



# Bert Rodgers Schools



## 14-Hour Real Estate Continuing Education Course

FOR FLORIDA SALES ASSOCIATES AND BROKERS



14-HR COURSE INCLUDES:


**Mandatory 3-Hour  
Core Law**

AND

**Newly Required  
3-Hour Business Ethics**



**ALSO INCLUDED ARE 8-HOURS  
OF SPECIALTY EDUCATION TOPICS!**

- ◆ Understanding Real Estate and Mortgage Fraud
  - ◆ Working with Real Estate Investors
  - ◆ From Contract to Closing: Don't Derail Your Sale!
  - ◆ Impact of Gentrification on Real Estate
- 

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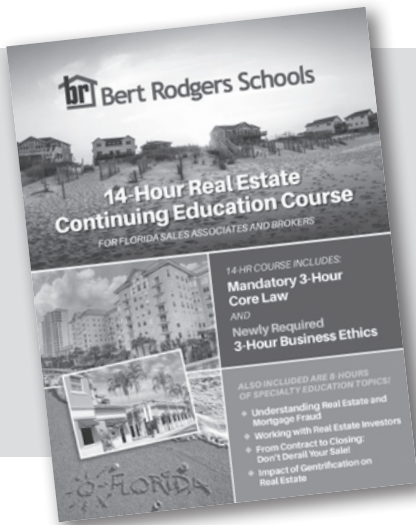


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# 14-Hour Real Estate Continuing Education Course

EDITION 21

FREC (Florida Real Estate Commission) Course Approval  
#0023660 / #0023661

Required Continuing Education for Florida  
Sales Associates, Brokers, and Broker Associates



# Acknowledgements

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Bert Rodgers Schools is fortunate to have industry leaders contribute to the 21st edition of this continuing education course for real estate professionals. We thank Randy Schwartz, John Greer, and Melanie McLane for sharing their expertise with our students.

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Warm Regards,



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# Table of Contents

14-HOUR REAL ESTATE CONTINUING EDUCATION COURSE

MODULE 1 – REAL ESTATE CORE LAW

**Recent Law and Rule Changes** **1**

*by Randy Schwartz, J.D.*

✓ Comprehension Answer Key 32

MODULE 2 – BUSINESS ETHICS

**Business Ethics for Real Estate Professionals** **35**

*by John Greer*

---

***Trending in Real Estate Today -***

***SPECIALTY TOPICS FOR TODAY'S REAL ESTATE PROFESSIONAL (MODULES 3-6):***

MODULE 3

**Understanding Real Estate and Mortgage Fraud** **55**

*by John Greer*

MODULE 4

**Working with Real Estate Investors** **69**

*by John Greer*

MODULE 5

**From Contract to Closing: Don't Derail Your Sale!** **81**

*by Melanie McLane*

MODULE 6

**Impact of Gentrification on Real Estate** **95**

*by John Greer*

Module Review Answer Key 109

Index 113

Final Examination Section 119

    Registration Form Instructions 128

    Registration Form 129

**NOTE:** The ✓ Comprehension questions in Module 1 and the Module Review questions throughout the course are optional exercises intended to enhance your knowledge. You are not required to complete these exercises to obtain course credit.

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# Our Authors

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### **Real Estate Core Law**

Randy Schwartz has over 40 years' experience as an attorney in the real estate field. He was Bureau Chief for the Real Estate Bureau of the Orlando Office of the Florida Attorney General and also served as the General Counsel for the Florida Association of REALTORS® for over 20 years. Randy has spoken at local, state, and international conferences on all aspects of real estate regulation and brokerage law and served as an adjunct professor at UCF and FAMU Law Schools. For several years he was on the Executive Committee of the Real Property Section of the Florida Bar.

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## John Greer

Author of:

### **Business Ethics for Real Estate Professionals; Understanding Real Estate and Mortgage Fraud; Working with Real Estate Investors; Impact of Gentrification on Real Estate**

John Greer has over 30 years of experience in Florida real estate and real estate education. He has authored and co-authored numerous Florida real estate texts and online courses, and personally taught thousands of Florida real estate licensees. John's educational background includes a Master's degree in Adult Education, and a Doctorate in Educational Leadership and Management. John has participated in many Florida Real Estate Commission workshops and task forces including the latest Sales Associate and Broker pre-license syllabus updates.

John is a United States Air Force veteran, and enjoys playing ice hockey, offshore fishing, and scuba diving in his spare time.



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## Melanie McLane

Author of:

### **From Contract to Closing: Don't Derail Your Sale!**

Melanie McLane is a second generation REALTOR®, who is an appraiser, broker and educator. Recently awarded REALTOR® Emeritus status, she has been in real estate all of her adult life. A graduate of Kenyon College, Gambier Ohio, she holds the following designations and certifications: ABR, CRB, CRS, EPRO, GREEN, GRI, RAA, RSPS, PSA, SRES, SRS; she is also certified as a distance instructor (CDEI) and is an Appraiser Qualifications Board approved USPAP (Uniform Standards of Professional Appraisal Practice) Instructor.

Melanie has written numerous courses, both for her own use, and as works for hire for other educational companies. Her book and course topics range from Smart Houses to Green Houses. She has served as President for her local association, West Branch Valley Association of REALTORS®, a District Vice-President for the Pennsylvania Association of REALTORS® (two terms), and has served on various NAR committees, task forces, and forums. In 2008, she was inducted into the REBAC Hall of Fame as an instructor, and in 2012, she was named RSPS of the Year for her contributions to the RSPS course. She has also been honored by her local association with "REALTOR® of the Year," on two occasions, in 1994 and in 2017; "Spirit Award," and "Outstanding Achievement Award." Melanie continues to list, sell and appraise, as well as teach.

In her free time, she enjoys gardening and spending time with her grandchildren.









# Real Estate Core Law

## RECENT LAW AND RULE CHANGES

This module satisfies the 3 hours of Core Law required by the FREC.



### Glossary

**Moral turpitude**—conduct that is considered contrary to community standards of justice, honesty, or good character

**Prima facie**—a matter that appears to be self-evident upon initial observation; the evidence presented to support a legal claim

**Funds**—money in hand or available for the payment of a debt, claim, or expense

**Promulgate**—the formal act of announcing a statute or rule of court

**Latent material defect**—a defect that has a significant adverse impact on the value of a real property and is not observable by a visual inspection

## PART I: REAL ESTATE LICENSE LAW—THE FLORIDA STATUTES

### LEARNING OBJECTIVES

*Upon completion of Part I, the student will be able to:*

1. Review key definitions of Florida real estate license law.
2. Distinguish among the different forms of representation offered by a licensee.
3. Examine the real estate licensing requirements and exemptions for brokers, broker associates, and sales associates.
4. Discuss the renewal and continuing education requirements for licensees.
5. Consider the effect of relocating a brokerage office without notifying the DBPR.
6. Identify the safest, fastest, and least expensive method to resolve an escrow dispute.

### INTRODUCTION

Chapter 475, Part I, F.S., is the relevant section of law dealing with real estate matters such as licensees, real estate business entities, and real estate schools. The following are some of the most important sections of the law that real estate licensees should be familiar with.

### DEFINITIONS

#### **Broker:**

a licensed person who, for another, and for compensation, or with the intent to receive compensation, acts as an agent for others in the performance of one or more services of real estate; this includes transactions involving business enterprises or opportunities. As set forth in Chapter 475, F.S., the term broker also includes:

- 1) any person who advertises rental property information or lists
- 2) any person who is a general partner of a brokerage partnership, or an officer or director of a brokerage corporation if they perform brokerage activity. An unlicensed person can be an officer or partner of a real estate entity as long as they do not engage in brokerage activity, and
- 3) any person or entity who lists, advertises for sale, promotes, or sells by any means whatso-

ever one or more timeshare periods per year on behalf of others, except as otherwise provided by law

In simpler terms, just about anyone who performs services of real estate *for another, for compensation* in Florida must have a Florida real estate license. One area that the Florida Real Estate Commission is still struggling with is property management. Unfortunately it is a term that is used in the industry but not defined in the law. Therefore does a property manager need a license? It depends on activity. There are a few exemptions which are covered in this section.

This definition does not mean if you receive a commission, you automatically need a license. The license requirement is determined more by your actions than how you are paid. Each situation must be independently reviewed.

#### **Broker Associate:**

a person who has earned a broker's license but chooses to be licensed as a broker associate and operate as a sales associate registered with a broker.

*Reminder:* Broker associates and sales associates cannot hold multiple licenses nor can they be an officer or director of a brokerage entity.

**Sales Associate:**

a person who performs any act specified in the definition of **broker**, but who performs such act under the direction, control, or management of another person. Chapter 61J2-6.006, of the *Florida Administrative Code* further states that a sales associate or broker associate may only be employed by one broker or by one owner-developer.

Even though the definition refers to “employment” of a sales associate or broker associate by a broker or owner-developer, most brokers enter into independent contractor agreements with their sales associates and broker associates.

When the terms *employ*, *employment*, *employer*, and *employee*, are used in Chapter 475, they describe the relationship between a broker and a sales associate or broker associate and include an independent contractor relationship when such relationship is intended by and established between a broker and a sales associate.

**Fiduciary:**

a broker in a relationship of trust and confidence between that broker as **agent** and the seller or buyer as **principal**. The duties of the broker as a fiduciary are:

- Loyalty
- Confidentiality
- Obedience
- Full disclosure
- Accounting for all funds, and
- The duty to use skill, care, and diligence

In today’s real estate practice, the vast majority of brokers operate as transaction brokers. Transaction brokers do *not* owe fiduciary duties. Only single agents owe full fiduciary duties to the parties they represent. This is why the term *agent* is not appropriate to use unless the broker, and thereby their associates, enter into a single agent relationship.

It is important to remember that *only brokers may enter into agency and nonagency relationships with buyers and sellers*. As noted in the definition of broker above, a broker performs services of real estate for another, for compensation. Sales associates and broker associates operate under their broker and cannot enter into agency relationships on their own and cannot be paid directly by customers or clients.

**Principal:**

the party with whom a real estate licensee has entered into a single agent relationship. When a real estate broker represents a buyer or seller (or a lessor or lessee) as a single agent and thereby functions in a fiduciary capacity, the party represented is the broker’s principal.

**Customer:**

a member of the public who is or may be a buyer or seller of real property and may or may not be represented by a real estate licensee in an authorized brokerage relationship.

**Single Agent:**

a broker who represents only one buyer or seller (or lessee or lessor) per transaction, as a fiduciary, but not both in the same transaction.

In a single agent relationship, a broker is a fiduciary and owes these duties to their principal:

- Loyalty
- Confidentiality
- Obedience
- Full disclosure
- Accounting for all funds, and
- The duty to use skill, care, and diligence

The most important distinction between a single agent and a transaction broker is their representation of and loyalty to only one party. Single agents must keep *all* information confidential and work solely for the benefit of their principal, the buyer or seller or lessor or lessee.

**Transaction Broker:**

a broker who provides limited representation to a buyer, a seller, or both, in a real estate transaction, but does not represent either in a fiduciary capacity or as a single agent. In a transaction broker relationship, *a buyer or seller is not responsible for the acts of a licensee*. Additionally, the parties to a real estate transaction are giving up their rights to the undivided loyalty of a licensee. This aspect of limited representation allows a licensee to facilitate a real estate transaction by assisting both the buyer and the seller, but a licensee cannot work to represent one party to the detriment of the other party when acting as a transaction broker to both parties.

In Florida, all licensees are presumed to be transaction brokers unless another relationship is established in writing. This is the most prevalent form of brokerage relationship in our state. In a transaction broker relationship the broker (and their sales associates and broker associates) owes these duties:

- Dealing honestly and fairly
- Accounting for all funds
- Using skill, care, and diligence in the transaction
- Disclosing all known facts that materially affect the value of residential real property and are not readily observable to the buyer
- Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing
- Limited confidentiality, unless waived in writing by a party. This limited confidentiality will prevent disclosure that the seller will accept a price less than the asking or listed price, that the buyer will pay a price greater than the price submitted in a written offer, of the motivation of any party for selling or buying property, that a seller or buyer will agree to financing terms other than those offered, or of any other information requested by a party to remain confidential
- Any additional duties that are mutually agreed to with a party

Did you notice the line in the definition of transaction broker that says the buyer or seller is not responsible for the actions of the broker? That language is there because a buyer or seller in a single agency relationship with a broker *is responsible for the actions of the broker* within the scope of the services performed. Interesting! This exists due to common law in the area of agency.

### Designated Sales Associate:

in a commercial transaction in which both the buyer and seller are working with the same real estate licensee, the broker may allow different sales associates of the same firm to act as designated sales associates to represent the buyer and seller as single agents as long as the following conditions are met:

- The request must be made by the buyer *and* seller
- The transaction must involve only commercial real estate, and

- The buyer and seller each must have assets of \$1 million or more

Designated sales associates have the same duties as a single agent including disclosure requirements.

### No Brokerage Relationship:

in a no brokerage relationship, even though a customer is not represented, the following duties are still owed by a real estate licensee:

- Dealing honestly and fairly
- Disclosing all known facts that materially affect the value of the residential real property that are not readily observable by the buyer, and
- Accounting for all funds entrusted to the licensee

A licensee who has no brokerage relationship with a buyer or seller must fully describe and disclose the relationship in writing to the buyer or seller. The disclosure must be made before the showing of property.

### Disclosure Requirements

Chapter 475, F.S., requires disclosure of agency and nonagency relationships. The disclosures apply *only* to residential transactions. Notice must be provided in writing using specific forms.



See §475.278 or go to <http://www.flsenate.gov/Laws/Statutes/2014> for full details.

### Review

**Single Agency:** Fiduciary relationship with a buyer or seller who is the broker's principal.

**Transaction Broker:** Limited Representation and limited duties, not a fiduciary relationship.

**No Brokerage Relationship:** The customer is not represented by the broker but the broker must deal honestly, disclose known material facts, and account for all funds.

