any dispute between Agent and Broker or with any other Agent employed by Broker that cannot be settled by Broker, or resolved by the State Labor Commission or by non-binding mediation, will be arbitrated under the rules of the American Arbitration Association.	
4.5 <input type="checkbox"/> See addendum for additional provisions. [See RPI Form 250]	
----- PAGE 1 OF 2 — FORM 506 -----	

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

However labeled in writings, an agent is a labor law employee and the broker is still liable as an employer for their agent's conduct. An agent may not permissibly act independent of the broker under an *IC agreement* and the broker employing agents using an IC agreement still owes a duty of supervision (as well as a mandated worker's compensation policy). [See Figure 1, **RPI** Form 506; see *Agency* Chapter 5]

Consider a sales agent employed by a broker under an IC agreement. The broker gives the agent *total discretion* in their handling of clientele and documentation.

However, the IC agreement includes a provision calling for the agent to deliver to the broker a *binder for liability insurance* on the agent's car naming the broker as an insured party. 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*. [See *Risk Management* Chapter 1]

While the sales agent is driving their car 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. Thus, the broker claims they have no liability for the losses inflicted on the driver by the agent.

The driver claims the broker is liable 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*. This relationship exists without concern for the type of employment agreement the broker and agent have entered into.

Further, the agent is subject to supervision by their broker by DRE mandates to actively conduct their brokerage business. This mandatory supervision cannot be contracted away by an IC employment agreement allowing total discretion to the agent in the conduct of their handling of listings and sales.

Since the sales agent is an agent of the broker, and at the time of the injury the agent was acting within the course of their agency with the broker, the broker cannot escape liability for their agent's negligence.¹¹

The broker who hires agents who use their own cars to conduct real estate activities not only needs to be a named insured party on the agent's car insurance policy, but also needs to maintain:

- *general comprehensive business liability insurance;*
- *worker's compensation coverage; and*
- *professional liability coverage, also known as errors and omissions (E and O) insurance.* [See *Risk Management* Chapter 1]

Active control of brokerage business

¹¹ Gipson, *supra*

Proper insurance coverage is a requisite of good brokerage practice. Tortious conduct of all sorts can arise out of listings and sales transactions solicited and negotiated by agents employed by the broker.

**Risk
Management
Chapter 2
Summary**

Brokers are authorized to deal with members of the public to offer, contract for and render brokerage services for compensation. A sales agent cannot contract in their own name or on behalf of anyone other than their employing broker. Thus, an agent is an agent of their employing broker.

Brokers are responsible for providing reasonable supervision over all the activities their agents carry out within the course and scope of their employment. Employing brokers need to establish office policies and systems relating to all steps in the process of facilitating a real estate transaction. Thus, they ensure their agents are diligently complying with the duties owed to their clientele and others.

As part of these office policies, brokers develop a business model establishing the means and manner by which listing are produced and serviced, and how purchase agreements are negotiated and closed by their agents.

**Risk
Management
Chapter 2
Key Terms**

business modelpg. 275
licensed activitiespg. 273



Due diligence obligations of the seller's and buyer's broker

Risk Management Chapter 3

After reading this chapter, you will be able to:

- practice the level of due diligence owed under an exclusive or open listing agreement;
- maintain an accurate client file to record your exercise of due diligence;
- gather all the information required to list and market a property for sale; and
- apply yourself to fully and fairly respond to a customer's inquiry.

activity sheet
due diligence

open listing (of property)
physical file

Learning Objectives

Key Terms

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.

Due diligence by the seller's agent

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.

due diligence

The concerted and continuing efforts of an agent employed to meet the objectives of their client, the agent's promise given in exchange for the client's promise to pay a fee.

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.

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.¹

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;² and

¹ *Coleman v. Mora* (1968) 263 CA2d 137

² *Jue v. Smiser* (1994) 23 CA4th 312

- *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]

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;³
- 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

Gathering facts on adverse features



Click to watch

³ Calif. Civil Code §2079

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.

The fiduciary duty owed to the client under an exclusive listing

An *exclusive listing agreement* entered into by an agent on behalf of their broker creates a client relationship with the buyer or seller who employs them. The employment imposes *special duties* on the broker and the agent, owed to the client as their fiduciary, to use due diligence in a continuous and meaningful effort to meet the objective of the employment. [See **RPI** Form 102 §1.2]

The promise of *due diligence* is the consideration a broker and their agents give their client in exchange for employment and a promise to pay a fee. The promise to use due diligence in the employment is stated in the exclusive listing agreement. If not, it is implied as existing by law.

The broker granted exclusive representation by a client is to take reasonable steps to promptly gather all **material facts** about the property being marketing it for sale. In addition to gathering material facts about the property, the broker's agent proceeds to do every reasonable and ethical activity to pursue, with utmost care, the purpose of the employment.

The fiduciary duty owed to the client under an open listing

In contrast to an exclusive listing, a broker and agents entering into an **open listing** are not committed to the seller to render any services at all. The brokers and agents are said to have only a *best-effort obligation* to act on the employment.

However, when an agent under an open listing enters into preliminary negotiations with a buyer, a due diligence obligation owed to the seller arises.

At this point, the seller's agent is to provide the utmost care and protection of the client's (the seller's) best interests.

open listing

An employment entered into by a broker to render real estate services on a best-efforts basis under which a fee is due to the broker if they achieve the client's objective of the employment before the client or another broker separately first meets the objective, such as the sale or locating of a property.

Having acted on the open listing having contact with a buyer, the agent needs to promptly inspect the property, if they have not already done so, and gather all the readily available information on the property under consideration. Further, the agent is to advise the seller on the nature of the information and any ramifications the transaction might have on them.

Once the seller's agent begins to *perform services* under an open listing, the agent has *acted on the employment*. The due diligence standards of duty owed to the seller then apply to the agent's future conduct with all parties involved.

Typically, the agent who produces a listing becomes the agent in the broker's office responsible for the care and maintenance of the **client's file**.

On entering into a listing, a **physical file** is created to store information and document all the activity which arises within the broker's office due to the existence of the listing. At minimum, the *physical file* on a property listing contains:

- the original listing agreement;
- any addenda to the listing agreement; and
- all the property disclosure documents the seller and seller's agent are to provide to prospective buyers seeking additional information on a property, and always before the seller accepts or counters a buyer's offer to purchase their property.

Further, the file needs an **activity sheet** for the entry of information on all manner of file activity. The *activity sheet* is evidence of the due diligence efforts rendered on behalf of the client. [See **RPI** Form 520]

Any paperwork, notes, messages, billings, correspondence, email printouts, fax transmissions, disclosure sheets, worksheets, advertising copy, copies of offers/counteroffers and rejections, and all other related documentation are kept in the physical file. Essentially, everything which occurs as a result of the client employment is placed and retained in the file.

The file is owned by the broker as it is the **broker's file**, not the file of the broker's agent. However, it will likely remain with the broker's agent until the close of a transaction or expiration of the listing. The agent then hands the broker the completed file on close of escrow or expiration of the listing. Delivery of the complete file is usually a *condition precedent* to payment of the agent's share of the fee received by the broker.

Guidelines used to build a file's content are available in many forms. These include:

- checklists prepared by a broker or their listing coordinator;
- a transaction coordinator's (TC's) closing checklist [See **RPI** Form 521];
- escrow worksheets [See **RPI** Form 403];
- work authorization forms;
- advance fee and advance cost checklists; and
- income property analysis forms. [See **RPI** *Income Property Brokerage (IPB)* Suite of Forms]

Checklists are contained in the physical file. They are reviewed periodically by the agent, office manager, TC or employing broker as mandated by oversight requirements for work to be done to better service the listing and earn a fee.

Maintaining the client file

physical file

A file to store all the information and documents regarding a transaction, such as agreements and disclosures.

activity sheet

A control sheet documenting all the activity within the broker's office due to the existence of a property listing or buyer listing to locate property. [See **RPI** Form 520]

Guidelines and checklists avoid missteps

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.

In a real estate transaction, brokers and their agents need to be certain who their client is. Likewise, agents need to determine who isn't their client, but is a **customer** with whom the broker is directly negotiating or who is represented by another broker. The seller's broker only owes a customer a **general duty** to deal fairly and honestly.

A seller's broker and their agents have a **special fiduciary agency duty** owed solely to the seller who has employed the broker. The *fiduciary agency duty* requires the broker or agent to diligently market the listed property for sale. The objective of this employment is to continually and conscientiously work to locate a prospective buyer who is ready, willing and able to acquire the property on the listed terms.

On locating a prospective buyer, either directly or through a buyer's agent, the seller's agent owes the prospective buyer a limited, non-client *general duty* to voluntarily provide information on the listed property, collectively called **disclosures**.

The information disclosed by the seller's agent need only be sufficient in content to place the buyer on notice of material facts which may have an adverse effect on the property's value or the buyer's use of it.

Advice and its consequences

Thus, the disclosure obligations of the seller's agent to voluntarily inform prospective buyers about the fundamentals of the listed property limit the seller's agent's ability to exploit the prospective buyer. 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 for determining its value;
- give *unfounded opinions or deceptive responses* in response to the buyer's inquiries; or
- stifle buyer inquiries about the property in the pursuit of the best financial advantage obtainable for the seller (or the seller's agent).

The pass-through of filtered information



The statutory duty a seller's agent owes to prospective buyers to disclose facts about the physical condition of a one-to-four unit residential property is limited to their:

- *prior knowledge* about the property; and
- observations made while conducting their *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 listing 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, called **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 are to, as a matter of law, be brought to the attention of prospective buyers.

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.

Facts: A residential property contains an empty swimming pool with a diving board in the backyard. A real estate agent who lists the property for sale inspects the property and has the pool inspected for any damage, but does not find any defects. The agent shows the property to a prospective buyer. The prospective buyer stands on the diving board, which collapses. The buyer falls into the pool and sustains serious injuries.

Claim: The prospective buyer seeks money losses from the agent's broker, claiming the broker is liable for the condition of the diving board since they listed the property for sale and did not ensure the safety of the diving board or disclose its defects.

Counter claim: The agent's broker claims they are not responsible for the state of the diving board since the real estate agent completed a thorough inspection of the property and found no defects with the diving board.

Holding: A California Court of Appeals holds the broker is not liable for the state of the diving board since they had no reason to believe there were any defects. [*Jacobs v. Coldwell Banker Residential Brokerage Company* (July 25, 2017) _CA4th_]

Editor's note — Here, the agent has fulfilled their statutory duty to disclose any facts about the physical condition observed during their mandatory visual inspection. The agent has no duty to further investigate features of a property to determine if defects exist which are not observable during inspection.

Case in point

**Jacobs v.
Coldwell Banker
Residential
Brokerage
Company**

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:

- 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;

The dumb agent rule for seller's agents

No duty to prospective buyers

Case in point

Does a seller's agent owe a duty to a buyer to confirm an earthquake fault hazard report is compliant with current earthquake investigation standards?

Facts: A seller's agent lists an undeveloped parcel of land on the multiple listing service (MLS). The listing states the parcel is located in an earthquake study zone. The listing also references a Fault Hazard Investigation report generated 25 years before by a licensed geologist declaring the parcel was suitable for development. A buyer submits an offer to purchase the property with the intent to develop the land for commercial use. While in escrow, the seller's agent gives the Fault Hazard Investigation report to the buyer. After closing, the buyer discovers the report is not in compliance with current earthquake investigation standards and the county prohibits development of the land.

Claim: The buyer seeks money losses from the seller's agent, claiming the seller's agent did not fulfill their general duty to the buyer to be honest and avoid deceitful conduct by making false claims in the listing since the seller's agent did not confirm the findings of the outdated report.

Counter claim: The seller's agent claims they did not breach their general duty to the buyer since they had no duty to further investigate the accuracy of the report as the listing correctly reflected what the report concluded, and displayed the date the report was published.

Holding: A California court of appeals holds the seller's agent did not breach their general duty of fair dealing with the buyer since the listing truthfully restated the information in the report and the seller's agent had no duty to further investigate the ongoing reliability of a report or confirm the report complies with current earthquake investigation standards. [*Saffie v. Schmeling* (2014) _CA4th_]

Editor's note — While the seller's agent owes a general duty to be truthful and timely disclose known facts about the condition of the property, the onus to confirm a property is suitable for the buyer's needs falls on the buyer's agent. It is the buyer's agent who owes the buyer a special fiduciary duty to care for and protect the buyer's best interest. The buyer's agent is therefore responsible for reviewing all natural hazard reports, investigating further and confirming the property meets the objectives of the buyer.

- 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 listing agent.

Further, 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.

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.

Distinguishing advice given by the buyer's agent

**Risk
Management
Chapter 3
Summary**

Diligent effort on the part of the seller's agent is broadly achieved by making a concerted and continuing effort to locate a buyer. An agent's failure to exercise due diligence gives the seller cause to terminate the agency relationship, voiding their obligation to pay a fee.

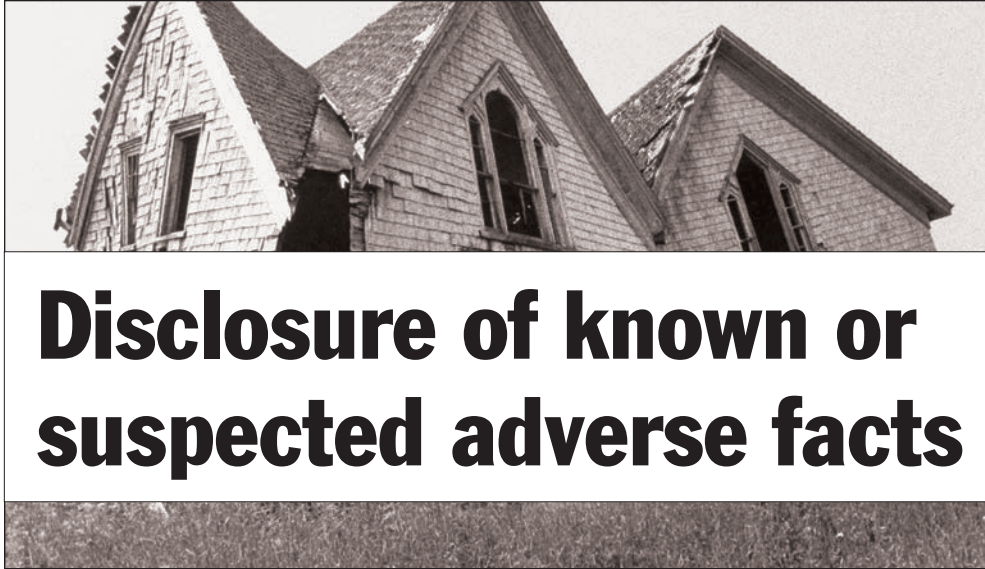
On entering into a listing, a physical file is set up to house information and document all the activity which arises due to the existence of the listing. Guidelines, checklists and activity sheets are used to build a file's content, and are kept in the file to be reviewed periodically by the agent, broker or office manager.

In a real estate transaction, brokers and agents only owe a general duty to deal fairly and honestly with the opposing party who is not their client. The seller's agent's limited general duty owed to a prospective buyer is to put the buyer or the buyer's agent on notice of facts which might, if known, adversely affect their valuation of the listed property.

The duty of the buyer's agent goes well beyond limited disclosure obligations owed the buyer and the buyer's agent by the seller's agent. A buyer's agent has an affirmative duty of care to protect their buyer.