## LICENSE REQUIREMENT EXEMPTIONS

**§475.011.** The licensing requirements for Florida real estate brokers, broker associates, sales associates, and schools do *not* apply to any:

- Person acting as an attorney-in-fact for the purpose of the execution of contracts or conveyances only; as an attorney-at-law within the scope of her or his duties; as a certified public accountant, as defined in Chapter 473, within the scope of her or his duties; as the personal representative, receiver, trustee, or general or special magistrate under, or by virtue of, an appointment by will or by order of a court of competent jurisdiction; or as trustee under a deed of trust, or under a trust agreement, where the ultimate purpose and intent is charitable or philanthropic.

Many Florida attorneys are under the mistaken belief that they are totally exempt from license law. The exemption does not allow attorneys to take listings or get paid to find buyers.

- Individual, corporation, partnership, trust, joint venture, or other entity which sells, exchanges, or leases its own real property. This exemption is not available if an agent, employee, or independent contractor paid a commission or other compensation *strictly on a transactional basis* is employed to make sales, exchanges, or leases to or with customers in the ordinary course of an owner's business of selling, exchanging, or leasing real property to the public.

Just because an employee is paid on a commission basis they are not automatically excluded from this exemption. For example, the office manager's job is to have everyone come to work on time. The office manager can receive a bonus for this. This is true if no brokerage activity is performed by the office manager. No license activity was performed therefore no license is required.

- Salaried employee of an owner, or of a registered broker for an owner, of an apartment community who works in an on-site rental office of the apartment community in a leasing capacity.
- Person employed for a salary as a manager of a condominium or cooperative apartment complex as a result of any activities or duties which the person may have in relation to the renting of individual units

within such condominium or cooperative apartment complex *if rentals arranged by the person are for periods no greater than one year.*

- Person, partnership, corporation, or other legal entity which, for another and for compensation or other valuable consideration, rents or advertises for rent, for transient occupancy, any public lodging establishment licensed under Chapter 509, F.S.

The *property* must be registered under Chapter 509, not the person.

- Property management firm or any owner of an apartment complex for the act of paying a finder's fee or referral fee to an unlicensed person who is a tenant in such apartment complex provided the value of the fee does not exceed \$50 per transaction. Unlicensed persons are not authorized by this law to advertise or promote this service.



Generally, salaried employees performing duties within the scope of their employment for the owner and where a commission or bonus are not paid are exempt from Chapter 475, F.S.

## REGISTRATION AND LICENSING

### General Partners, Members, Officers, and Directors of a Firm

**§475.15.** Each partnership, limited liability partnership, limited liability company, or corporation which acts as a broker must register with the Commission and must renew the licenses or registrations of its members, officers, and directors for each license period. However, if the partnership is a limited partnership, only the general partners must be licensed brokers or brokerage corporations registered pursuant to this part. If the license or registration of at least one active broker member is not in force, the registration of a corporation, limited liability company, limited liability partnership, or partnership is canceled automatically during that period of time.

A sales associate *cannot* be an officer or director of a brokerage corporation but a sales associate *can* own all the stock or shares of the corporation.

**COMPREHENSION QUESTION 1**

Secretary Olivia mailed the license renewals to the DBPR for all three general partners of Bamboo Realty one week before the deadline. Unfortunately, the envelope was damaged and they were delayed in the mail. The status of all three broker licenses became involuntarily inactive for five days until they were successfully renewed online. What was the status of the partnership's registration during those five days?

\_\_\_\_\_

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**Broker Associates and Sales Associates**

**§475.161.** The Commission must license a broker associate or sales associate as an individual or—if the licensee provides the Commission with authorization from the Department of State—as a professional corporation, limited liability company, or professional limited liability company. A license will be issued in the licensee's legal name only and, when appropriate, must include the entity designation. This section does not allow a broker associate or sales associate to register or be licensed as a general partner, member, manager, officer, or director of a brokerage firm.

**Post-license Education**

**§475.17.** The first time a license is renewed, post-license education is required: 45 hours for sales associates and 60 hours for broker associates and brokers. If the post-license education is not completed by the initial renewal deadline, the license becomes null and void. To obtain a new sales associate license, the individual must meet the pre-license requirements again. Brokers and broker associates can revert to a sales associate license if they satisfactorily complete the 14-hour continuing education course within six months after the license expiration. To operate as a broker, the licensee must repeat the broker pre-license requirements.

 **Post-License Education Requirements**
**Before First License Renewal - §475.17**

Sales Associates	45 hours
Brokers and Broker Associates	60 hours

**New License Renewal Education Requirement Rule**

Beginning October 1, 2017 licensees are required to take a FREC approved 3-hour Business Ethics course during each license renewal cycle.

**NOTE:** Completion of the 3-hour Business Ethics module included in this book will satisfy the requirement.

**LICENSE RENEWAL: CONTINUING EDUCATION**

**§475.182.** After the first license renewal sales associates, broker associates, and brokers are required to complete 14 hours of Commission-approved continuing education during each two-year license period, which must include three hours of real estate Core Law. Beginning October 1, 2017, licensees must also take a Commission-approved three-hour Ethics and Business Practices course once during each license renewal period. Licensees who complete the Core Law course and Ethics and Business Practices course will receive six hours credit toward the 14 hour requirement. 61J2-3.009(2)(b). The education may be completed online, by correspondence, or in a classroom. Licensees must certify that they have completed the required continuing education during the license period. A license is renewed when the department receives the renewal application and fee.

The required education may be completed any time during the two-year license period, however the DBPR only accepts renewal applications and fees within 90 days prior to the expiration of the license.

Licensees may choose active or inactive license status. If you are performing services of real estate, your license must be active. Sales associates and broker associates must have their license registered with a broker to be active. Changing your license status is fairly simple.



Go online to [www.myfloridalicense.com](http://www.myfloridalicense.com), print DBPR Form RE 11, and follow the directions on the form.

**Involuntarily Inactive License**

**§475.183.** Any license that is not renewed at the end of the license period prescribed by the department

will automatically revert to *involuntarily inactive status*. Under current Commission rule, a license may remain involuntarily inactive for up to 24 months. Remember, if you are performing services of real estate, your license must be active and sales associates and broker associates must have their license registered with a broker to be active.

Licensees may reactivate a license that has been involuntarily inactive for 12 months or less by satisfactorily completing at least 14 hours of approved continuing education and paying late renewal fees. If the license has been involuntarily inactive for more than 12 months but fewer than 24 months, they must complete a Commission-approved 28-hour education course. A renewal fee plus any late fees must be paid to the DBPR for each renewal period in which the license was involuntarily inactive.

Any license that has been involuntarily inactive for more than two years will automatically expire. After that, the license becomes **null and void**. For example, Sales Associate Ali did not renew her license in September of 2014 and again in September 2016. On October 1, 2016, her license status became null and void.

### COMPREHENSION QUESTION 2

If your license expires on March 31 and you do not complete the renewal requirements on time, what is the status of your license on April 1?

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### MULTIPLE LICENSES

**§475.215.** A licensed broker may be issued additional licenses as a broker whenever it is clearly shown that the requested additional licenses are necessary to the conduct of real estate brokerage business (e.g., one for a main corporation and one for a referral corporation). Sales associates and broker associates may *not* be issued additional licenses because they cannot have more than one registered employer at any one time.

At the current time, multiple broker licenses are more closely reviewed than ever before. What was at one time a routine matter has now been subject to closer scrutiny. The FREC wants to prevent the practice of

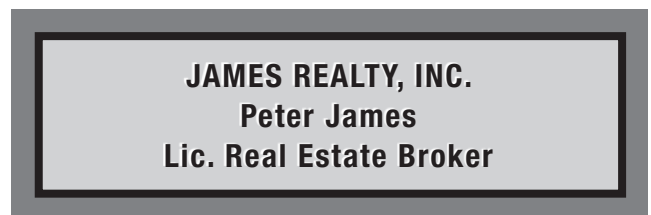
brokers lending their license to entities. The FREC has discussed limiting the number, but such limitations would probably require legislative action.

### BROKER OFFICE AND SIGN REQUIREMENTS

**§475.22.** Each active broker must maintain an office consisting of at least one enclosed room in a building of stationary construction. Each active broker must maintain a sign on or about the entrance of her or his principal office and each branch office. The sign must be easily observed and read by any person about to enter the office. Each sign must contain the name of the broker and the broker's trade name, if any. For a partnership or corporation, the sign must contain the name of the firm or corporation or trade name of the firm or corporation, and the name of at least one of the brokers. At a minimum, the words "licensed real estate broker" or "lic. real estate broker" must appear on the office entrance signs. See Figure 1.1.

Brokers who do not want to pay the extra expense of having an outside office may use a room in their house as an office. This is permissible as long as the proper signage outside the entrance to the room is not a violation of local zoning laws.

**Figure 1.1:**  
**Requirements of a Corporation Office Sign**



If a broker's registered office is located outside the State of Florida, prior to registering this office or branch office, the broker must agree in writing to cooperate with any investigation initiated in accordance with this chapter or commission rules. Cooperation includes promptly supplying documents requested by authorized representatives of the department and personally appearing at any designated office of the department or other location in the state or elsewhere as reasonably requested by the department. Failure to comply with a request to provide documents or appear as requested is a violation of the license law.

## CHANGE OF BUSINESS ADDRESS

It is not uncommon to move your office space as well as your home in today's mobile economy. It is a big job! Remember to update your address with the DBPR within 10 days.

**§475.23.** Until a new address has been reported to the DBPR, a license will expire and cease to be in force when:

- A broker changes her or his business address
- A sales associate working for a broker or an instructor working for a real estate school changes employer, or
- A real estate school operating under a permit changes its business address

Licensees must notify the commission of the change no later than 10 days after the change, on a form provided by the commission. When a broker or a real estate school changes the business address, the brokerage firm or school permit holder must file with the commission a notice of the change of address, along with the names of any sales associates or instructors who are no longer employed by the brokerage or school. Such notification will also fulfill the change of address notification requirements for sales associates who remain employed by the brokerage and instructors who remain employed by the school.

Any time a licensee changes their address, they should make and keep a computer record of when, to whom, and how the change of address was submitted to the DBPR. Remember the burden could be on the licensee to establish it was done properly.



### Counting Days

Days are usually counted as calendar days unless the law, rule, or agreement contains language that states otherwise. Some organizations recognize when a time period ends on a day other than a business day and will allow the last day of the time period to be the next business day. To avoid unwanted consequences, address the issue at the beginning of the time period or when the agreement is written.

## BRANCH OFFICE FEES

**§475.24.** Whenever any licensee desires to conduct business at some other location, either in the same or a different municipality or county than where she or he is licensed, the additional place of business shall be registered as a branch office, and an annual registration fee prescribed by the commission, in an amount not exceeding \$50, shall be paid for each additional office. Any office is considered to be a branch office if the name or advertising of a broker having a principal office located elsewhere is displayed in such a manner as to reasonably lead the public to believe that the office is owned or operated by that same broker. As you can see whether or not a location is a branch office is a rather subjective area.



## DISCIPLINE

**Section 475.25** is probably the most important section of the license law not only because violating this section could result in loss of your license; it also establishes how you are to conduct your business.

The Commission has broad powers that include:

- Denying an application for licensure, registration, or permit, or renewal thereof
- Placing a licensee, registrant, or permittee on probation
- Suspending a license, registration, or permit for a period not exceeding 10 years
- Revoking a license, registration, or permit
- Imposing an administrative fine not to exceed \$5,000 for each count or separate offense
- Issuing a reprimand

The Commission may choose any or all of the above actions if it finds that the licensee, registrant, permittee, or applicant has:

- been guilty of fraud, misrepresentation, concealment, false promises, false pretenses, dishonest dealing by trick, scheme, or device, culpable negligence, or breach of trust in any business transaction in this state or any other state, nation, or territory; has violated a duty imposed upon her or him by law or by the terms of a listing contract, written, oral, express, or implied, in a real estate transaction; has aided, assisted, or conspired with any other person engaged in any such misconduct and in furtherance thereof; or has formed an intent, design, or scheme



to engage in any such misconduct and committed an overt act in furtherance of such intent, design, or scheme. It is immaterial to the guilt of the licensee that the victim or intended victim of the misconduct has sustained no damage or loss; that the damage or loss has been settled and paid after discovery of the misconduct; or that such victim or intended victim was a customer or a person in confidential relation with the licensee or was an identified member of the general public. Please note that culpable negligence is a higher degree of negligence than simple negligence.

- advertised property or services in a manner which is fraudulent, false, deceptive, or misleading in form or content. The commission may adopt rules defining methods of advertising that violate this paragraph. Advertising by real estate team names is an area of concern of FREC. Currently there is no prohibition for individuals to advertise as teams, but is such an ad misleading to the public? This is an issue to watch for in the future.

### COMPREHENSION QUESTION 3

A licensee was found guilty of misrepresentation and breach of trust. His fine was \$10,000. Why was the fine more than \$5,000?

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FREC may impose any of the disciplinary actions above if it finds that the licensee, registrant, permittee, or applicant has:

- failed to account or deliver to any person, including a licensee under this chapter, at the time which has been agreed upon or is required by law or, in the absence of a fixed time, upon demand of the person entitled to such accounting and delivery, any personal property such as money, funds, deposit, check, draft, abstract of title, mortgage, conveyance, lease, or other document or thing of value, including a share of a real estate commission if a civil judgment relating to the practice of the licensee's profession has been obtained against the licensee and said judgment has not been satisfied in accordance with the terms of the judgment within a reasonable time, or any secret or illegal profit, or any divisible share or portion thereof, which has come into the

licensee's hands and which is not the licensee's property or which the licensee is not by law or equity entitled to retain under the circumstances.

However, if the licensee, in good faith, entertains doubt as to what person is entitled to the accounting and delivery of the escrowed property, or if conflicting demands have been made upon the licensee for the escrowed property, which property she or he still maintains in her or his escrow or trust account, the licensee must promptly notify the commission of such doubts or conflicting demands and will promptly:

- request that the commission issue an escrow disbursement order determining who is entitled to the escrowed property, or
- submit the matter to arbitration with the consent of all parties, or
- seek adjudication of the matter in court by interpleader or otherwise, or
- submit the matter to mediation with the written consent of all parties

The Department may conduct mediation or may contract with public or private entities for mediation services. However, the mediation process must be successfully completed within 90 days following the last demand or the licensee must promptly employ one of the other escape procedures contained in this section. Payment for mediation will be as agreed to in writing by the parties.