**Risk
Management
Chapter 3
Key Terms**

activity sheet	pg. 283
due diligence	pg. 280
open listing	pg. 282
physical file	pg. 283



Disclosure of known or suspected adverse facts

Risk Management Chapter 4



 [Click to watch](#)

After reading this chapter, you will be able to:

- order a home inspection report (HIR) to assist in a risk free preparation of the mandatory Transfer Disclosure Statement (TDS);
- judiciously select a qualified, insured home inspector to prepare an HIR;
- confirm the accuracy and completeness of the seller's disclosures to a buyer; and
- understand when to disclose a death on the property to a buyer.

home inspection report (HIR)

Transfer Disclosure Statement (TDS)

Learning Objectives

Key Terms

A seller's broker or their agent, before marketing a one-to-four unit residential property for sale, are to:

- conduct a *visual inspection* of the property on behalf of the seller;¹ and
- *disclose their observations and knowledge* about the property on a **Transfer Disclosure Statement (TDS)** or other separate document to be handed to prospective buyers.²

When preparing the TDS, the seller's broker or their agent may rely on *specific items* in a **home inspection report (HIR)** to prepare their final TDS. Importantly, their reliance on an HIR prepared by a **home inspector** in preparation of the TDS relieves the seller and broker from liability for errors in their disclosures which are unknown to them to exist.

Selecting and hiring a home inspector

Transfer Disclosure Statement (TDS)

A mandatory disclosure prepared by a seller and given to prospective buyers setting forth any property defects known or suspected to exist by the seller, generically called a condition of property disclosure. [See RPI Form 304]

¹ Civil Code §2079

² CC §1102.1

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 TDS and assure prospective buyers about a property's condition.

However, to rely on the HIR, the seller and broker cannot be negligent in their selection of the *home inspector* who prepares the HIR. Thus, the seller's broker needs to exercise *ordinary care* when they or their agents select the home inspector.

The home inspector who holds a professional license or is registered with the state as a general contractor, architect, pest control operator or engineer is deemed to be qualified. If licensed or registered, their selection meets the ordinary care requirement, unless the broker or agent knows of information to the contrary.

When hiring a home inspector, the qualifications to look for include:

- *educational training* in home inspection related courses;
- *length of time* in the home inspection business or related property or building inspection employment;
- errors and omissions (E&O) insurance covering professional liability;
- professional and client references; and
- membership in the *California Real Estate Inspection Association*, the *American Society of Home Inspectors* or other nationally recognized professional home inspector associations with standards of practice and codes of ethics.

By hiring a home inspector to assist the seller and the seller's agent to accurately prepare the TDS and better represent the actual condition of the property to prospective buyers, the risk of error is reduced.

Use of an HIR by the seller's agent does not replace or relieve the agent (or their broker) of their duty to conduct the mandatory visual inspection of a listed one-to-four unit residence.³

The home inspector's malpractice insurance

Home inspectors occasionally fail to detect and report a material defect in their report which is relied on by the seller's broker, the seller, and the buyer. Often, the cost to correct the oversight is significant and the negligent home inspector is liable for that cost. However, unless the home inspector is insured, the buyer is at a disadvantage in any recovery effort against the home inspector.

Likewise, if the same defect was negligently missed by the seller's agent during the agent's mandatory visual inspection, the broker and the seller's agent are also liable to the buyer for the costs of curing the defect. However, the broker and seller's agent, though possibly negligent in their visual inspection, have an *indemnification claim* against the home inspector for payment of all or a portion of the buyer's loss.

³ CC §1102.4(a)

Unless the home inspector has insurance coverage, the ability of the seller's broker to force the home inspection company to pay the home inspector's share for failing to observe the same defect will be limited to the home inspector's personal assets.⁴

A seller and their agent need to disclose to a prospective buyer all **known and observable** property conditions which adversely affect the value of the property.

A TDS completed by the seller and their agent, without the benefit of an HIR, too often does not fully reveal the significant property defects or code violations which exist, whether known or unknown to the seller or agent.

When the seller does not authorize the preparation of an HIR at the time of the listing, or at least prior to their entering into a purchase agreement, the prudent buyer always needs to order out an HIR — a concern of the buyer's agent. Further, when the seller's agent does not provide an HIR with the TDS, the buyer or the buyer's agent needs to order the preparation of an HIR to independently confirm the condition of the property.

An inspection undertaken by a buyer avoids:

- post-closing discoveries of defects which require correction; and
- post-closing claims made by the buyer against the seller to recover the value lost or the costs incurred to correct the defects.

The buyer's discovery of defects after acceptance of the purchase agreement and prior to closing, whether by the buyer's investigation or by the seller's tardy disclosure, does not alter the buyer's rights if the buyer proceeds to close escrow. Thus, the buyer may acquire the property and pursue the seller and seller's broker to recover costs to cure the defects or the loss of value in the price paid for the property.

Armed with an HIR containing findings of material defects not known to the buyer or disclosed at the time the purchase agreement was accepted, the buyer can then make the necessary demands for corrections on the seller. Thus, the buyer ensures the property will be delivered in the condition *as disclosed* by the seller and made known to the buyer at the moment of entering into the purchase agreement, whether a TDS was received prior to or after acceptance of the buyer's offer.

The duty of each agent in a transaction to disclose facts which may adversely affect the property's value is not limited to disclosures of the property's physical condition.

Consider a buyer who enters into a purchase agreement. The offer includes the seller's TDS disclosures about the condition of the property and environmental hazards surrounding the property. However, the buyer is unaware multiple murders occurred on the property.

Confirm the seller's disclosures

Deaths affecting market value

⁴ Leko v. Cornerstone Building Inspection Service (2001) 86 CA4th 1109

The seller's 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 agreed to pay. The seller's agent does not disclose the murders.

The transaction closes and the buyer later learns of the murders on the property. The buyer seeks to collect their price-to-value money loss from the seller's agent, claiming the agent had a duty to disclose deaths since, due to the stigma of the deaths, the property's market value was *measurably lower* than the purchase price paid by the buyer.

Did the agent have an affirmative duty to disclose the deaths?

Yes! Even though the deaths did not affect the physical condition of the property, the deaths had an adverse effect on the property's market value. The deaths are a **material fact** affecting value and were known to the agent and not disclosed. Every agent has an affirmative duty to disclose prior deaths when the death might affect the buyer's valuation or desire to own the property.⁵

Further, on direct inquiry by the buyer or the buyer's agent, the seller's agent needs to disclose their knowledge about whether deaths have occurred on the real estate, no matter when they occurred.⁶ [See *Ethics* Chapter 12]

The broker's unlawful "as-is" sale



Click to watch

Consider a seller's agent who, on conducting their visual inspection, senses the property fails to conform to building and zoning regulations.

A buyer submits a purchase agreement offer. The seller's agent knows the prospective buyer is unaware of the possible violations, and might view the property's value differently if they learn of the conditions. The seller's agent prepares a counteroffer, inserting an "as-is" disclaimer provision. The disclaimer states the agent "makes no representations regarding the property and incurs no liability for any defects, the buyer agreeing to purchase the property 'as is.'" The counteroffer is accepted.

After closing, the city refuses to provide utility services to the residence due to building code and zoning violations.

The buyer makes a demand on the seller's agent for the buyer's money losses due to the cost of corrective permits and repairs. The buyer claims the seller's agent breached their *general agency duties* owed the buyer by failing to disclose material defects known by the seller's agent.

The broker claims the buyer waived their right to collect money losses when they signed the purchase agreement with the "as-is" disclaimer.

Does use of an "as-is" provision shield a seller's broker from liability?

No! The seller's broker and agent have a **general duty** to personally conduct a competent visual inspection of the property sold. Based on that level of expertise for their inspection, they are to disclose *all known and observable*

⁵ *Reed v. King* (1983) 145 CA3d 261

⁶ CC §1710.2(d)

property conditions which adversely affect the value and desirability of the property for the use intended. The failure to disclose is not excused by writing an “as-is” disclaimer provision into the purchase agreement in lieu of factual disclosures.⁷

“As is” provisions become an unnecessary distraction for an explanation of the property’s condition when information regarding defects is included in the seller’s TDS and handed to the buyer. The seller and the seller’s agent simply disclose the defects, whether or not the seller agrees to make repairs. [See *Ethics* Chapter 3]

⁷ *Katz v. Department of Real Estate* (1979) 96 CA3d 895

Seller’s brokers and agents need to conduct a visual inspection of a property for conditions that adversely affect the property’s value or use. In turn, their observations and any prior knowledge they have of property defects are entered on the Transfer Disclosure Statement (TDS) initially prepared and signed by the seller.

After the seller’s agent completes their visual inspection of the listed property, they may use a home inspection report (HIR) to assist in preparing their entries on the seller’s TDS. If used to prepare the TDS, an HIR completed by a qualified home inspector relieves the seller’s broker and their agents from liability for unreported defects that were unknown to them to exist.

Any agent ordering a HIR is to verify the home inspection company has professional liability insurance coverage before hiring the company to conduct an investigation and prepare a report.

A seller’s agent needs to also disclose any knowledge about deaths on the property on a direct inquiry from a buyer about the matter. Further, if the deaths adversely affect the property’s value and are, thus, a material fact, the agent is to voluntarily disclose the circumstances of the deaths.

home inspection report (HIR) pg. 292
Transfer Disclosure Statement (TDS) pg. 291

Risk Management Chapter 4 Summary

Risk Management Chapter 4 Key Terms



FIRST TUESDAY

Your real estate CE has gone Hollywood

Binge-watch our **Video Renewal Course™** and
complete your education in as little as 6 days
(popcorn optional)

[Enroll now](#)



A seller's residence in foreclosure

After reading this chapter, you will be able to:

- identify an equity purchase (EP) transaction;
- comply with the statutory procedures for equity purchase transactions;
- provide a seller-in-foreclosure with notice of their right to cancel an equity purchase transaction;
- recognize the disadvantages of accepting an exclusive listing on a property in foreclosure; and
- avoid circumstances which allow a seller-in-foreclosure to claim an investor created an unconscionable advantage in an equity purchase and to rescind the sale.

equitable indemnity

equity purchase (EP)

equity purchase (EP)

investor

right of rescission

unconscionable advantage

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.

Editor's note – Alternatively, an EP transaction does not occur and the EP rules do not apply if the buyer acquires the property for use as their personal residence.

Risk Management Chapter 5

Learning Objectives

Key Terms

The equity purchase investor scheme

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 a seller-occupied, one-to-four unit residential property in foreclosure for dealer, investment or security purposes.

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.¹

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.² [See Figure 1, **RPI** Form 156]

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.³

*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 Figure 1, **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. If 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*, if it is to occur first.⁴

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.⁵

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

¹ *Segura v. McBride* (1992) 5 CA4th 1028

² Calif. Civil Code §§1695.2, 1695.3, 1695.5

³ *Segura, supra*

⁴ CC §1695.4(a)

⁵ CC §1695.4(b)

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.⁶

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.⁷

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.⁸

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.⁹

Prohibited activities until expiration of right to cancel

⁶ CC §1695.1(d)

⁷ CC §1695.6(b)

⁸ CC §1695.4(b)

⁹ 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.¹⁰

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.¹¹

If 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.¹²

equitable indemnity

When one party takes on the obligation to pay for a loss incurred by another party.

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.¹³

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

¹⁰ CC §1695.6(d)

¹¹ CC §1695.17(a)

¹² CC §1695.17(b)

¹³ **San Francisco Examiner Division, Hearst Publishing Company v. Sweat** (1967) 248 CA2d 493

Figure 1

Form 156

Equity Purchase Agreement

EQUITY PURCHASE AGREEMENT

Prepared by: Agent _____ Broker _____ Phone _____ Email _____

NOTE: This form is used by a buyer's agent when an absentee-owner/investor will purchase an owner-occupied one-to-four unit residential property in foreclosure, to prepare an offer containing all the terms, conditions and disclosures required of an equity purchase transaction.

DATE: _____ at _____, California.

Items left blank or unchecked are not applicable.

FACTS:

- Received from _____ as the Buyer(s),
 - The sum of \$ _____ evidenced by _____ personal check, or _____ for deposit only on acceptance of this offer, payable to _____
 - deposit to be applied toward Buyer's obligations under this agreement to purchase property situated in the City of _____, County of _____, California,
 - referred to as "the property."
- including personal property, see attached Personal Property Inventory. [See RPI Form 246]
- The interest acquired will be fee simple, unless leasehold or _____
- This agreement is comprised of this six-page form and _____ pages of addenda/attachments.

TERMS: Buyer to pay the purchase price as follows:

- Cash payment through escrow, including deposits, in the amount of \$ _____
- Buyer to obtain a first, or second, trust deed loan in the amount of \$ _____ payable approximately \$ _____ monthly for a period of _____ years. Interest on closing not to exceed _____% ARM.
- Take title subject to, or Assume, an existing first trust deed note held by _____ with an approximate unpaid principal balance of \$ _____, payable \$ _____ monthly, including interest not exceeding _____% ARM, plus a monthly tax/insurance impound payment of \$ _____
- The unpaid amount includes delinquent payments, late charges and foreclosure costs to be the responsibility of Buyer in the amount of \$ _____ including unpaid delinquent monthly payments, beginning with payment due _____
- The impound account to be transferred without charge.
- Take title subject to, or assume, an existing second trust deed note held by _____ with an approximate unpaid principal balance of \$ _____, payable \$ _____ monthly, including interest not exceeding _____% ARM, due _____
- The unpaid amount includes delinquent payments, late charges and foreclosure costs to be the responsibility of Buyer in the amount of \$ _____ including unpaid delinquent monthly payments beginning with the payment due _____

- At closing, loan balance differences from those stated above as disclosed by beneficiary statements) to be adjusted into the purchase price unless the balances exceed the amount stated, in which case the difference is to be adjusted into cash payment.
- Assume an improvement bond lien with an unpaid principal balance of \$ _____
- Assume a solar bond lien with an unpaid principal balance of \$ _____
- Note for the balance of the purchase price in the amount of \$ _____ to be executed by Buyer in favor of Seller and secured by a trust deed on the property junior to any above referenced financing, payable \$ _____ monthly, or more, beginning one month after closing, including interest at _____% per annum from closing, due _____ after closing.
- This note and trust deed will not contain provisions for due-on-sale, prepayment penalty or late charges.
- Financial Disclosure Statement is attached as an addendum. [See RPI Form 300]

11. Total Purchase Price is \$ _____ 0.00

----- PAGE 2 OF 6 - FORM 156 -----

12. Acceptance and performance:

- This offer to be deemed revoked unless accepted in writing _____ presentation, or _____ within _____ days after date, and acceptance is personally delivered or faxed to Offeror or Offeror's Broker within this period.
- After acceptance, Broker(s) are authorized to extend any performance date up to one month.
- On the inability of Buyer to obtain or assume financing as agreed by the date scheduled for closing, Buyer may terminate the agreement.
- Buyer's close of escrow is conditioned on Buyer's prior or concurrent closing on a sale of other property, commonly referred to as _____
- Any termination of the agreement will be by written Notice of Cancellation timely delivered to the other party, the other party's Broker or escrow, with instructions to escrow to return all instruments and funds to the parties depositing them. [See RPI Form 183]
- Both parties reserve their rights to assign and agree to cooperate in effecting an Internal Revenue Code §1031 exchange prior to close of escrow on either party's written notice. [See RPI Form 171 or 172.2]
- Before any party to this agreement files an action on a dispute arising out of this agreement which remains unresolved after 30 days of informal negotiations, the parties agree to enter into non-binding mediation administered by a neutral dispute resolution organization and undertake a good faith effort during mediation to settle the dispute.
- If Buyer breaches the agreement, Buyer's monetary liability to Seller is limited to \$ _____

13. Property conditions:

- Seller to furnish prior to closing:
 - a structural pest control inspection report and certification of clearance of corrective conditions,
 - a home inspection report prepared by an insured home inspector showing the land and improvements to be free of material defects.
 - a one-year home warranty policy: _____
 - Insurer: _____
 - Coverage: _____
 - a certificate of occupancy, or other clearance or retrofitting, required by local ordinance for the transfer of possession or title.
 - a certification by a licensed contractor stating the sewage disposal system is functioning properly, and if it contains a septic tank, it is not in need of pumping.
 - a certification by a licensed water testing lab stating the well supplying the property meets potable water standards.
 - a certification by a licensed well-drilling contractor stating the well supplying the property produces a minimum of _____ gallon(s) per minute.
 - Energy Audit Report stating the rating for the property's improvements is no greater than _____