In **mediation**, a professionally trained neutral third party facilitates a discussion between the buyer and seller. The mediator does not have the ability to render a decision. If the buyer and seller reach a mutually agreeable solution it is not binding unless they sign a written mediation settlement agreement.

If the licensee promptly employs one of the escape procedures contained herein and abides by the order or judgment resulting therefrom, no administrative complaint may be filed against the licensee for failure to account for, deliver, or maintain the escrowed property. Under certain circumstances, which the commission must set forth by rule, a licensee may disburse property from the licensee's escrow account

without notifying the commission or employing one of the procedures listed above. For example, the buyer of a residential condominium unit delivers to a licensee written notice of the buyer's intent to cancel the contract for sale and purchase, as authorized by section 718.503, F.S., or if the buyer of real property in good faith fails to satisfy the terms in the financing clause of a contract for sale and purchase, the licensee may return the escrowed property to the purchaser without notifying the commission or initiating any of the procedures listed above.



### Escrow Dispute Options

If, in good faith, the licensee is unsure of who should receive a disbursement, the licensee must promptly notify the commission and request either:

- an escrow disbursement order—the commission decides who receives the escrow
- arbitration—a neutral third party decides the outcome
- adjudication in court—litigation
- mediation—the buyer and seller work with a neutral third party to reach a mutually agreeable solution.

The commission may impose punishment if it finds that the licensee, registrant, permittee, or applicant:

- has failed to deposit money in an escrow account when the licensee is the purchaser of real estate under a contract that requires the deposit money to be placed in an escrow account and to be applied to the purchase price if the sale closes.
- has been convicted or found guilty of, or entered a plea of *nolo contendere* to, regardless of adjudication, a crime in any jurisdiction which directly relates to the activities of a licensed broker or sales associate, or involves moral turpitude or fraudulent or dishonest dealing. The record of a conviction certified or authenticated in such form as to be admissible in evidence under the laws of the state will be admissible as *prima facie* evidence of such guilt.
- has had a broker's or sales associate's license revoked, suspended, or otherwise acted against, or has had an application for such licensure denied, by the real estate licensing agency of another state, territory, or country.
- has shared a commission with, or paid a fee or other compensation to, a person not properly licensed as a broker, broker associate, or sales associate under the laws of this state, for the referral of real estate business, clients, prospects, or customers, or for any one or more of the services set forth in section 475.01(1)(a), F.S. For the purposes of this section, it is immaterial that the person to whom such payment or compensation is given made the referral or performed the service from within this state or elsewhere; however, a licensed broker of this state may pay a referral fee or share a real estate brokerage commission with a broker licensed or registered under the laws of a foreign state (i.e., a state or government that is not Florida), so long as the foreign broker does not violate any law of this state.
- is temporarily incapacitated from acting safely and capably as a broker or sales associate for investors or those in a fiduciary relation with her or him because of drunkenness, use of drugs, or temporary mental derangement; but suspension of a license in such a case will be only for the period of such incapacity.
- has failed, if a broker, to immediately place, upon receipt, any money, fund, deposit, check, or draft entrusted to her or him by any person dealing with her or him as a broker in escrow with a title company, banking institution, credit union, or savings and loan association located and doing business in this state, or to deposit such funds in a trust or escrow account maintained by her or him with some bank, credit union, or savings and loan association located and doing business in this state, wherein the funds must be kept until disbursement thereof is properly authorized; or has failed, if a sales associate, to immediately place with their registered employer any money, fund, deposit, check, or draft entrusted to them by any person dealing with her or him as agent of the registered employer. The commission must establish rules to provide for records to be maintained by the broker and the manner in which such deposits will be made. A broker may place

and maintain up to \$5,000 of personal or brokerage funds in the broker's property management escrow account and up to \$1,000 of personal or brokerage funds in the broker's sales escrow account. A broker will be provided a reasonable amount of time to correct escrow errors if there is no shortage of funds and such errors pose no significant threat to economically harm the public. It is the intent of the legislature that, in the event of legal proceedings concerning a broker's escrow account, the disbursement of escrowed funds not be delayed due to any dispute over the personal or brokerage funds that may be present in the escrow account.



### Brokers Maximum Personal Funding Allowance

<u>Escrow Account</u>	<u>Amount</u>
Property Management	\$ 5,000
Sales	\$ 1,000

## Table 1.1: The Administrative Complaint Process

- Step 1 Complaint is filed
- Step 2 Notification sent to licensee
- Step 3 Investigation
- Step 4 Report to prosecutor
- Step 5 Prosecutor recommendation to Probable Cause Panel:
  - a. dismiss, or
  - b. administrative complaint
- Step 6 If disputed facts, a hearing occurs
- Step 7 Administrative Law Judge – recommended order
- Step 8 Final Order – FREC minus the probable cause panel members

- is confined in any county jail, post adjudication; is confined in any state or federal prison or mental institution; is under home confinement ordered in

lieu of institutional confinement; or, through mental disease or deterioration, can no longer safely be entrusted to competently deal with the public.

- has failed to inform the commission in writing within 30 days after pleading guilty or nolo contendere to, or being convicted or found guilty of, any felony.
- has failed in any written listing agreement to include a definite expiration date, description of the property, price and terms, fee or commission, and a proper signature of the principal(s); and has failed to give the principal(s) a legible, signed, true, and correct copy of the listing agreement within 24 hours of obtaining the written listing agreement. The written listing agreement cannot contain a provision requiring the person signing the listing to notify the broker of the intention to cancel the listing after such definite expiration date.
- has failed, if a broker, to direct, control, or manage a broker associate or sales associate employed by such broker. A rebuttable presumption exists that a broker associate or sales associate is employed by a broker if the records of the department establish that the broker associate or sales associate is registered with that broker. A record of licensure which is certified or authenticated in such form as to be admissible in evidence under the laws of the state is admissible as prima facie evidence of such registration.

An administrative complaint against a broker, broker associate, or sales associate must be filed *within five years after the time of the act* giving rise to the complaint or *within five years after the time the act is discovered* or should have been discovered with the exercise of due diligence.

### SCENARIO 1

Customer A finally has the nerve to file a complaint against the biggest broker in town. The customer says the broker misled him in 2005. Why was the case dismissed by the FREC?

*The case was filed beyond the 5 years statute of limitation.*

### CASE STUDY 1

Respondent violated Florida Statute Section 475.25(1)(b) by giving the property inspector the wrong email address for the buyer in a real estate purchase transaction, giving the buyer an altered report instead of the inspector's report, and by telling the buyer that the inspection company would refund the cost of the inspection when it never offered to make the refund. By stipulation, the Respondent agreed to the following penalty: 30 days of suspension beginning six months after the effective date; administrative fine of \$1,000; investigative costs of \$251.25; and restitution to buyer in the amount of \$25,130.

### CASE STUDY 2

Respondent violated Florida Statute Section 475.25(1)(b) by committing an act of breach of trust by converting his client's earnest money deposits for his own personal usage; Section 475.25(1)(d)1 by failing to account and deliver his client's earnest money deposits on demand; Section 475.42(1)(d) for collecting money in connection with a real estate brokerage transaction in a name other than that of his registered employer; and Section 475.25(1)(e) through a violation of Florida Administrative Code Rule 61J2-14.009 by failing to deliver escrow deposits to his registered broker no later than the end of the next business day. Penalty: revocation; administrative fine of \$4,000; investigative costs of \$561.

## BROKERAGE RELATIONSHIP: AGENCY OR TRANSACTIONAL

**§475.255.** Without consideration of the related facts and circumstances, the mere payment or promise to pay compensation to a licensee does not determine whether an agency or transactional brokerage relationship exists between the licensee and a seller, landlord, buyer, or tenant.

## THE BROKERAGE RELATIONSHIP DISCLOSURE ACT (BRDA)

**§475.2701.** This legislation was enacted in 1997 to create the role of the transaction broker, allowing a licensee to provide limited representation to both parties in the same transaction. It is further explained in sections 475.272-.2801, F.S.

### The Purpose of BRDA

**§475.272.** In order to eliminate confusion and provide for a better understanding on the part of customers in real estate transactions, the Legislature determined the intent of the Brokerage Relationship Disclosure Act is to provide that:

1. Disclosed dual agency as an authorized form of representation by a real estate licensee in this state is expressly revoked
2. Disclosure requirements for real estate licensees relating to authorized forms of brokerage representation are established
3. Single agents may represent either a buyer or a seller, but not both, in a real estate transaction, and
4. Transaction brokers provide a limited form of non-fiduciary representation to a buyer, a seller, or both in a real estate transaction.

### Required Relationship and Transaction Disclosures

**§475.278.** There are *four types* of authorized brokerage relationships a real estate licensee may have with a buyer or seller:

- Transaction Broker—the most common form of representation
- Single Agent
- No Brokerage Relationship
- Designated Sales Associate

In Florida, it is presumed that all licensees are operating as transaction brokers unless a single agent or no brokerage relationship is established **in writing** with a customer. A licensee may change from single agent to a transaction broker as long as the buyer or seller, or both, gives consent as required by section 475.278(3)(c)2, F.S., prior to the change and the appropriate written disclosure of duties is made to the buyer and seller.



While the duties of authorized brokerage relationships apply in all brokerage activities, the disclosure requirements of BRDA apply only to residential sales.

Whenever a licensee is representing a buyer or seller in a capacity other than a transaction broker or if they are transitioning from one type of authorized relationship to another, disclosure must be provided before, or at the time of, entering into a listing agreement or an agreement for representation or before the showing of property, whichever occurs first. The disclosure must be made in writing and fully describe the duties of the specified type of brokerage relationship being entered into.

## CONTRACTS BY AN UNLICENSED PERSON

**§475.41.** A contract for a commission or compensation for any act or service is not valid unless the broker or sales associate has complied with this chapter in regard to issuance and renewal of the license ***at the time the act or service was performed.***

For example: John had a valid sales associate license when he earned a commission from his last closing. Before his broker issued the commission check, John's license was revoked by FREC due to an unrelated matter. Can John's broker still pay him? Yes, because his license was valid at the time he performed the services. The key is license status *at the time of the service*, NOT the license status at the time of payment.

## LICENSE VIOLATIONS AND PENALTIES

**§475.42.** Any person who violates any of the provisions below is guilty of a misdemeanor of the second degree unless the punishment is prescribed in this chapter.

- A person may not operate as a broker or sales associate without being the holder of a valid and current active license; therefore, any person who violates this paragraph commits a felony of the third degree, punishable as provided in sections 775.082 or 775.083, F.S., or, if a corporation, as provided in section 775.083.
- A person licensed as a sales associate may not operate as a broker or operate as a sales associate

for any person not registered as her or his employer.

- A sales associate may not collect any money in connection with any real estate brokerage transaction, whether as a commission, deposit, payment, rental, or otherwise, except in the name of the employer and with the express consent of the employer; and no real estate sales associate, whether the holder of a valid and current license or not, will commence or maintain any action for a commission or compensation in connection with a real estate brokerage transaction against any person except a person registered as her or his employer at the time the sales associate performed the act or rendered the service for which the commission or compensation is due.
- A broker or sales associate may not place, or cause to be placed, upon the public records of any county, any contract, assignment, deed, will, mortgage, affidavit, or other writing which purports to affect the title of, or encumber, any real property if the same is known to her or him to be false, void, or not authorized to be placed of record, or not executed in the form entitling it to be recorded, or the execution or recording whereof has not been authorized by the owner of the property, maliciously or for the purpose of collecting a commission, or to coerce the payment of money to the broker or sales associate or other person, or for any unlawful purpose. However, nothing in this paragraph will be construed to prohibit a broker or a sales associate from recording a judgment rendered by a court of this state or to prohibit a broker from placing a lien on a property where expressly permitted by contractual agreement or otherwise allowed by law.
- A person may not operate as a broker under a trade name without causing the trade name to be noted in the records of the commission and placed on the person's license, or so operate as a member of a partnership or as a corporation or as an officer or manager thereof, unless such partnership or corporation is the holder of a valid current registration.

### COMPREHENSION QUESTION 4

Which violation of real estate license law is a third-degree felony?

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**CASE STUDY 3**

Respondent violated Florida Statute Sections 475.25(1)(d) for failure to account or deliver; 475.25(1)(b) for fraud; 475.24(1)(k) for failure to place funds received with his employer; and 475.25(1)(d) for collecting money in a real estate transaction not in the name of the employer and without the express consent of the employer. The Respondent received wired money into his personal account from a client for a real estate transaction. He did not have the consent of the employer to receive these monies in his personal account, did not turn the funds over to his employer, did not account for, nor deliver the deposit to the client upon demand, and committed fraud in the transaction. Penalty: revocation; investigative costs of \$584.10.

**ADVERTISING BY REAL ESTATE SCHOOLS**

**§475.4511.** No person representing a real estate school offering and teaching real estate courses under this chapter will make, cause to be made, or approve any statement, representation, or act, oral, written, or visual, in connection with the operation of the school, its affiliations with individuals or entities of courses offered, or any endorsement of such, if such person knows or believes, or reasonably should know or believe, the statement, representation, or act to be false, inaccurate, misleading, or exaggerated.

A school cannot use advertising of any nature which is false, inaccurate, misleading, or exaggerated. Publicity and advertising of a real estate school, or of its representative, must be based upon relevant facts and supported by evidence establishing their truth. One of the areas that FREC is wrestling with: can a school advertise its pass-fail rate? Can a school do such or is it misleading per se? Would this information be important so a member of the public knows which school is best for his or her chances to pass the exam? This is an area to watch to see if upcoming legislation gives more guidance.

No representative of any school or institution coming within the provisions of this chapter will promise

or guarantee employment or placement of any student or prospective student using information, training, or skill purported to be provided, or otherwise enhanced, by a course or school as an inducement to enroll in the school, unless such person offers the student or prospective student a bona fide contract of employment agreeing to employ the student or prospective student.