13.2 Seller's Condition of Property Disclosure—Transfer Disclosure Statement (TDS) [See RPI Form 304]

- is attached; or
- is to be handed to Buyer on acceptance for Buyer's review. Within ten days after receipt, Buyer may either cancel the transaction based on a reasonable disapproval of the disclosure or deliver to Seller or Seller's Broker a written notice itemizing any material defects in the property disclosed by the statement and unknown to Buyer prior to acceptance. [See RPI Form 269] Seller to repair, replace or correct noticed defects prior to closing.
- On Seller's failure to repair, replace or correct noticed defects under §12.2b or §12.4a, Buyer may tender the purchase price reduced by the cost to repair, replace or correct the noticed defects, or close escrow and pursue available remedies. [See RPI Form 183]

13.3 Seller's Transfer Fee Disclosure Statement [See RPI Form 304-2]

- is attached; or
- is to be handed to Buyer on acceptance for Buyer's review. Within ten days after receipt, Buyer may terminate this agreement based on a reasonable disapproval of the Transfer Fee Disclosure.
- Seller to pay any transfer fees arising out of the transaction.

13.4 Buyer inspect the property before closing:

- an initial property inspection is required on acceptance to confirm the property's condition is substantially the same as observed by Buyer and represented by Seller or Seller's Agents, prior to acceptance, and if not substantially the same, Buyer to promptly notify Seller in writing of undisclosed material defects discovered. [See RPI Form 268] Seller to repair, replace or correct noticed defects prior to closing; and

----- PAGE 3 OF 6 - FORM 156 -----

13.5 Seller's Natural Hazard Disclosure (NHD) Statement [See RPI Form 314] is attached, or is to be handed to Buyer on acceptance for Buyer's review. Within ten days of Buyer's post-acceptance receipt of the NHD, Buyer may terminate the agreement based on a reasonable disapproval of hazards disclosed by the Statement and unknown to Buyer prior to acceptance. [See RPI Forms 182 and 183]

13.6 Buyer acknowledges receipt of a booklet and related seller disclosures containing Environmental Hazards: A Guide for Homeowners, Buyers, Landlords and Tenants (on all one-to-four units) [See RPI Form 316-1]. Protect Your Family From Lead in Your Home (on all pre-1978 one-to-four units) [See RPI Form 315], and The Homeowner's Guide to Earthquake Safety (on all pre-1960 one-to-four units). [See RPI Form 315]

13.7 The property is located in: _____ an industrial use area, a military ordnance area, a rent control area, airport, farmland, San Francisco Bay or mining operation area, see attached Notice Addendum [See RPI Form 306] or _____

13.8 On acceptance, Seller to hand Buyer the following property information for Buyer's review: Property Expense Report [See RPI Form 305].

- Within ten days of receipt, Buyer may terminate the agreement based on a reasonable disapproval of the property information received.

13.9 The property is located in a Homeowners' Association (HOA) community. The Homeowners' Association (HOA) Addendum [See RPI Form 309]:

- is attached; or
- is to be handed to Buyer on acceptance for Buyer's review.

13.10 A solar equipment lease lien exists on the property for the solar equipment located on the property payable \$ _____ monthly, expiring _____

- On acceptance, Seller to hand Buyer all documentation concerning the solar bond lien on the property and solar equipment lease. Within ten days after receipt, Buyer may terminate the agreement based on Buyer's reasonable disapproval of the documents. [See RPI Form 182]
- Solar equipment lease to be assumed by Buyer and prorated to close of escrow.

13.11 Seller's Neighborhood Security Disclosure [See RPI Form 321]

- is attached; or
- is to be handed to Buyer on acceptance for Buyer's review. Within ten days after receipt, Buyer may terminate this agreement based on a reasonable disapproval of the Criminal Activity and Security Disclosure Statement.

13.12 Complying smoke detector(s) and water heater bracing exist, and if not, Seller to install.

13.13 If this property or an adjoining property contains a solar collector authorized by the Solar Shade Control Act (California Public Resources Code §25880 et seq.) and notice of its existence has been sent or received by Seller, then on acceptance, Seller to hand Buyer copies of the notices sent or received by Seller or provided to Seller by prior Owners of the property for Buyer's review. Buyer may, within ten days after receipt, terminate this agreement based on a reasonable disapproval of the conditions disclosed by the solar shade control notices.

13.14 Possession of the property and keys/access codes to be delivered: _____ on close of escrow, or _____ as stated in the attached Occupancy Agreement. [See RPI Forms 271 and 272]

13.15 Seller to maintain the property in good condition until possession is delivered.

13.16 Fixtures and fittings attached to the property include but are not limited to: window shades, blinds, light fixtures, plumbing fixtures, curtain rods, wall-to-wall carpeting, draperies, hardware, antennas, air conditioners and conditioners, trees, shrubs, mailboxes and other similar items.

13.17 Notice: Pursuant to Section 290.46 of the Penal Code, information about specified registered sex offenders is made available to the public via an Internet Web site maintained by the Department of Justice at www.megastaw.ca.gov. Depending on an offender's criminal history, this information will include either the address at which the offender resides or the community of residence and ZIP code in which he or she resides.

14. CLOSING CONDITIONS:

- This transaction to be escrowed with _____ Parties to deliver instructions to escrow as soon as reasonably possible after acceptance.

----- PAGE 4 OF 6 - FORM 156 -----

14.2 Escrow holder is authorized and intended to act on the provisions of this agreement as the mutual escrow instructions of the parties and to draft any additional instructions necessary to close this transaction. [See RPI Form 401]

14.3 Escrow instructions, prepared and signed by the parties, are attached to be handed to escrow on acceptance. [See RPI Form 401]

14.4 Escrow to be closed on or before _____, 20____, or within _____ days after acceptance. Parties to hand escrow all documents required by the title insurer, lenders or other third parties to this transaction prior to close of escrow on or before _____

- Each party to pay its customary Escrow charges. [See RPI Forms 310 and 311]
- The amount of any taxes, liens, bonds, assessments or other encumbrances on the property not referenced as, at Buyer's option, to remain of record and be deducted first from the cash payment and then from any carryback note.
- Buyer's title to be subject to covenants, conditions, restrictions, reservations and easements of record.

14.5 Title to be vested in Buyer or Assignee free of encumbrances other than those set forth herein Buyer's interest in title to be insured under a policy issued by _____ title company on a(n) _____ (Homeowner's) policy (one-to-four units), _____ Residential ALTA-R policy (vacant or improved residential parcel), _____ Owner's policy (other than one-to-four units), _____ CLTA Joint Protection policy (also naming Carryback Seller or purchase-assist lender), or _____ Blinder (to insure resale or refinancing within two years).

- Endorsements
- Seller, or Buyer, to pay the title insurance premium.

14.6 Buyer to furnish a new fire insurance policy covering the property.

14.7 Taxes, assessments, insurance premiums, rents, interest and other expenses to be prorated to close of escrow, unless otherwise provided.

14.8 Bill of Sale to be executed for any personal property being transferred. [See RPI Form 408]

14.9 If Seller is unable to convey marketable title as agreed, or if the improvements on the property are materially damaged prior to closing, Buyer may terminate the agreement. Seller to pay all reasonable escrow cancellation charges. [See RPI Form 183]

15. Buyer's Broker and sales agent hereby confirms under penalty of perjury that:

- they hold a valid, current Department of Real Estate (DRE) license; and
- they have provided proof of the license to the seller-in-foreclosure by attaching:
 - a copy of their license as issued by the DRE; or
 - a printout of the DRE's Current License Status for the licensee.

16. FURTHER CONDITIONS:

17. NOTICE OF YOUR SUPPLEMENTAL PROPERTY TAX BILL: California property tax law requires the Assessor to revalue real property at the time the ownership of the property changes. Because of this law, you may receive one or two supplemental tax bills, depending on when your loan closes. The supplemental tax bills are not mailed to your lender. If you have arranged for your property tax payments to be paid through an impound account, the supplemental tax bills will not be paid by your lender. It is your responsibility to pay these supplemental bills directly to the Tax Collector.

If you have any questions concerning this matter, please call your local Tax Collector's Office.

18. NOTICE REGARDING GAS AND HAZARDOUS LIQUID PIPELINES: This notice is being provided simply to inform you that information about the general location of gas and hazardous liquid transmission pipelines is available to the public via the National Pipeline Mapping System (NPMS) Internet Web site maintained by the United States Department of Transportation at <http://www.npms.dot.gov>. To seek further information about possible transmission pipelines near the property, you may contact your local gas utility or other pipeline operators in the area. Contact information for pipeline operators is searchable by ZIP Code and county on the NPMS Internet Web site.

19. BROKERAGE FEES:

- Parties to pay the below mentioned Broker(s) a fee now due of \$ _____ or _____% of the purchase price as follows:
 - Seller to pay the brokerage fee on the change of ownership.
 - The party wrongfully preventing this change of ownership to pay the brokerage fee.

----- PAGE 5 OF 6 - FORM 156 -----

EP investor, is a buyer who coincidentally 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, if 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.¹⁴

¹⁴ Calif. Business and Professions Code §§10176(d), 10176(g), 10176(h)

Figure 1
Form 156
Equity Purchase
Agreement
(cont.)

19.2 Buyer's Broker and Seller's Broker, respectively, to share the brokerage fee or as specified in the attached Fee Sharing Agreement. (See RPI Form 105)

19.3 Attached is the Agency Law Disclosure. (See RPI Form 305)

19.4 Broker is authorized to report the sale, its price and terms for dissemination and use of participants in brokerage trade associations or listing services.

20. CANCELLATION PERIOD:

20.1 Seller has the below noticed right to cancel this agreement until midnight of the fifth business day following the day Seller signs this agreement, or until 8 a.m. on the day scheduled for a trustee's foreclosure sale of the property, whichever occurs first.

NOTICE REQUIRED BY CALIFORNIA LAW:

Until your right to cancel this contract has ended, _____ (Buyer)
or anyone working for _____ (Buyer)

CANNOT ask you to sign or have you sign any deed or any other document. You may cancel this contract for the sale of your house, without any penalty or obligation at any time before _____, _____, 20____.

See attached Notice of Cancellation form for an explanation of this right.
(To be filled out by Buyer)

Seller's Broker: _____	Buyer's Broker: _____
Broker's DRE #: _____	Broker's DRE #: _____
is the broker for: Seller _____	is the broker for: Buyer _____
both Buyer and Seller (dual agent)	both Buyer and Seller (dual agent)
Seller's Agent: _____	Buyer's Agent: _____
Agent's DRE #: _____	Agent's DRE #: _____
is Seller's agent (salesperson or broker-associate)	is Buyer's agent (salesperson or broker-associate)
both Buyer's and Seller's agent (dual agent)	both Buyer's and Seller's agent (dual agent)
Signature: _____	Signature: _____
Address: _____	Address: _____
Phone: _____ Cell: _____	Phone: _____ Cell: _____
Email: _____	Email: _____
I agree to the terms stated above. See attached Signature Page Addendum. (RPI Form 251)	I agree to the terms stated above. See attached Signature Page Addendum. (RPI Form 251)
Date: _____, 20____	Date: _____, 20____
Buyer: _____	Seller: _____
Signature: _____	Signature: _____
Buyer: _____	Seller: _____
Signature: _____	Signature: _____

----- PAGE 5 OF 6 ----- FORM 156 -----

----- PAGE 5 OF 6 ----- FORM 156 -----

----- NOTICE OF CANCELLATION -----
(To be filled out by Buyer)

Seller signed the Equity Purchase Agreement on _____, 20____.

You may cancel this contract for the sale of your house, without any penalty or obligation, at any time before _____, _____, 20____.

To cancel this transaction, personally deliver a signed and dated copy of this cancellation notice, or send a telegram to _____ (Buyer) at _____ (Business Address)

NOT LATER THAN _____, _____, 20____.

I hereby cancel this transaction.
Date: _____, 20____

Seller's Signature: _____

Seller's Signature: _____

----- NOTICE OF CANCELLATION -----
(To be filled out by Buyer)

Seller signed the Equity Purchase Agreement on _____, 20____.

You may cancel this contract for the sale of your house, without any penalty or obligation, at any time before _____, _____, 20____.

To cancel this transaction, personally deliver a signed and dated copy of this cancellation notice, or send a telegram to _____ (Buyer) at _____ (Business Address)

NOT LATER THAN _____, _____, 20____.

I hereby cancel this transaction.
Date: _____, 20____

Seller's Signature: _____

Seller's Signature: _____

FORM 156 01-19 ©2019 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517

For a full-size, fillable copy of this or any other form in this book that may be legally used in your professional practice, go to realtypublications.com/forms

Representing a seller who is insolvent

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 if 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.¹⁵

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.

¹⁵ CC §§2924(c)(e), 2903

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.

If 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.

A two-year **right of rescission** period allows a seller-in-foreclosure to recover their residence if there is evidence the EP investor took **unconscionable advantage** of them when negotiating the purchase of the property.

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?

Difficult to close

Two-year right of rescission

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.

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.

No! The EP investor's title remains subject to the seller-in-foreclosure's *right of rescission* for two years after closing. If 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**.¹⁶

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 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.

If 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.¹⁷

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**.

¹⁶ CC §1695.14

¹⁷ *Colton v. Stanford* (1890) 82 C 351

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.

An **unconscionable advantage** occurs if 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.¹⁸

**Un-American
activity
coupled with
a low price**

¹⁸ *Carboni v. Arrospide* (1991) 2 CA4th 76

**Risk
Management
Chapter 5
Summary**

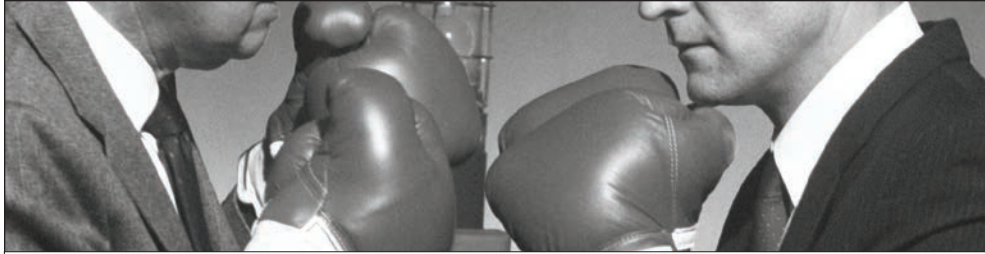
An equity purchase (EP) transaction occurs when an owner-occupied, one-to-four unit residential property is acquired for rental, investment or dealer purposes by an EP investor. EP investors and their agents are subject to harsh penalties if they fail to adhere to all the regulations governing equity purchase transactions.

A seller-in-foreclosure is granted a statutory five-business-day right to cancel an equity purchase agreement, with or without reason. The seller also has a two-year right of rescission after closing the sale to recover their residence if they can demonstrate the EP investor took unconscionable advantage of them when negotiating the purchase of the property. An unconscionable advantage occurs if the EP investor exploits an element of oppression or surprise and exacts an unreasonably low and favorable purchase price or terms of payment.

A broker representing an EP investor is to deliver to all the parties to the EP transaction a written EP disclosure statement confirming they are a licensed real estate broker, along with proof that their license is current and valid in the State of California. If the broker or agent themselves are the EP investor, use of the agency law disclosure and proof licensure are eliminated.