**RENTAL INFORMATION**

**§475.453.** Each broker or sales associate who furnishes a rental information list to a prospective tenant, for a fee, must provide the tenant with a contract or receipt. The contract or receipt must contain a provision for the repayment of any amount over 25% of the fee to the prospective tenant if he or she does not obtain a rental. If the rental information list provided by the broker or sales associate is not current or accurate in any material respect, the full fee must be repaid to the prospective tenant upon demand. A demand from the prospective tenant for the return of the fee, or any part thereof, must be made within 30 days following the day on which the real estate broker or sales associate was contracted to perform services. The contract or receipt must also conform to the guidelines adopted by the Commission. Violation of these provisions is a misdemeanor of the first degree. In addition to the penalty, the license of any broker or sales associate who participates in any rental information transaction which is in violation of the provisions of section 475.453(1), F.S., is subject to suspension or revocation by the Commission. Figure 1.2 is an example of the notice required by F.A.C. 61J2-10.030.

**NOTICE PURSUANT TO FLORIDA LAW:**

If the rental information provided under this contract is not current or accurate in any material aspect, you may demand within 30 days of this contract date a return of your full fee paid. If you do not obtain a rental you are entitled to receive a return of 75% of the fee paid, if you make a demand within 30 days of this contract date.

**Figure 1.2: Rental Information Notice**

If a prospective tenant paid \$50.00 for a rental information list and did not obtain a rental, he or she can receive a \$37.50 refund ( $50 \times 75\% = 37.50$ ), if the refund is requested within 30 days.

## BROKERAGE BUSINESS RECORDS

**§475.5015.** Each broker must keep and make available to the Department books, accounts, and records that enable the department to determine whether the broker is in compliance with the provisions of this chapter. Each broker must preserve at least one legible copy of all books, accounts, and records pertaining to her or his real estate brokerage business *for at least five years* from the date of receipt of any money, fund, deposit, check, or draft entrusted to the broker or, in the event no funds are entrusted to the broker, for at least five years from the date of execution by any party of any listing agreement, offer to purchase, rental property management agreement, rental or lease agreement, or any other written or verbal agreement which engages the services of the broker. If any brokerage record has been the subject of or has served as evidence for litigation, relevant books, accounts, and records must be retained for at least two years after the conclusion of the civil action or the conclusion of any appellate proceeding, whichever is later, but in no case less than a total of five years as set above. There is nothing in the law that specifically mentions emails or text messages. Representatives of the State have stated it's not required, however it might be needed to avoid a prosecution in some particular cases. In other words maintaining such documents might be wise for a licensee's own protection.

### SCENARIO 2

An investigator from the DBPR comes to inspect the office of Broker A. The Investigator asks to see business records. The broker does not have copies of all emails and texts. Is he in violation?

*Nothing in the law says emails and texts have to be kept for five years, however if the texts and emails are necessary for the broker to avoid liability, the broker would be well advised to maintain these as records. In other words he is not required do so, but the emails and texts could be needed for the broker to defend a specific action against him.*

## AUTHORITY TO INSPECT AND AUDIT

**§475.5016.** Duly authorized agents and employees of the Department have the power to inspect and audit in a lawful manner at all reasonable hours any broker or brokerage office licensed under this chapter for the purpose of determining if any of the provisions of this chapter, Chapter 455, F.S., or any rule of either chapter is being violated.

### SCENARIO 3

Broker A is in his office and a DBPR investigator arrives unannounced and requests to review all business records. The broker agrees to give the investigator access to the records but at a later, more convenient time. Is broker in violation?

*Yes, the law states that the DBPR has the power to inspect and audit in a lawful manner at all reasonable hours any broker or brokerage office licensed under Chapter 475, Florida Statutes. In most cases, unless there is an emergency, the investigator will notify the broker well ahead of the visit.*

Audit numbers are up! Be prepared. The length of any inspection depends on whether the brokerage company keeps an escrow account. To avoid the requirement to perform a monthly reconciliation many brokerages do not have an escrow account. Instead they choose to have earnest money held by an independent entity.

### CASE STUDY 4

Respondent violated Florida Statute Sections 475.5015 by failing to be present for a scheduled office and escrow audit inspection and failing to make her brokerage's escrow accounts available to the Department; 475.25(1)(e) and Florida Administrative Code Rule 61J2-5.019 by operating as the qualifying broker of a corporation that did not hold a current and active license. Penalty: investigative costs of \$660; attendance at two complete FREC meetings; 10 years of probation, during which Respondent is to manage no licensees, maintain no escrow accounts, and is not to manage rental properties.

## FLORIDA REAL ESTATE COMMISSION (FREC)

**§475.02.** The Commission consists of seven members appointed by the Governor, subject to confirmation by the Senate. Four members must be licensed brokers, each of whom has held an active license for the five years preceding appointment; one member must be a licensed broker or a licensed sales associate who has held an active license for the two years preceding appointment; and two members must be persons who are not, and have never been, brokers or sales associates. At least one member of the com-

mission must be 60 years of age or older. The current members may complete their present terms unless removed for cause.

In 2010, the Department determined that a licensed real estate broker or sales associate who holds an active real estate school permit, chief administrator permit, school instructor permit, or any combination of such permits issued by the DBPR may serve on the Florida Real Estate Commission (FREC). Members are appointed to four-year terms and may serve no more than two consecutive terms.

## PART II: FLORIDA REAL ESTATE COMMISSION RULES

### LEARNING OBJECTIVES

*Upon completion of Part II, the student will be able to:*

1. Explain the changes in a brokerage partnership when the general partner withdraws.
2. State the real estate licensing restrictions for officers and directors of a Florida real estate brokerage corporation.
3. Discuss the factors that determine if a location qualifies as a branch office which must be registered with the FREC.
4. Review the Commission's requirements for advertising by real estate firms.
5. Recall the five forms of disciplinary actions imposed by the FREC.

### INTRODUCTION

The Florida Statute section 475.05 authorizes the Real Estate Commission to adopt rules pursuant to Chapter 120, Laws of Florida. Below is a review of the Commission rules most relevant to your daily practice of real estate. The complete list of FREC's rules can be found in Chapter 61J2 of the *Florida Administrative Code* (F.A.C.) online at:



<https://www.flrules.org>

### CHAPTER 61J2-4; PARTNERSHIPS

Real estate brokerage partnerships must be registered with the Florida Real Estate Commission. The partnership must contain at least one licensed or registered active real estate broker. In addition, each partner that deals with the public must hold a valid real estate broker license. Under general partnership law, when a general partner dies or withdraws, the partnership is *automatically dissolved* and a new partnership must be created. However, for FREC purposes, *if the business is continued by two or more*



persons, one of whom is an active real estate broker, the partnership will be able to continue. In this scenario, it is only necessary to cancel, issue, or reissue registration or licenses reflecting the change in the organization.

## CHAPTER 61J2-5; CORPORATIONS

Corporations must have a legal existence with the State of Florida before being registered with the FREC. A registration will *not* be granted or renewed for any corporation if:

- It appears that the individual(s) having control of the corporation has been denied, revoked, or suspended and not reinstated, or
- A person having control of the corporation has been convicted of a felony in any court and has not had civil rights restored for at least five years, or
- An injunction has been entered against the individual for operating as a real estate licensee without a license

When applying this rule, a person is deemed to be in control of a corporation when the person or their spouse, children, or member of the household owns or controls, directly or indirectly, more than 40% of the voting stock.

All officers and directors of a corporation must be registered with the FREC. An officer or director can be either a real estate broker or member of the general public. However, a real estate sales associate or a broker associate may not be a director or officer of a real estate corporation. Even though a real estate sales associate or broker associate cannot hold the titles of either director or officer, they are allowed to own 100% of the stock of the corporation.

### 61J2-5.018 Vacancies of Office.

(1) A brokerage shall have at all times registered the name(s) of its officer(s) and director(s). In the event that a brokerage has but one active broker, and such broker dies, resigns, or is unexpectedly unable to remain in the position as the active broker, then, in such event, such vacancy shall be filled within 14 calendar days during which no new brokerage business may be performed by the brokerage or a licensee registered with the brokerage until a

new active or temporary broker is appointed and registered with the brokerage.

### CASE STUDY 5

Respondent violated Florida Statute Section 475.25(1)(b) by operating as a broker without the requisite license and by operating as a sales associate for a company not registered as his employer; Section 475.25(1)(k) by failing to place a deposit in an escrow account and failing to place a deposit with his registered broker; Section 475.42(1)(d) for collecting money in a name other than his employer; Section 475.25(1)(e) through a violation of Rule 61J2-10.038, Florida Administrative Code, for failing to notify the Department of a change in his mailing address within 10 days after the change; and Rule 61J2-14.009, Florida Administrative Code, for failing to deliver a deposit to his broker no later than the end of the next business day. Penalty: Revocation; administrative fine of \$1,000; investigative costs of \$577.50.

### COMPREHENSION QUESTION 5

Who is prohibited from being an officer or director of a real estate corporation?

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## CHAPTER 61J2-10; BUSINESS OPERATIONS

### Brokerage Offices

A real estate brokerage must have an office. This office may be located in a residential location as long as it is not in violation of local zoning ordinances and must still have a sign on or about the entrance of the office—not necessarily on the front door of the house. A broker may also have a branch office, which is required to be registered with the FREC.

While there is no clear-cut definition of what constitutes a branch office, a mere temporary

shelter, on a subdivision being sold by the broker, for the protection of sales associates and customers and at which transactions are not closed and sales associates are not permanently assigned, is not deemed to be a branch office. The permanence, use, and character of activities customarily conducted at the office or shelter will determine whether it must be registered.

### Gifts and Kickbacks

An issue that frequently arises is whether a real estate licensee can give a gift to a member of the general public. Permissibility is determined by the reason the gift is given. For example:

- A real estate licensee refers a buyer to a moving company and in return receives compensation. This kickback or rebate, is permissible *if* the buyer has been told all the details of this arrangement ahead of time.
- A real estate licensee can share part of their commission with a party of the transaction if full disclosure is made to all interested parties.
- A real estate licensee is usually *not* allowed to compensate a nonlicensee for the referral of real estate brokerage business. The only exception can be found on page 5 of this module (i.e. property manager and a finder's fee).

### SCENARIO 4

Broker A recommends to a new buyer to use ABC Moving Company, and discloses to the buyer orally ahead of time that for every referral the broker gets \$100. The new buyer files a complaint against the broker when ABC drops his antique piano. Result: no violation of the licensing law.

*While it would have been wise to disclose the relationship in writing, the Rule does not say it must be in writing. So there is no violation.*

### Advertising

Advertising by real estate firms must be designed so that a reasonable person knows they are dealing with a real estate licensee. It must always include the registered name of the brokerage firm. If a licensee's name appears in the advertisement, the name must

be the same as licensed with the Commission. Informally, the FREC has allowed nicknames to appear in advertisements as long as they are not considered to be misleading. When advertising on a site on the Internet, the brokerage firm name must be placed adjacent to or immediately above or below the *point of contact information*. **Point of contact information** refers to any means by which to contact the brokerage firm or individual licensee including all mailing addresses, physical street addresses, email addresses, telephone numbers, and facsimile telephone numbers.

In regard to nicknames, the use of Tom instead of Thomas would be acceptable. Remember, the allowance is not official and cannot be misleading, so a prudent person would refrain from using nicknames such as Skippy or Fair Fiona.

### COMPREHENSION QUESTION 6

Is it misleading per se for a sales team to have a team name that does not include their last name? For example the "Sunshine Realty A-team."

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### Trade Names

The FREC will *not* issue a license containing a trade name that is the same as the real or trade name of another licensee. Further, no individual partnership or corporation may be registered under more than one trade name.

### COMPREHENSION QUESTION 7

When are nicknames allowed to be used in advertising?

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**NEW****Team or Group Advertising**

A new rule (FAC: 61J2-10.026) has been created which regulates team or group advertising. The rule was first created in 2018, however, to give licensees time to meet compliance requirements, it did not go into effect until July 1, 2019. The complete rule can be viewed at the Florida Department of State website via the following link: <https://www.flrules.org/gateway/ruleNo.asp?id=61J2-10.026>

## CHAPTER 61J2-14; FUNDS ENTRUSTED TO BROKERS - DEPOSITS AND ESCROWS

Once the parties have entered into a sales contract, usually the buyer puts down a deposit toward the purchase of real property. If the deposit is to be held in escrow by an attorney or a title company, the sales contract must contain their name, address, and telephone number.

Be aware of the timeline:

- *Within 10 days of the due date* for every deposit specified in the sales contract, the buyer's broker must request in writing that the attorney or title company verify that the deposit was received (unless the seller or the seller's agent selected the attorney or title company to hold the deposit).
- *Ten days after the written request is made*, the buyer's broker must provide the seller's broker with a copy of the written verification or written notice that no verification was received.
- If the seller is not represented by a broker, then the buyer's broker must notify the seller directly in the same manner described above.

The FREC allows a broker to place a limited amount of the broker's personal money in the real estate brokerage escrow account. The amount is \$1,000 in the sales escrow account, and \$5,000 in the property management escrow account.

**Note:** *A broker is not required to maintain an escrow account and most brokerages do not; however, if a broker does maintain an escrow account, the brokerage must prepare a monthly reconciliation statement. The statement must then be reviewed, signed, and dated by the broker. This is the primary reason many brokerage firms do not keep escrow accounts.*

The role of escrow agent may be one of the most important roles that a real estate broker undertakes. Not only is the broker entrusted with the monies of another, but the broker is required to timely deposit the funds in an appropriate institution, maintain the funds until properly instructed as to how and to whom to disburse, and perform the regular reconciliation of the escrow account to ensure the proper accounting of the funds being maintained.

### Table 1.2: Monthly Escrow Reconciliation Statement Required Information

- Date the reconciliation was undertaken
- Date used to reconcile the balances
- Name(s) of the bank(s)
- Name(s) of the account(s)
- Account number(s)
- Account balance(s) and date(s)
- Deposits in transit
- Outstanding check identified by date and check number
- Itemized list of the broker's trust liability

Include any other items necessary to reconcile the bank account balance(s) with the balance per the broker's checkbook(s) and other trust account books and records disclosing the date of receipt and the source of the funds.

If a broker holding funds in their escrow account receives **conflicting demands** from the parties or if the broker has **good faith doubts** as to who is entitled to the escrow funds, the broker must follow Chapter 61J2-10.032, F.A.C., which states:

- Within 15 business days of receiving the last party's demand or of having good faith doubts, the broker must report **in writing** the dispute or doubts to the FREC.
- Within 30 business days of the last demand or of having good faith doubts, the broker must institute a settlement procedure and notify FREC of that action.