**Risk
Management
Chapter 5
Key Terms**

equitable indemnity	pg. 300
equity purchase (EP)	pg. 297
equity purchase (EP) investor	pg. 298
right of rescission	pg. 303
unconscionable advantage	pg. 303



Cancellation, release and waiver

Risk Management Chapter 6

After reading this chapter, you will be able to:

- identify the types of disputes that may arise at various stages of a real estate transaction;
- judiciously handle disputes arising between agents, buyers and sellers; and
- provide for and properly document the cancellation of employment and purchase agreements and the release and waiver of liabilities.

agency disputes
principal disputes

unknown and unsuspected claims

Learning Objectives

Key Terms

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 party 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.

Known and unknown claims

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

Disputes between an agent and their client which arise during the marketing period, in escrow or after closing.

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.

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.

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.

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.

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,

Terminating the agency

Escrow period disputes

principal disputes
Disputes between a buyer and seller.

Form 181

Cancellation of Agreement

CANCELLATION OF AGREEMENT Release and Waiver of Rights with Distribution of Funds in Escrow	
NOTE: This form is used by an agent when cancelling escrow, to release the buyer, seller, and their agents from all claims and obligations arising out of the cancelled purchase or exchange agreement.	
DATE: _____, 20____, at _____, California. <i>Items left blank or unchecked are not applicable.</i>	
FACTS:	
1. This mutual cancellation and release agreement with waiver of rights pertains to the following agreement: <input type="checkbox"/> Purchase agreement <input type="checkbox"/> Exchange agreement <input type="checkbox"/> _____	
1.1 dated _____, 20____, at _____, California, 1.2 entered into by _____, as the Buyer, and _____, as the Seller,	
1.3 whose real estate brokers (agents) are Buyer's Broker _____ Seller's Broker _____	
a. If an exchange is involved, the first and second parties to the exchange are here identified as Buyer and Seller, respectively.	
1.4 regarding real estate referred to as _____	
1.5 Escrow Agent _____ Escrow Number _____	
AGREEMENT:	
2. Buyer and Seller hereby cancel and release each other and their agents from all claims and obligations, known or unknown, arising out of the above referenced agreement.	
3. The real estate broker(s) and escrow agent(s) are hereby instructed to return all instruments and funds to the parties depositing them.	
4. Costs and fees to be disbursed and charged to <input type="checkbox"/> Seller, or <input type="checkbox"/> Buyer.	
4.1 \$ _____ to _____ 4.2 \$ _____ to _____ 4.3 _____ _____ _____ _____	
5. The parties hereby waive any rights provided by Section 1542 of the California Civil Code, which provides: "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor."	
I agree to the terms stated above. <input type="checkbox"/> See attached Signature Page Addendum. [RPI Form 251] Date: _____, 20____ Buyer's Name: _____ Signature: _____ Buyer's Name: _____ Signature: _____	I agree to the terms stated above. <input type="checkbox"/> See attached Signature Page Addendum. [RPI Form 251] Date: _____, 20____ Seller's Name: _____ Signature: _____ Seller's Name: _____ Signature: _____
FORM 181 03-11 ©2016 RPI — Realty Publications, Inc., P.O. BOX 5707, RIVERSIDE, CA 92517	

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 Form 181 accompanying this chapter]

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.

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 *annoyance 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.

As mortgage rates rise, the value and pricing complaint will be heard more often than it was during the declining rate years of 1980 through 2013. This thirty-year prior run was reversed by *zero lower-bound interest rates*, rates that can only go up for a few decades to come.

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]

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

Post-closing disputes

The documentation

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.¹

unknown and unsuspected claims
Claims unknown to the parties which are later established and pursued after entering into a general release.

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.²

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.³

¹ Calif. Civil Code §1542
² CC §1542
³ CC §1541

**Risk
Management
Chapter 6
Summary**

Disputes with a client or another party occasionally arise in real estate transactions. Agency disputes may arise during the marketing period, escrow period and post-closing period. These disputes may become significant enough that an agent's best option is to terminate the agency relationship. To do this, a release and waiver needs to be entered into by all parties concerned as part of the cancellation agreement.

A mutual cancellation agreement terminates any further activity under the existing agreement or agency relationship. A release agreement, signed by all parties to a transaction as part of a cancellation agreement, retroactively extinguishes all known claims and ends all possible liabilities in disputes the parties have between themselves.

**Risk
Management
Chapter 6
Key Terms**

agency disputes pg. 308
principal disputes pg. 309
unknown and unsuspected claims pg. 312

Glossary

A

- activity sheet**283
A control sheet documenting all the activity within the broker's office due to the existence of a property listing or buyer listing to locate property. [See **RPI** Form 520]
- advance cost sheet**199
An itemization of the costs incurred to properly market a property for sale which are to be paid by the owner. [See **RPI** Form 107]
- advance costs** 255
Deposits handed to a broker to cover out-of-pocket costs incurred on behalf of the depositor while performing brokerage services.
- advance fee** 196, 254
Broker fees deposited with the broker before they are earned.
- affiliated business arrangement (ABA)** 228
A business arrangement in which a broker may lawfully profit from referring a client to a service provider the broker owns; requires the broker to make a disclosure of their ownership interest to the client. [See **RPI** Form 205 and 519]
- affirmative fraud** 122
Intentionally and knowingly misrepresenting information to someone.
- agency confirmation provision**86, 95
A provision in all purchase agreements and counteroffers disclosing the agency of each broker in the transaction.
- agency disputes** 308
Disputes between an agent and their client which arise during the marketing period, in escrow or after closing.
- Agency Law Disclosure**86
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. [See **RPI** Forms 305, 305-1 and 550-2]
- agent**81
One who is authorized to represent another, such as a broker and client or sales agent and their broker.
- aggrieved person** 131
Any person who claims to have been injured by a discriminatory housing practice.
- Americans with Disabilities Act (ADA)** 139
Federal regulations prohibiting an employer from discriminating against a qualified person based on a disability.
- Annual Property Operating Data sheet (APOD)** 245
A worksheet used when gathering income and expenses on the operation of an income producing property, to analyze its suitability for investment. [See **RPI** Form 352]
- "as-is" clause**240
An unenforceable provision stating the buyer accepts the property without a full disclosure of known conditions. Properties are sold "as-disclosed," never "as-is."
- associate licensee**96
A sales agent employed by a broker.

B

- blockbusting** 130, 160
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.
- broker-associate** 40
A California Department of Real Estate (DRE)-licensed broker who works in the employment of another DRE broker.
- business model** 4, 15, 275
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.
- buyer's agent** 87
An agent representing the buyer. Also known as a selling agent. [See **RPI** Form 103]

C

- California Department of Real Estate (DRE)** 82
A government agency which oversees, regulates, administers and enforces California real estate law as practiced by licensees.
- Civil Rights Act** 51
A federal law which provides broad protections to numerous classes of individuals in the United States against discriminatory activity.
- The Civil Rights Acts of 1866 and 1870** 135
Federal prohibitions against racial discrimination on all types of real estate.
- classified risk** 270
Improper activity or activity leading to a lack of proper performance which may impose liability for losses the activity may cause to others.
- clients** 2
Members of the public who retain brokers and agents to perform real estate related services.
- client file** 36
A physical file established at the beginning of a listing to house information and document all the activity which arises within the broker's office due to the existence of the employment.
- commercial facility** 141
Property owned, leased or operated by a private entity whose operation affects commerce.
- commingling** 45, 207
The mixing of personal funds with client or third-party funds held in trust.
- conflict of interest** 103, 227
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. [See **RPI** Form 527]
- conversion** 189
The unlawful appropriation of another's property, as in the conversion of trust funds.
- counteroffer** 236
An alternative response to an offer received consisting of terms different from those of the offer rejected. [See **RPI** Form 180]

credit reporting agency 167
A private agency which collects and reports information regarding an individual's credit history.

D

debt-to-income (DTI) ratio 177
The percentage of monthly gross income that goes towards paying non-mortgage debt.

defacing 235
When a document is modified on its face, usually by striking copy and interlineation, after it is signed by one or both parties.