Many brokerages feel that the best recourse in this situation is to request an escrow disbursement order from FREC. It can be a safe, quick, and inexpensive way to have the matter decided.

## CHAPTER 61J2-24; DISCIPLINARY MATTERS

This chapter contains the disciplinary guidelines that the FREC follows when licensees are guilty of violating Chapter 455 or Chapter 475. These guidelines give the FREC wide discretion in imposing penalties and provide for a range of penalties, including differentiation between first time violations and second and subsequent violations. The order of penalties, ranging from lowest to highest, is: reprimand, fine, probation, suspension, and revocation or denial.

The FREC may choose to impose any of the following disciplinary sanctions:

- **Notice of Noncompliance:** A violation is considered a minor violation if it does not result in economic or physical harm to a person or adversely affect the public health, safety, or welfare or create a significant threat of such harm. The notice of noncompliance shall only be issued for an initial offense of a listed minor violation.
- **Citations:** A citation will be issued for violations that are not a substantial threat to the health, safety, and general welfare of the public.
- **Mediation:** The process whereby a mediator appointed by the DBPR acts to encourage and facilitate resolution of a legally sufficient complaint. It is an informal process with the objective of assisting the complainant and subject of the complaint to reach a mutually acceptable resolution.
- **Revocation:** Revocation of a license is permanent except for a few specific violations.

- **Probation:** Unless otherwise stated in the final order a term of probation shall be 90 days, beginning 30 days after the filing of the final order.

Of all the violations that go before the FREC, improper handling of escrow funds is considered the most serious. When the public has entrusted their money to a broker and the broker mishandles the funds or fails to properly reconcile the account, the FREC does not hesitate to take the appropriate and sometimes harsh action to not only discipline the broker, but to send the message to the licensee community that escrow violations will not be treated lightly.

## CHAPTER 61J2-26; NONRESIDENT LICENSURE

An individual does not have to be either a Florida resident or a United States citizen to qualify for a Florida real estate license. Applicants are expected to be knowledgeable in Florida law, statutes, and administrative rules. They must meet education, experience, and examination requirements comparable to the requirements for Florida resident applicants as prescribed in sections 475.17(2), (6), and 475.175, F.S.

Prior to May 4, 2012, Florida nonresident licensees were required to sign an Irrevocable Consent Form that would allow legal actions against the licensee to commence in any county in the State of Florida where the plaintiff resided. When the governor approved House Bill 693 during the 2012 legislative session, the Irrevocable Consent Form requirement was eliminated.

## PART III: STATE AND FEDERAL LAWS AFFECTING REAL ESTATE

### LEARNING OBJECTIVES

*Upon completion of Part III, the student will be able to:*

1. Describe the purpose for the energy-efficiency rating, radon gas, Residential Swimming Pool Safety Act, and property tax disclosures.
2. Explain when the lead-based paint, homeowners' associations, condominiums, and property condition disclosures are required.
3. Give examples of material facts that must be disclosed to the seller.
4. Recognize special laws that apply to contracts for military personnel.
5. Explain the proper handling and disposition of deposit money or advance rent as required in the Florida Landlord Tenant Act.

### INTRODUCTION

In this section we review state and federal laws such as Community Development Districts, the Residential Swimming Pool Safety Act, contracts with military personnel, and landlord/tenant regulations. Various disclosure requirements are addressed including radon gas, lead-based paint, property tax, homeowners' associations, condominiums, property conditions, and energy-efficiency.

### COMMUNITY DEVELOPMENT DISTRICT (CDD)

A Community Development District, commonly known as a CDD, is a local special-purpose government authorized under the Uniform Community Development Act of 1980 by Chapter 190 of the *Florida Statutes* and is an alternative method for managing and financing infrastructure required to support community development.

CDDs are legal entities and possess several powers such as: the right to enter into contracts; the right to own both real and personal property; adoption of by-laws, rules, regulations, and orders; the right to sue and be sued; to obtain funds by borrowing; to issue bonds; and to levy assessments.

#### Legal overview of a CDD

- A CDD provides a mechanism to finance, construct, and maintain community or subdivision infrastruc-

ture improvements. Infrastructure includes water and sewer collection systems, roads, sidewalks, drainage and storm water systems, parks, boardwalks, community areas, landscaping, and wetlands mitigation.

- A CDD is organized as a special-purpose unit of local government and operates as an independent taxing district.
- Because a CDD is an independent special district, the governing body establishes their own budget and operates independently of the local governmental entity within the scope of specific and very limited powers.
- A CDD does not have police powers and cannot regulate land use or issue development orders; those powers reside with the local general-purpose government (city or county).
- The primary function of a CDD is to issue tax-exempt bonds to construct infrastructure such as roads, water and sewer lines, recreational facilities, etc.
- CDDs are designed to pay for themselves. Theoretically, the cost of growth is allocated proportionately by levying special assessments on the lands which receive the benefit of the improvements.
- Under ideal circumstances, the CDD provides a more efficient method of paying the operation and maintenance expense of infrastructure and related

services. However, there are inherent risks, especially during the recent economic downturn. If a CDD goes into foreclosure or only sells a small percentage of lots, owners could find themselves paying disproportionately high fees.

- CDDs may replace HOAs, but have board powers. As is true for all communities, the professionalism of the board members directly contributes to or detracts from the operation and harmony of the neighborhood.

### Required Disclosure Language

Subsequent to the establishment of a district under Chapter 190, F.S., each contract for the initial sale of a parcel of real property and each contract for the initial sale of a residential unit within the district must include, immediately prior to the space reserved in the contract for the signature of the purchaser, the following disclosure statement in boldfaced and conspicuous type which is larger than the type in the remaining text of the contract:

#### **COMMUNITY DEVELOPMENT DISTRICT DISCLOSURE- F.S. section 190.048**

**THE (Name of District) COMMUNITY DEVELOPMENT DISTRICT MAY IMPOSE AND LEVY TAXES OR ASSESSMENTS, OR BOTH TAXES AND ASSESSMENTS, ON THIS PROPERTY. THESE TAXES AND ASSESSMENTS PAY THE CONSTRUCTION, OPERATION, AND MAINTENANCE COSTS OF CERTAIN PUBLIC FACILITIES AND SERVICES OF THE DISTRICT AND ARE SET ANNUALLY BY THE GOVERNING BOARD OF THE DISTRICT. THESE TAXES AND ASSESSMENTS ARE IN ADDITION TO COUNTY AND OTHER LOCAL GOVERNMENTAL TAXES AND ASSESSMENTS AND ALL OTHER TAXES AND ASSESSMENTS PROVIDED FOR BY LAW.**

### ENERGY-EFFICIENCY RATING

A prospective buyer of a building must be provided with a copy of an information brochure notifying the buyer of the option for an energy-efficiency rating on the building. The brochure must be given at the time of or prior to the buyer's execution of the contract for sale and purchase pursuant to section 553.996, F.S.

The Department of Community Affairs provides free copies of this brochure.

### RADON GAS

A radon disclosure must be provided at the time of, or prior to, the execution of the sale or purchase of any building as well as prior to the execution of a rental agreement for any building. This disclosure is not required for residential transient occupancy provided the occupancy is for 45 days or less in duration as further discussed in Section 509.013 [12].

#### **RADON GAS**

Radon is a naturally occurring radioactive gas that, when it has accumulated in a building in sufficient quantities, may present health risks to persons who are exposed to it over time. Levels of radon that exceed federal and state guidelines have been found in buildings in Florida. Additional information regarding radon and radon testing may be obtained from your county health department (Chapter 404.056(5), F.S.).

### LEAD-BASED PAINT DISCLOSURE

Many houses and apartments built before 1978 have paint that contains lead (called lead-based paint). Lead from paint, chips, and dust can pose serious health hazards if not taken care of properly.

Federal law—Lead-Based Paint Hazard Reduction Act of 1992, 42 U.S.C Section 4852d—requires that individuals receive certain information before renting or buying pre-1978 housing:

- Landlords must disclose known information on lead-based paint and lead-based paint hazards before leases take effect. Leases must include a disclosure form about lead-based paint.
- Sellers must disclose known information on lead-based paint and lead-based paint hazards before selling a house. Sales contracts must include a disclosure form about lead-based paint. Buyers have up to 10 days to check for lead hazards.

Housing excluded from the disclosure requirement:

- Housing built after 1977 (Congress chose not to

cover post-1977 housing because the Consumer Product Safety Commission (CPSC) banned the use of lead-based paint for residential use in 1978)

- Zero-bedroom units, such as efficiencies, lofts, and dormitories
- Leases for less than 100 days, such as vacation houses or short-term rentals
- Housing for the elderly (unless children live there)
- Housing for the handicapped (unless children live there)
- Rental housing that has been inspected by a certified inspector and found to be free of lead-based paint
- Foreclosure sales

## PROPERTY TAX DISCLOSURE

A prospective purchaser of residential property must be given the following disclosure summary at or before the execution of the contract regardless of the age of the dwelling. Pursuant to section 689.261, F.S., it must either be included in the contract or must be provided by the seller.

### PROPERTY TAX DISCLOSURE SUMMARY

BUYER SHOULD NOT RELY ON THE SELLER'S CURRENT PROPERTY TAXES AS THE AMOUNT OF PROPERTY TAXES THAT THE BUYER MAY BE OBLIGATED TO PAY IN THE YEAR SUBSEQUENT TO PURCHASE. A CHANGE OF OWNERSHIP OR PROPERTY IMPROVEMENTS TRIGGERS REASSESSMENTS OF THE PROPERTY THAT COULD RESULT IN HIGHER PROPERTY TAXES. IF YOU HAVE ANY QUESTIONS CONCERNING VALUATION, CONTACT THE COUNTY PROPERTY APPRAISER'S OFFICE FOR INFORMATION.

## HOMEOWNERS' ASSOCIATION DISCLOSURE

A purchaser who is buying in a community that mandates membership in a homeowners' association (HOA) must be given a disclosure of said requirement prior to the execution of the contract for sale and purchase. This disclosure must be provided by either the

developer or the seller. If the required disclosure is not given to the buyer prior to the execution of the contract, the buyer has the option to void the contract in writing within three days after receipt of the disclosure summary or prior to closing, whichever occurs first. The buyer's right may not be waived by the buyer but terminates at closing. The exact language of the disclosure can be found in Section 720.401, F.S.

### COMPREHENSION QUESTION 8

Is an HOA disclosure required prior to contract execution for *all* residential property sales within a HOA community?

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## CONDOMINIUM DISCLOSURE

Chapter 718, F.S., requires a developer and a non-developer unit owner disclosure prior to the sale of a condominium. While the language of these disclosures varies between a developer and nondeveloper, both require that the disclosure be given prior to the execution of the sales contract. The language of both forms is contained in section 718.503, F.S. If a real estate licensee provides to, or otherwise obtains for, a prospective purchaser the documents described in this subsection, the licensee is not liable for any error or inaccuracy contained in the documents.

## DISCLOSURE OF MATERIAL FACTS

Florida law requires real estate licensees to disclose material facts affecting the value of residential property which are not readily observable to the buyer. The information is considered material to the extent that if the information had been disclosed, the sales contract would not have been signed or the terms may have been negotiated differently.

Physical material facts that affect the value of residential property can generally be measured monetarily. The court can determine the amount of damages due to a leaky roof or termite infestation, compare it with the purchase price and cost to repair the damages, and then decide whether the value was materially affected.



If a bucket has been placed in the attic to collect rainwater from a leaking roof, it must be disclosed that the roof is leaking. However, if the bucket is placed in the middle of the living room and the buyer can see the rain water going into the bucket from the ceiling, neither the seller nor licensee needs to disclose what is in clear view.

### Property Condition—Johnson v. Davis

The landmark case in the area of disclosures is the case of *Johnson v. Davis*, 480 So.2d 625 (Florida 1985). Prior to this case, the rule was *caveat emptor*, buyer beware, which is still the rule in commercial real estate contracts. In *Johnson v. Davis*, the Supreme Court of Florida held that:

...where the seller of a home knows of facts materially affecting the value of the property which are not readily observable and are not known to the buyer, the seller is under a duty to disclose them to the buyer. This duty is equally applicable to all forms of real property, new and used.

The Court next held in *Rayner v. Wise* that the doctrine in *Johnson* also applied to real estate professionals. This meant that the seller or licensed real estate professional must disclose material facts that affect the value of the property which are not readily observable and are not known to the buyer. This duty to disclose can also be found in Chapter 475, F.S. The case law does not mandate the manner in which disclosure must take place, whether written, oral, or any specific form.



A Seller's Disclosure is a common form used by many real estate professionals to comply with the property condition disclosure requirement. Whether written or oral, disclosure:

- is required in all residential real property transactions
- is not required in commercial transactions
- must disclose material facts not readily observable to the buyer that affect value

While disclosing a leaking roof is not a hard determination to make, other situations can be more difficult to determine if they are considered an unknown material defect. What if a halfway house is going in across the street? What if the halfway house is going in five houses down? What if it is public record that the property is zoned for this type of occupancy? At this time, these questions have not been addressed by legal decisions.

Some might argue that you cannot go wrong with disclosing, but what if the seller tells you not to and you owe the seller a fiduciary duty as a single agent? In other words, the legal obligation in these situations is not always clear. Standards of Practice 1-9 of the 2016 REALTOR® Code of Ethics states, "Information concerning latent material defects is not considered confidential information." Please note that the Code of Ethics does not apply to all licensees, only members of NAR. Remember, if the seller asks you not to tell or in any situation, you always have the option to seek legal counsel.

### COMPREHENSION QUESTION 9

If a seller represented by a transaction broker reveals that their home experienced flood damage several years ago but they covered it up with new carpeting, is the broker required to disclose this information to potential buyers?

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### Sinkholes

When there is a non-observable sinkhole on the property, it is clear that it should be disclosed. Less clear is whether there is a duty to disclose a *repaired* sinkhole on the property. Correlate this with the situation of a repaired roof leak. It would be uncommon to disclose that in the past the roof leaked, when there is no leak now.