Department of Fair Employment and Housing 156
The state agency designated to protect Californians from discrimination in housing, employment and public accommodation.

designated officer 73
The individual who is the licensed officer qualifying a corporation for a corporate broker license. [See **RPI** Form 511]

disabled person 151
Anyone who has a physical or mental impairment which significantly limits major life activities, has a record of disability, or is regarded as being disabled.

discriminatory practices 159
Unequal treatment given to members of a protected class of individuals.

double-end 100
When the seller's agent receives the entire fee in the real estate transaction, there being no buyer's agent for fee splitting.

dual agency 103, 230
The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction. [See **RPI** Form 117]

dual agent 97
A broker who represents both parties in a real estate transaction. [See **RPI** Form 117]

due diligence 280
The concerted and continuing efforts of an agent employed to meet the objectives of their client, the agent's promise given in exchange for the client's promise to pay a fee.

dwelling 179
A building or personal property occupied or designed to be occupied as a residence by one or more families.

E

embezzlement 202, 225
The dishonest act of converting a client's assets for personal use.

eminent domain 244
The right of the government to take private property for public use. The government pays the owner the fair market value of the property taken.

Equal Credit Opportunity Act (ECOA) 163
A federal law which prohibits discriminatory and unfair lending practices.

- equitable indemnity** 300
When one party takes on the obligation to pay for a loss incurred by another party.
- equity purchase (EP)**297
The acquisition of an owner-occupied, one-to-four unit residential property in foreclosure for rental, investment or dealer purposes.
- equity purchase (EP) investor**298
A person who acquires title to a seller-occupied, one-to-four unit residential property in foreclosure for dealer, investment or security purposes.
- errors and omissions (E&O) insurance** 23, 269
An insurance policy protecting brokers and agents from negligent conduct when acting as a licensee.
- estimate** 124
Prediction of future amounts which have not yet actually occurred.
- exclusive agent**87
An agent who is acting exclusively on behalf of only one party in a transaction.

F

- fact** 114
An existing condition which is presently known or readily knowable by the agent.
- FARM**59
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.
- Federal Fair Housing Act (FFHA)** 127, 179
A collection of policies designed to prevent discrimination in the access to housing based on an occupant's inclusion in a protected class.
- fictitious business name**66
The name under which a business or operation is conducted, also known as a d.b.a. ("doing business as...").
- fiduciary duty** 88, 119, 266
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** 125
Analysis of anticipated changes in circumstances influencing the future income, expenses and use of a property.
- further-approval contingency** 242
A provision in an agreement calling for the further approval of an event or activity as a condition precedent to the further performance or cancellation of the transaction by the persons benefiting from the provision. [See **RPI** Form 185 §9 and 279 §2]

G

- general account** 189
A broker or agent's personal or business account, not to be commingled with trust funds.

general duty 266

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.

general ledger 211

Bookkeeping records of funds in an overall trust account.

good faith deposit 195

A money deposit made by a buyer to evidence their good faith intent to buy when making an offer to acquire property. Also known as earnest money. [See **RPI** Form 401 §1.1]

guarantee 122

An assurance that events and conditions will occur as presented by the agent.

H**home inspection report (HIR)** 292

A report prepared by a home inspector disclosing defects in improvements on a property and used by the seller's agent to complete a TDS and assure prospective buyers about a property's condition.

Home Mortgage Disclosure Act (HMDA) 175

A federal law mandating data collection on mortgage originations and applications of lenders who meet Home Mortgage Disclosure Act (HMDA) threshold requirements.

I**implicit discrimination** 53, 160

Actions which are not openly discriminatory but yield discriminatory results.

independent contractor (IC) 6

A salesperson employed by a broker under an employment arrangement which avoids income tax withholding and unemployment benefit payments by the broker. [See **RPI** Form 506]

K**kickback** 259

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

L**licensed activities** 4, 273

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

listing agreement 2

An employment agreement used by brokers and agents when a client retains a broker to render real estate transactional services as the agent of the client. [See **RPI** Form 102 and 103]

M

- material fact** 56, 184, 240
Information about a listed property which may affect the property's value or alter a client's decision to purchase or sell the property and, thus, needs to be disclosed.
- multiple listing service (MLS)** 102
An association of real estate agents pooling and publishing the availability of their listing properties.

N

- negative fraud** 123
Deceitfully withholding or failing to disclose information to someone.
- net listing agreement** 230
A type of listing in which the agent's fee is set as all sums received exceeding a net price established by the owner.

O

- office manager** 70, 108
A licensee hired by a broker to fulfill the supervisory responsibility of reviewing documents and maintaining office files. [See **RPI** Form 510]
- open listing** 282
An employment entered into by a broker to render real estate services on a best-efforts basis under which a fee is due to the broker if they achieve the client's objective of the employment before the client or another broker separately first meet the objective, such as the sale or locating of a property.
- opinion** 114
A statement by an agent concerning an event or condition which has not yet occurred based on readily available facts.
- overage** 213
A surplus amount in a trust account exceeding the amount of trust funds held in all the subaccounts for individuals.
- owner's statement** 190
An accounting on the status, expenditure and location of negotiable trust funds provided to the owner of those funds.

P

- physical file** 283
A file to store all the information and documents regarding a transaction, such as agreements and disclosures.
- principal** 82
A person, an individual or an entity, acting as a buyer or seller, represented by a broker and their agents.
- principal disputes** 309
Disputes between a buyer and seller.
- projection** 125
An opinion about an income property's future performance based on its performance during the preceding 12-month period, adjusted for presently known trends.

- protected groups** 147, 161
A class of people who receive special protections against discrimination due to their distinguishing factors.
- public accommodation** 141
Property owned, leased or operated by a private entity whose operation affects commerce.
- public housing** 136
Subsidized housing typically reserved for low-income families, the elderly, and persons with disabilities.
- public records** 247
Documents recorded with the county and available to the public. Includes information regarding property ownership, property tax values and pending litigation.
- punitive damages** 223
Monies awarded in excess of actual money losses in order to deter unlawful actions.
- pure risk** 23, 269
Entirely unacceptable acts leading to absolute liability for the misconduct.

R

- redlining** 55, 170
Failure to provide financing in certain communities based on the demographics of that community.
- referral fee** 261
A fee paid by one service provider to another for referring a client to them. Prohibited by the Real Estate Settlement Procedures Act (RESPA) when consumer financing funds the purchase of one-to-four unit residential property.
- residence** 128
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.
- restitution** 222
A money award given to restore an injured party to the condition they held before being damaged.
- right of rescission** 303
The right to cancel a completed transaction such as a sale or letting of property, including restoration, after the transaction has been closed.
- risk reduction program** 21
Office procedures implemented and actively overseen by a broker to mitigate risk of liability by ensuring the broker's employees conduct themselves as the broker expects.

S

- seller's agent** 87
An agent representing the seller. Also known as a listing agent. [See **RPI** Form 102]
- senior citizen housing** 146, 157
Housing intended for persons 55 or 62 years of age or older.
- signer** 206
An employee who has written authorization from the broker to withdraw or disburse funds from the trust account.

- steering** 129
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.
- subaccount ledger** 189, 212
An accounting document or file identifying the owner of trust funds and the amount held for the owner.
- subagent** 101
An individual who has been delegated agency duties by the primary agent of the client, not the client themselves.
- supervisory scheme** 107
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** 33, 111
A licensed or unlicensed individual hired to assist an agent or broker to process documents, contracts and disclosures in a real estate file.
- Transfer Disclosure Statement (TDS)** 183, 240, 291
A mandatory disclosure prepared by a seller and given to prospective buyers setting forth any property defects known or suspected to exist by the seller, generically called a condition of property disclosure. [See **RPI** Form 304]
- trust account** 205
An account separate and apart 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** 43, 187
Items which have or evidence monetary value held by a broker for a client when acting in a real estate transaction.

U

- unconscionable advantage** 303
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** 312
Claims unknown to the parties which are later established and pursued after entering into a general release.
- unlicensed assistant** 24
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. [See **RPI** Form 507]
- Unruh Civil Rights Act** 52, 145
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.