Although the law is unclear about a repaired sinkhole, Florida law does provide direction when an insurance claim is processed for a sinkhole repair. Section 627.7073, F.S., requires the professionally prepared sinkhole report and certification to be filed with the County Clerk of the Court:



- When an insurer has paid a claim
- As a precondition to accepting payment for a loss
- Upon completed foundation repairs or building stabilization

 **Disclosure of a sinkhole claim.** Section 627.7073(2)(c), F.S. (2005), states: The seller of real property upon which a sinkhole claim has been made by the seller and paid by the insurer must disclose to the buyer of such property, before the closing, that a claim has been paid and whether or not the full amount of the proceeds was used to repair the sinkhole damage.

**Stigmatized Property**

Fortunately, some areas of the law have made it clear what one should disclose and what one should not. Section 689.25, F.S., states that if the property was a site of a homicide, suicide, or death it is not a material fact which must be disclosed. Other situations are not as clear. Further, according to Florida law, HIV and AIDS status are not material facts that must be disclosed in a real estate transaction. No cause of

action arises against a real estate licensee or owner for failure to disclose that the occupant of the property is infected with HIV/AIDS.

What if a seller believes their house is haunted? Is the listing agent or seller required to disclose this belief to prospective buyers? The law is silent on haunting. Your best course of action is to consult your broker and/or legal counsel.

**COMPREHENSION QUESTION 10**

Broker A knows that a house has a reputation for being haunted and fails to disclose to the buyer that fact. The buyer closes on the house and then files a complaint to the DRE for failing to disclose a material fact that affects the value of the property. What is the result of the broker failing to disclose this fact?

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**Table 1.3: Disclosure Guide**

**Property disclosures should be provided prior to contract execution under the following conditions:\***

<b>Type</b>	<b>Application</b>
<b>CDD:</b>	Prior to initial sale of real property or a residential unit in a CDD
<b>Energy-Efficiency Rating:</b>	The buyer of a building must be given an information brochure
<b>Radon Gas:</b>	Any building, except for residential transient rentals less than 45 days
<b>Lead-based Paint:</b>	Most residential housing built before 1978, see exceptions list
<b>Property Tax:</b>	All residential properties
<b>HOA:</b>	When membership is mandatory
<b>Condominium Association:</b>	All condominium units in residential transactions
<b>Sinkholes:</b>	When a claim has been made and paid by an insurer
<b>Property Condition:</b>	All residential property when material facts not readily observable affect the value

\*refer to the *Florida Statutes* for more specifics on each disclosure.

## RESIDENTIAL SWIMMING POOL SAFETY ACT

The Residential Swimming Pool Safety Act, Chapter 515, F.S., went into effect in the year 2000. It requires certain safety features to be installed on newly constructed homes with swimming pools to prevent drowning of a young child or medically frail elderly person.

To pass the final inspection and receive a certificate of completion, a residential swimming pool must meet *one* of the following safety features pursuant to Section 515.27, F.S.:

- The pool must be isolated from access to a home by an enclosure that meets the pool barrier requirement.
- There must be an approved safety pool cover.
- All doors and windows with direct access from the home to the pool must be equipped with an approved exit alarm system with minimum sound pressure ratings.
- All doors providing direct access from the home to the pool must be equipped with a self-closing, self-latching device with the release mechanism at least 54 inches above the floor.

The failure to equip a new residential home and pool with at least one of the above safety features is a second-degree misdemeanor. No penalty will be imposed if the person, within 45 days after arrest or issuance of a summons or a notice to appear, has equipped the pool with at least one safety feature as listed above and has attended a drowning prevention education program. However, the requirement of attending a drowning prevention education program is waived if such program is not offered within 45 days after issuance of the citation.

**§515.33, F.S.,** Information required to be furnished to buyers: A licensed pool contractor, on entering into an agreement with a buyer to build a residential swimming pool, or a licensed home builder or developer, on entering into an agreement with a buyer to build a house that includes a residential swimming pool, must give the buyer a document containing the requirements of this chapter and a copy of the publication produced by the department under section 515.31 that provides information on drowning prevention and the responsibilities of pool ownership.

## CONTRACTS WITH MILITARY PERSONNEL

An active member of the United States Armed Forces, the United States Reserve Forces, or the Florida National Guard, collectively known as **servicemember**, may terminate a contract to purchase real property, prior to closing, by providing to the seller or mortgagor on the property a written notice of termination under the following circumstances:

- Servicemember is required, by permanent change of station orders, to move 35 miles or more from the location of the property
- Servicemember is released from active duty and the property is more than 35 miles from the member's home of record
- Servicemember receives orders to move into government quarters, or the member becomes eligible to live in government quarters, or
- Servicemember receives temporary duty orders to move more than 35 miles from the location of the property and the temporary duty orders exceed 90 days

The notice to the seller or mortgagor canceling the contract must be accompanied by either a copy of the official military orders or a written verification signed by the servicemember's commanding officer. Upon termination of the contract, the member is entitled to a full refund of the deposit within seven days.

The law may not be waived or modified by agreement of the parties under any circumstances. §689.27, F.S., (2003).

### COMPREHENSION QUESTION 11

When military personnel are required to move more than 35 miles from the location of the property during active duty, what proof is required to terminate a real estate purchase contract?

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## LANDLORD-TENANT REGULATIONS

The most current laws can be seen by going to the 2016 Florida Statutes at: [www.flsenate.gov/Laws/Statutes](http://www.flsenate.gov/Laws/Statutes). The Landlord-Tenant Act Chapter 83, F.S., is divided into three sections:

- Part I: Nonresidential Tenancies
- Part II: Residential Tenancies
- Part III: Self-service storage space

### Residential Tenancies

For the purposes of this section, the discussion concerning landlord-tenant regulations will focus solely on the regulations in residential tenancies. Part II of the Landlord-Tenant Act applies to the rental of dwelling units. It does *not* apply to the following:

- Residency or detention in a facility, whether public or private, when residence or detention is incidental to the provision of medical, geriatric, educational, counseling, religious, or similar services
- Transient occupancy in a hotel, condominium, motel, rooming house, or similar public lodging, or transient occupancy in a mobile home park
- Occupancy by a holder of a proprietary lease in a cooperative apartment
- Occupancy by an owner of a condominium unit
- Occupancy under a contract of sale of a dwelling unit or the property of which it is a part in which the buyer has paid at least 12 months' rent or in which the buyer has paid at least one month's rent and a deposit of at least 5% of the purchase price of the property.

### Disposition of Deposit Money or Advanced Rent

**§83.49, F.S.** This is one of the more important sections of the Landlord-Tenant Act. When a landlord or his/her agent receives deposit money or advance rent, they must hold the money in one of three manners:

- Hold the total amount of such money in a separate noninterest-bearing account in a Florida banking institution for the benefit of the tenant or tenants. The landlord cannot commingle such moneys with any other funds of the landlord
- Hold the total amount of such money in a separate interest-bearing account in a Florida banking institution for the benefit of the tenant or tenants, in which case the tenant will receive and collect

interest in an amount of at least 75% of the annualized average interest rate payable on such account or interest at the rate of 5% per year, simple interest, whichever the landlord elects. The landlord cannot commingle such moneys with any other funds of the landlord

- Post a surety bond with the clerk of the circuit court in the county in which the dwelling unit is located in the amount of the security holdings or \$50,000, whichever is less

The landlord shall, in the lease agreement or within 30 days after receipt of advance rent or a security deposit, give written notice to the tenant which includes disclosure of the advance rent or security deposit. Subsequent to providing such written notice, if the landlord changes the manner or location in which he or she is holding the advance rent or security deposit, he or she must notify the tenant within 30 days after the change as provided in paragraphs (a)-(d) (see following bullet points). The landlord is not required to give new or additional notice solely because the depository has merged with another financial institution, changed its name, or transferred ownership to a different financial institution. This subsection does not apply to any landlord who rents fewer than five individual dwelling units. Failure to give this notice is not a defense to the payment of rent when due. The written notice must:

- Be given in person or by mail to the tenant
- State the name and address of the depository where the advance rent or security deposit is being held or state that the landlord has posted a surety bond as provided by law
- State whether the tenant is entitled to interest on the deposit
- Contain the following disclosure:

#### ADVANCE RENT AND SECURITY DEPOSIT DISCLOSURE

YOUR LEASE REQUIRES PAYMENT OF CERTAIN DEPOSITS. THE LANDLORD MAY TRANSFER ADVANCE RENTS TO THE LANDLORD'S ACCOUNT AS THEY ARE DUE AND WITHOUT NOTICE. WHEN YOU MOVE OUT, YOU MUST GIVE THE LANDLORD YOUR NEW ADDRESS SO THAT THE LANDLORD CAN SEND YOU NOTICES REGARDING YOUR

DEPOSIT. THE LANDLORD MUST MAIL YOU NOTICE, WITHIN 30 DAYS AFTER YOU MOVE OUT, OF THE LANDLORD'S INTENT TO IMPOSE A CLAIM AGAINST THE DEPOSIT. IF YOU DO NOT REPLY TO THE LANDLORD STATING YOUR OBJECTION TO THE CLAIM WITHIN 15 DAYS AFTER RECEIPT OF THE LANDLORD'S NOTICE, THE LANDLORD WILL COLLECT THE CLAIM AND MUST MAIL YOU THE REMAINING DEPOSIT, IF ANY.

IF THE LANDLORD FAILS TO TIMELY MAIL YOU NOTICE, THE LANDLORD MUST RETURN THE DEPOSIT BUT MAY LATER FILE A LAWSUIT AGAINST YOU FOR DAMAGES. IF YOU FAIL TO TIMELY OBJECT TO A CLAIM, THE LANDLORD MAY COLLECT FROM THE DEPOSIT, BUT YOU MAY LATER FILE A LAWSUIT CLAIMING A REFUND.

YOU SHOULD ATTEMPT TO INFORMALLY RESOLVE ANY DISPUTE BEFORE FILING A LAWSUIT. GENERALLY, THE PARTY IN WHOSE FAVOR A JUDGMENT IS RENDERED WILL BE AWARDED COSTS AND ATTORNEY FEES PAYABLE BY THE LOSING PARTY.

THIS DISCLOSURE IS BASIC. PLEASE REFER TO PART II OF CHAPTER 83, FLORIDA STATUTES, TO DETERMINE YOUR LEGAL RIGHTS AND OBLIGATIONS.

Upon the vacating of the premises for termination of the lease, if the landlord does not intend to impose a claim on the security deposit, the landlord will have 15 days to return the security deposit together with interest if otherwise required, or the landlord will have 30 days to give the tenant written notice by certified mail to the tenant's last known mailing address of his or her intention to impose a claim on the deposit and the reason for imposing the claim. The notice must contain a statement in substantially the following form:

### NOTICE OF CLAIM

This is a notice of my intention to impose a claim for damages in the amount of \$\_\_\_\_\_ upon your security deposit, due to \_\_\_\_\_. It is sent to you as required by Chapter 83.49(3), F.S. You are hereby notified that you must object in writing to this deduction from your security deposit within 15 days from the time you receive this notice or I will be authorized to deduct my claim from your security deposit. Your objection must be sent to (landlord's address).



Unless the lease states otherwise, section 83.49(5), F.S., does allow the landlord some breathing room when a tenant vacates the premises prior to the expiration of the lease term and fails to give the landlord at least seven days' advance written notice to vacate. Failure of the tenant to give such notice shall relieve the landlord of the notice requirement of section 83.49(3)(a), but shall not waive any claim the tenant may have to any part of the security deposit.

As referred to in section 475.25(1)(d), F.S., when facing conflicting demands on money in escrow, a real estate broker is required to notify the Florida Real Estate Commission. However, section 83.49 prevails over conflicting provisions in Chapter 475 and permits licensed real estate brokers to disburse security deposits and deposit money without having to comply with the notice and settlement procedures contained in section 475.25(1)(d).

In most landlord/tenant disputes the burden is on the landlord to keep careful documentation. A meticulous paper trail will help keep potential conflicts to a minimum.

**COMPREHENSION QUESTION 12**

Broker A has conflicting demands on a security deposit in her escrow account. The tenant says he did not damage the property by putting holes in the wall for pictures and the landlord says the holes were not there before the tenant moved in so the tenant must have made them. Broker A disburses the money as set forth by 83.49 to the landlord. The tenant files a complaint to the DRE for the broker failing to follow the procedure set out in 475.25(1) d, Florida Statutes. Why is the case dismissed?

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**Landlord's Obligation to Maintain Premises**

**§83.51.** The law provides that the landlord must provide screens installed at the commencement of the tenancy (without qualification as to whether such item is covered in a lease agreement) and repair the screens once annually during the tenancy.

**Restoration of Possession to Landlord**

**§83.62.** In an action for possession, after entry of judgment in favor of the landlord, the clerk must issue a writ to the sheriff describing the premises and commanding the sheriff to put the landlord in possession after 24 hours' notice conspicuously posted on the premises. The new law clarifies that Saturdays, Sundays, and legal holidays do not stay the 24-hour notice period.

**Retaliatory Conduct**

**§83.64.** It is unlawful for a landlord to discriminatorily increase a tenant's rent or decrease services to a tenant, or to bring or threaten to bring an action for possession or other civil action, primarily because the landlord is retaliating against the tenant. In order for the tenant to raise the defense of retaliatory conduct, the tenant must have acted in good faith.

Furthermore, the law provides for two additional instances of retaliatory conduct:

- Where the tenant has paid rent to a condominium, cooperative, or homeowners' association after demand from the association in order to pay the landlord's obligation to the association, and

- Where the tenant has exercised his or her rights under local, state, or federal fair housing laws

**Termination of Rental Agreement by a Servicemember**

Any servicemember may terminate his or her rental agreement by providing the landlord with a written notice of termination to be effective on the date stated in the notice that is at least 30 days after the landlord's receipt of the notice if any of the following criteria are met:

- The servicemember is required, pursuant to a permanent change of station orders, to move 35 miles or more from the location of the rental premises
- The servicemember is prematurely or involuntarily discharged or released from active duty or state active duty
- The servicemember is released from active duty or state active duty after having leased the rental premises while on active duty or state active duty status and the rental premises is 35 miles or more from the servicemember's home of record prior to entering active duty or state active duty
- After entering into a rental agreement, the servicemember receives military orders requiring him or her to move into government quarters or the servicemember becomes eligible to live in and opts to move into government quarters
- The servicemember receives temporary duty orders, temporary change of station orders, or active duty orders to an area 35 miles or more from the location of the rental premises, provided such orders are for a period exceeding 60 days
- The servicemember has leased the property, but prior to taking possession of the rental premises, receives a change of orders to an area that is 35 miles or more from the location of the rental premises

The above is pursuant to Chapter 83.682, F.S.

**COMPREHENSION QUESTION 13**

A sergeant in the Air Force is renting a house near Patrick Air Force Base. The sergeant has three years left on his military service obligation. Due to the peaceful nature of the world, the government decides his service is no longer needed. Can the sergeant get out of his lease? What if the lease specifically states that members of the military cannot get out of their leases even if they get early discharge?

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**Prohibited Provisions in Rental Agreements**

A provision in a rental agreement is void and unenforceable to the extent that it purports to waive or preclude the rights, remedies, or requirements set forth in Chapter 83.47, F.S.

**IMPORTANT INFORMATION FOR ALL REAL ESTATE LICENSEES****Website Accessibility under Americans with Disabilities Act (ADA)**

When the Americans with Disabilities Act (ADA) was developed in 1990, the modern Internet and websites were not yet available. Businesses should be aware that recent rulings direct that websites and mobile apps must be accessible to people with vision, hearing, or other cognitive and physical disabilities. Brokers, Sales Associates, and anyone else with a website should check with their web developers to ensure that sites are in compliance. Failure to comply can result in lawsuits and judgments.

**COMPREHENSION QUESTION 14**

The tenant moved out of Landlord Kevin's unit on October 15. Shower tiles were damaged and need to be replaced. By what date must Kevin mail his Notice of Claim on the security deposit to the tenant?

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**COMPREHENSION QUESTION 15**

Does the notice requirement change if the tenant vacated the premises prior to the expiration of the lease term and did not give at least seven days written notice of vacating?

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## MODULE 1 REVIEW – CORE LAW

You are *not* required to answer the module review questions to complete the 14-hour course. They are intended to help prepare you for the Final Exam. Choose the best response to each question. The answers are found in the back of the book.

- 1. In a mandatory homeowners' association the required disclosure must be provided by the:**
  - a. developer or seller.
  - b. broker or sales associate.
  - c. mortgage company.
  - d. closing agent.
  
- 2. A fiduciary duty is owed by:**
  - a. a transaction broker.
  - b. a single agent.
  - c. all real estate licensees.
  - d. all parties in a real estate transaction.
  
- 3. A broker who owns a brokerage firm and a referral company may be issued upon request:**
  - a. dual licenses.
  - b. blanket permits.
  - c. multiple operations permits.
  - d. multiple licenses.
  
- 4. A real estate license is required when acting as a/an:**
  - a. attorney-in-fact for the purpose of the execution of contracts.
  - b. individual selling their own real property.
  - c. salaried employee for an owner of an apartment community who works on site.
  - d. leasing agent who is paid on a transactional basis.
  
- 5. Under the license law, it is presumed that all licensees are operating as:**
  - a. single agents.
  - b. transaction brokers.
  - c. broker associates.
  - d. seller's agents.



## MODULE 1 COMPREHENSION ANSWER KEY

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1. Secretary Olivia mailed the license renewals to the DBPR for all three general partners of Bamboo Realty one week before the deadline. Unfortunately, the envelope was damaged and they were delayed in the mail. The status of all three broker licenses became involuntarily inactive for five days until they were successfully renewed online. What was the status of the partnership's registration during those five days? **The partnership was canceled automatically during that period of time. The license or registration of at least one active broker member must be in force.**
2. If your license expires on March 31 and you do not complete the renewal requirements on time, what is the status of your license on April 1? **If you miss the renewal deadline, your license status becomes involuntarily inactive the first day of the next license period.**
3. A licensee was found guilty of misrepresentation and breach of trust. His fine was \$10,000. Why was the fine more than \$5,000? **The commission can impose a fine up to \$5,000 per offense. Two separate offenses would amount to a \$10,000 fine.**
4. Which violation of real estate license law is a third-degree felony? **A person who operates as a broker or sales associate without a valid or current license is committing a third-degree felony.**
5. Who is prohibited from being an officer or director of a real estate corporation? **A sales associate or broker associate may not be an officer or director of a real estate corporation.**
6. Is it misleading per se for a sales team to have a team name that does not include their last name? For example the "Sunshine Realty A-team." **While it cannot be said that it is a per se violation, in all likelihood if this issue came before FREC it would be ruled a misleading advertisement. However each case would have to be determined on an individual basis.**
7. When are nicknames allowed to be used in advertising? **The FREC permits nicknames to be used in advertising as long as they are not misleading; however, the licensee's last name must appear as it is licensed with the commission.**
8. Is an HOA disclosure required prior to contract execution for *all* residential property sales within a HOA community? **If the homeowners' association mandates membership, then the HOA disclosure is required prior to contract execution for all residential sales.**
9. If a seller represented by a transaction broker reveals that their home experienced flood damage several years ago but they covered it up with new carpeting, is the broker required to disclose this information to potential buyers? **Yes, the Brokerage Relationship Disclosure requires all licensees to disclose all known unobservable facts that materially affect a property's value.**





## MODULE 1

# COMPREHENSION ANSWER KEY

10. Broker A knows that a house has a reputation for being haunted and fails to disclose to the buyer that fact. The buyer closes on the house and then files a complaint to the DRE for failing to disclose a material fact that affects the value of the property. What is the result of the broker failing to disclose this fact? **The “fact” that a house is haunted is not a material fact that would have to be disclosed. Therefore that matter would not be prosecuted by the DRE.**
11. When military personnel are required to move more than 35 miles from the location of the property during active duty, what proof is required to terminate a real estate purchase contract? **In order to terminate a real estate purchase contract or rental agreement, the servicemember must provide either a copy of the official military orders or a written verification signed by the servicemember’s commanding officer.**
12. Broker A has conflicting demands on a security deposit held by her in the escrow account. The tenant says he did not damage the property by putting holes in the wall for pictures and the landlord says the holes never existed and the tenant did it. Broker A disburses the money as set forth by 83.49 to the landlord. The tenant files a complaint to the DRE for the broker failing to follow the procedure set out in 475.25(1) d, Florida Statutes. Why is the case dismissed? **Case is dismissed because Chapter 83 controls this matter and as long as Section 83.49 was followed, the requirements of F.S. 475.25 need not be followed.**
13. A sergeant in the Air Force is renting a house near Patrick Air Force Base. The sergeant has three years left on his military service obligation. Due to the peaceful nature of the world, the government decides his service is no longer needed. Can the sergeant get out of his lease? What if the lease specifically states that members of the military cannot get out of their leases even if they get early discharge? **The sergeant would be able to get out of the lease. Having a clause in the lease with a statement that servicemembers cannot get out of their lease is not enforceable because it attempts to waive or circumvent the law.**
14. The tenant moved out of Landlord Kevin’s unit on October 15. Shower tiles were damaged and need to be replaced. By what date must Kevin mail his Notice of Claim on the security deposit to the tenant? **To comply with the notice requirement Landlord Kevin must mail his notice by November 14, which is within 30 days of the tenant’s departure.**
15. Does the notice requirement change if the tenant vacated the premises prior to the expiration of the lease term and did not give at least seven days written notice of vacating? **If the tenant vacated the premises prior to the expiration of the lease term and did not give at least seven days written notice of vacating, the landlord does not have to follow the 30-day notice requirement. However, the tenant is still owed whatever is due from the balance of the security deposit.**

**~ NOTES ~**

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# Business Ethics for Real Estate Professionals

*This module satisfies the 3 hours of Business Ethics required by the FREC.*



## LEARNING OBJECTIVES

*Upon completion of this module, the student will be able to:*

1. Define business ethics.
2. List examples and causes of unethical behavior.
3. Describe the strategies for establishing an ethical business culture.
4. Discuss the history of the code of ethics.
5. Explain the Preamble to the Code.
6. Discuss the Code's Articles and Standards of Practice.
7. Explain how changes to the Code are made.
8. Describe the informal ombudsman program of Code enforcement.
9. Discuss mediation.
10. Explain how ethics complaints are handled.
11. Discuss arbitration.
12. Describe the Pathways to Professionalism.

## Glossary

**Business Ethics**—deals with the ethical practices that arise in a business environment.

**Code of Conduct**—generally addressed to and intended for employees alone. It usually sets out restrictions on behavior and will emphasize compliance and rules.

**Corporate Social Responsibility**—a term used to create a higher level of accountability, trust, and understanding between businesses and consumers.

**Code of Practice**—identifies professional responsibilities in relationship to difficult issues and provides a clear directive as to what behavior is considered ethical or correct.

**Unethical Behavior**—any action that falls outside of what is considered morally right or proper for a person, a profession or an industry.

**Whistleblower**—a person who exposes any kind of information or activity that is deemed illegal or unethical.

**Code of Ethics**—improves the professionalism and reliability of the real estate industry.

**Preamble**—contains a number of thoughts as to how licensees should conduct themselves.

**Articles**—outline the way that REALTORS® should conduct their activities both personally and professionally.

**Standards of Practice**—are designed to support, interpret, and amplify an Article.

**Dispute Resolution**—designed to assist licensees who are unable to resolve a difficulty.

**Ombudsman Program**—a form of informal dispute resolution which focuses on communication and finding mutual, non-coerced agreement between the parties.

**Mediation**—an informal intervention process conducted by a trained third party.

**Ethics Complaint**—gives members of the public an alternative to legal action, saving time and money for licensees and consumers.

**Grievance Committee**—conducts a review of the complaint to determine if a possible violation of the Code of Ethics has occurred.

**Hearing Panel**—the group that conducts any full “due process” hearings.

**Arbitration**—arbitration issues are typically monetary disputes among broker members of the Association.

**Pathways to Professionalism**—a list of professional courtesies that agents should follow.

## BUSINESS ETHICS

### Definition

Business ethics deals with the ethical practices that arise in a business environment. It applies to all aspects of business activities and is relevant to the conduct of a few individuals in an organization or the entire organization as a whole. Business ethics is an ever-changing subject because it is rooted in the fluid nature of laws, official guidelines, cultural norms, contemporary standards of behavior, and societal perceptions.

In this chapter, we will first look at business ethics from a broad-brush viewpoint and get a basic understanding of the interaction between business practices and ethics. Then we will focus on ethics as it relates to the real estate industry, and how the concept of ethics is formally enforced in the real estate industry.

### Overview

Hardly a day goes by without hearing a media announcement regarding unethical business practices uncovered by an investigative reporter. Unethical business practices are certainly not a new or recent phenomenon. If you remember back to your ancient history class in grade school, surely your teacher covered the Code of Hammurabi, which was a Babylonian law code of ancient Mesopotamia, dating back to about 1754 BC. The Code identified a number of topics such as:

- **Theft—Law #22:** “If anyone commits a robbery and is caught, then he shall be put to death.”
- **Trade—Law #104:** “If a merchant give an agent corn, wool, oil, or any other goods to transport, the agent shall give a receipt for the amount, and compensate the merchant therefor. Then he shall obtain a receipt from the merchant for the money that he gives the merchant.”
- **Liability—Law #53:** “If anyone be too lazy to keep his dam in proper condition, and does not so keep it; if then the dam break and all the fields be flooded, then shall he in whose dam the break occurred be sold for money, and the money shall replace the corn which he has caused to be ruined.”

In the Middle-Ages, the chivalric code was a code of conduct associated with the medieval institution of knighthood which developed between 1170 and 1220. The code of *chivalry* emphasized bravery, military skill, generosity in victory, piety, and courtesy to women.

Over the centuries other rules, guidelines, and laws have been instilled into our business practices. Western civilizations have drawn upon a number of sources to develop rules for behavior, such as Roman law, canon law, and the Justinian Code.

The term “business ethics” came into common usage in the 1970s. By the mid-1980s at least 500 courses in business ethics were offered at colleges and universities nationwide. This effort was supported by at least some twenty textbooks being published at the same time.

Firms started highlighting their ethical standing in the late 1980s to try to distance themselves from the current business scandals, such as the savings and loan crisis.

**Ethics is the body of rules or standards that govern our decisions.** Some individuals equate ethics with conscience or a sense of right from wrong. Others say that ethics is an internal code that governs an individual’s conduct, ingrained into each person by family, faith, tradition, community, laws, and personal mores. Most professional organizations have a written “Code of Ethics” that governs standards of professional conduct expected of all in a chosen field.

It is important to note that “law” and “ethics” are not synonymous, nor are the “legal” and “ethical” courses of action in a given situation necessarily the

same. Statutes and regulations passed by legislative bodies and administrative boards set forth the “law” but do not rise to the level of defining specific ethical behaviors. This dichotomy is glaringly apparent in the practice of slavery that was once legal in the U.S., but certainly was not an ethical act.

## Corporate Social Responsibility

Over the years the concept of Business Ethics has expanded to ensure a level of trust between businesses and consumers. Terms such as corporate accountability and corporate social responsibility are now used to create a higher level of accountability, trust, and understanding between businesses and consumers. For example, a company who encourages its employees to serve on local environmental protection boards or projects may be perceived as being socially responsible and therefore trusted to be more accountable than an organization that does not provide the same type of volunteer activity. A company that sponsors little league teams may be perceived as caring about children and the community.

To help create a stronger public image and build trust in the community, many companies are actively engaged in Corporate Social Responsibility projects. Some companies offer their employees unlimited time to volunteer in the community. Others offer their employees up to 50 hours per year in paid time off for volunteering. Many businesses will offer some type of incentive or matching programs for donations that their employees make to the community.

While it is tough to measure the exact impact these types of activities have on a business, generally speaking the businesses are seen as being responsible, trustworthy, and often as great places to work. This in turn should lead to a more secure standing in the community and more revenue.

## Codes That Regulate Behavior

Many companies use the phrases ethical code, code of conduct, and code of practice interchangeably, but there are distinctions. A *code of ethics* sets out the values that underpin the code and describes a company’s obligation to its stakeholders. The code is publicly available to anyone with an interest in the company’s activities and the way it does business. It will include details

of how the company plans to implement its values and vision, as well as guidance to staff on ethical standards and how to achieve them.

A *code of conduct* is generally addressed to and intended for employees alone. It usually sets out restrictions on behavior and will emphasize compliance and rules. Many employers have taken the code of conduct and broken it down even further into a series of fundamentals that explain exactly how each section of the code of conduct is to be interpreted. For example, what does “treat each other with respect” really mean? Instead of a simple bullet point, a fundamentals document will likely give the topic a paragraph or so of coverage to clearly define what that means in the course of business.

A *code of practice* is adopted by a profession, a governmental agency, or non-governmental organization to regulate their operations. A code of practice identifies professional responsibilities in relationship to difficult issues and provides a clear directive as to what behavior is considered ethical or correct. As a group member, failure to comply with a code of practice can result in expulsion from the professional organization.

A social contract is used by some organizations as a standard way to deal with internal issues in the organization. Typically, all employees will agree to the social contract which outlines how disputes will be resolved, and generally encourages strong communication to bring issues forward and resolve them in meaningful and ethical ways.

## The Ethics Codes Collection (ECC)

Today, business ethics is an important aspect of all organizations as noted by the creation of the Center for the Study of Ethics in the Professions, which is located in Chicago, Illinois. This organization operates the Ethics Codes Collection (ECC), which is the largest database of codes of ethics and guidelines in the world. It contains over 2,500 individual codes from approximately 1,500 different organizations and collects both current and historical versions of these documents. ECC’s goal is to provide practitioners, students, scholars, and the public access to codes of ethics for the purpose of assisting ethical decision making in professional, entrepreneurial, scientific, and technological fields.

## Business Ethics Magazine

In the publishing sector, the study of ethics has its own dedicated magazine called *Business Ethics*. Now an online-only magazine, it discusses current topics in the fields of ethics, governance, corporate responsibility, and socially-responsible investing. The mission of *Business Ethics* is “to promote ethical business practices, to serve that growing community of professionals and individuals striving to work and invest in responsible ways.”

## Ethics Officers

Another indication of how important ethics has become in business operations is the emphasis placed on the role of ethics officers in large organizations. Ethics officers, sometimes called compliance officers, have now been formally appointed to the organizational structure since the mid-1980s. One of the catalysts for the creation of this new role was a series of fraud, corruption, and abuse scandals prevalent in the U.S. defense industry at that time. Another critical factor in the decision of companies to appoint ethics officers was the passing of the Federal Sentencing Guidelines for Organizations in 1991, which set standards for organizations to follow in order to obtain a reduction in sentence if they should be convicted of a federal offense.

As a result of the backlash of numerous corporate scandals between 2001 and 2004 affecting large corporations like Enron, WorldCom, and Tyco, even small and medium-sized companies began to appoint ethics officers. Ethics officers are responsible for assessing the ethical implications of the company’s activities, making recommendations regarding policies, and training employees in ethical practices. Emphasis on ethical practices is partly due to the Sarbanes–Oxley Act, which was a response to the business scandals that took place in the early 2000s.

## The Sarbanes–Oxley Act of 2002

The Sarbanes–Oxley Act of 2002, enacted July 30, 2002 and also known as Sarbox or SOX, is a federal law that set new or expanded requirements for all U.S. public company boards, management organizations, and public accounting firms. The act contains eleven sections, ranging from additional corporate board responsibilities to criminal penalties, and requires the Securities and Exchange Commission (SEC) to

implement rulings on requirements to comply with the law.

The bill was enacted as a reaction to a number of major corporate and accounting scandals including those affecting Enron, Tyco International, Adelphia, Peregrine Systems, and WorldCom. Investors invested in these companies presuming that the accounting was accurate, and therefore share prices and profitability was also accurate. It was later discovered that the financial teams in these companies had made false statements or “cooked the books” resulting in much lower profits and valuations. These scandals, which cost investors billions of dollars when the share prices of affected companies collapsed, shook public confidence in the nation’s securities markets.

Debate continues over the perceived value of SOX. Opponents say the bill has reduced America’s international competitive edge against foreign financial service providers due to overly complex regulatory rules now operating in the U.S. financial markets. Proponents of the measure say that SOX has been a blessing for improving the confidence of fund managers and investors regarding the legitimacy of corporate financial statements.

## Unethical Behavior

Unethical behavior is any action that falls outside of what is considered morally right or proper for a person, a profession or an industry. Individuals can behave unethically, as can businesses, professionals and politicians. The following lists identify some behaviors that would be considered as unethical.

### Unethical Behavior by Individuals

- Lying to a spouse
- Stealing money from the petty cash drawer
- Misrepresenting skills on a job
- Taking credit for work you didn’t do
- Cheating on an exam
- Sexually harassing someone at work
- Selling a house and not disclosing known defects
- Selling a car and lying about the vehicle’s history

### Unethical Behavior by Businesses

- Polluting the environment
- Keeping two sets of accounting books

- Not properly classifying a worker as an employee but as an independent contractor to avoid payroll taxes
- Engaging in price fixing to force competitors out of the market
- Using false advertising tactics to attract customers
- Rolling back the mileage on a vehicle that is for sale
- Knowingly selling counterfeit goods
- Knowingly releasing products with defects
- Failing to properly test products before delivery

### Unethical Behavior by Professionals

- Dating clients or patients
- Receiving a kickback for writing unnecessary brand name drug prescriptions
- Performing unnecessary procedures in order to receive additional insurance payments
- Representing parties on both sides of a transaction without full disclosure and approval
- Receiving insurance premiums and not informing the underwriters of an active policy
- Greatly exaggerating personal experiences in a public forum
- Being untruthful on a resume
- Claiming to possess degrees that were not earned or claiming degrees that were simply purchased

### Unethical Behavior by Elected and Government Officials

- Obtaining private tax information about a political opponent and using that information in a campaign
- Accepting contributions that violate campaign finance laws
- Using money that was donated to a campaign for non-approved expenses
- Using a position of power to coerce individuals into a sexual relationship
- Demanding kickbacks for permit approvals and special favors

### Causes for Unethical Behavior

There are five basic causes or reasons for breaches in ethical behavior. Unethical behavior may be based on any one or a multiple of the following reasons:

- **Financial Advantage** – A financial advantage allows a firm or individual to produce goods and/or services at a lower cost than other firms or individu-

als. Seeking a financial advantage gives a company the ability to sell goods and services at a lower price than its competitors and realize stronger sales margins. The problem occurs when an organization violates ethical standards to gain an advantage, for example, when a food processor substitutes a less expensive ingredient in a product and fails to inform consumers.

- **Power** – Power is the ability to influence or control the behavior of people. Some organizations and individuals seek power in order to dominate a business activity through unethical means, for example, when an elected official exceeds his or her authority by implementing an illegal executive order.
- **Hubris** – Hubris indicates a loss of contact with reality and an overestimation of one's own competence, accomplishments, or capabilities. Hubris is usually perceived as a characteristic of an individual, but organizations have been known to practice hubris behavior as well. For example, some lending institutions practiced hubris behavior during the heyday of mortgage lending. These lenders disregarded the consequences of approving a bad risk loan and passed the liability off to the secondary market.
- **Fear** – Fear is a feeling induced by perceived danger or threat. The fear of being fired, banished from the group or injured may drive an individual to act in an unethical manner, for example, an automobile engineer that is pressured to falsify auto emissions test results that are given to the EPA.
- **Misguided Loyalty** – Individuals sometimes lie because they think they are being loyal to the organization or their boss. For example, soldiers at the Abu Ghraib prison camp tortured and abused prisoners for the sake of eliciting military intelligence at any cost and then lied about their involvement.

### Whistleblowers

In today's society of social media and unprecedented media coverage, most unethical behavior is challenged and exposed at some point in time. This "outing" is typically the result of the acts of a whistleblower. A whistleblower is a person who exposes any kind of information or activity that is deemed illegal or unethical. The information of alleged wrongdoing can be classified in many ways. Such as:

- A violation of company policy
- A violation of laws and regulations



- A threat to public interest/national security
- An act of fraud
- An indication of corruption

Those who become whistleblowers can choose to bring allegations to the surface either internally or externally. Internally, a whistleblower can bring accusations to the attention of other people within the organization. Externally, a whistleblower can bring allegations to light by contacting a third party outside of an accused organization. Whistleblowers can reach out to the media, government, or law enforcement.

Currently, there is a patchwork of federal and state laws which protect whistleblowers from retaliation. Whistleblowers must be aware of all the laws and comply with any deadlines when making a proper complaint. Those who report a false claim against the federal government, and suffer adverse employment actions as a result, may have up to six years (depending on state law) to file a civil suit for remedies under the False Claims Act.

Following is just a sampling of whistleblowers who have captured the attention of the news and social media:

- **Adam B. Resnick – Omnicare**

Resnick sued the pharmaceutical company Omnicare, a major supplier of drugs to nursing homes. Omnicare allegedly paid kickbacks to nursing home operators in order to secure business, which constitutes Medicare and Medicaid fraud. In 2010, Omnicare settled a False Claims Act suit filed by Resnick and taken up by the U.S. Department of Justice by paying \$19.8 million to the federal government, while the two nursing homes involved in the scheme settled for \$14 million.

- **Justin Hopson – New Jersey State Police**

During his first few days as a rookie, Hopson witnessed an unlawful arrest and false report made by his training officer. When he refused to testify in support of the illegal arrest, he was subjected to hazing and harassment by his fellow troopers. He uncovered evidence of a secret society within the State Police known as the Lords of Discipline, whose mission it was to keep fellow troopers in line. Trooper Hopson blew the whistle on the Lords of Discipline, which sparked the largest internal investigation in State Police history. Hopson filed a federal lawsuit alleging that after he refused to support the arrest, Hopson was physically assaulted,

received threatening notes, and his car was vandalized while on duty. In 2007, the State of New Jersey agreed to a \$400,000 settlement with Hopson. Justin Hopson and his book were featured on ABC News 20/20 “Confessions of a Cop” in 2012 and “Crossing the Line” in 2014.

- **John Kiriakou – Central Intelligence Agency**

In an interview given to ABC News in 2007, CIA officer Kiriakou disclosed that the agency waterboarded detainees and that this constituted torture. In the months following, Kiriakou passed the identity of a covert CIA operative to a reporter. He was convicted of violating the Intelligence Identities Protection Act and sentenced on January 25, 2013 to 30 months’ imprisonment.

- **Cathy Harris – United States Customs Service**

As a former United States Customs Service employee, Harris personally observed numerous incidents of black travelers being stopped, frisked, body-cavity-searched, detained for hours at local hospitals, forced to take laxatives for bowel inspection purposes and subjected to public and private humiliation. Her book, “Flying While Black: A Whistleblower’s Story” contains detailed accounts of such treatment.

- **Chuck Blazer – The Fédération Internationale de Football Association (FIFA)**

The former FIFA executive, cooperating with the FBI on a major corruption inquiry, has admitted that he and other members of the executive committee were bribed in return for voting for South Africa’s bid for the 2010 World Cup.

- **John Tye – U.S. State Department**

Former State Department official John Tye released an editorial in The Washington Post in July 2014, highlighting concerns over data collection under Executive Order 12333. Tye’s concerns were rooted in the massive amounts of private confidential content that is sucked up by the National Security Agency.

## Developing an Ethical Business Culture

Ethics starts at the top of the organization by leadership that is keenly aware of the importance of fair and equal treatment of all clients, employees, suppliers, shareholders and the general public. Establishing an ethical business culture is based on a number of targeted strategies.

## 1. Establish Clear Expectations

Most organizations have a set of by-laws, slogans, mottos, policy manuals and some type of written performance standards for all employees to follow. Too often, this information is piled on the desk of the new hire on his or her first day on the job. The new hire is instructed to read the lofty prose but is not provided any additional directions or expected to give any feedback. Within a few weeks on the job, the new hire discovers how the organization truly operates and begins to understand the discrepancies between printed expectations and the realities of the actual work environment. Clear expectations should not only be in the written records of the company, but also must accurately reflect the actual ethical behavior expected.

## 2. Model Desired Behavior

Employees model their behavior after those in higher positions. Organizational leaders must practice what they preach and demonstrate by their actions which behaviors are expected within the ranks. The statement that actions speak louder than words is a true axiom.

## 3. Provide Ethics Training

Providing seminars and workshops on ethical topics demonstrates to everyone the importance that the organization places on ethical performance and reinforces the organization's standards of conduct.

## 4. Treat All Complaints Seriously

Employees who notify management of ethics violations should be treated in a supportive and earnest manner. Avoiding or ignoring complaints only results in the complaint being submerged and creating problematic friction in the organization.

## 5. Hire Ethical/Fire Unethical Employees

Members in the same profession network frequently regardless of which company they actually work for. Consider that when individuals change companies, chances are high that their reputation precedes them. Hiring a top-flight sales representative with a checkered past signals to other employees that behavior takes a backseat when it comes to meeting performance quotas.

When an employee demonstrates unethical practices, even after corrective counselling has taken place, the organization has to have the

courage to terminate the individual. Failure to do so sends a message that rules are just transparent rhetoric that can be circumvented without any consequences.

## 6. Reward Ethical Acts

Employees who take the high road and make tough decisions while maintaining high ethical standards should be rewarded by the organization.

## 7. Provide Protective Mechanisms

The organization needs to provide formal mechanisms so that employees can discuss ethical dilemmas and report unethical behavior.

## 8. Provide Corrective Feedback

Organizations need to reinforce behavior that is desired, but they must also be ready to take corrective action when behavior is unacceptable.

## 9. Provide Periodic Reminders

The demands of daily business operations oftentimes overshadow the intangible tenant of ethical behavior. Thus, the organization needs to remind all staff members periodically of the importance of conducting day-to-day business operations in an ethical fashion.

## ETHICS IN REAL ESTATE

Practicing with high ethical standards in real estate is critical because it involves doing what is right and proper. A broker and his or her agents must always act in the best interests of both the client and any third parties to a transaction. As discussed earlier, ethics have nothing to do with legality. Laws tend to set minimum standards for acceptable behavior. We have all heard stories about the sales associate who had a party at a house that he or she had listed, or about the agent who ate steaks out of the client's refrigerator. While these actions are not directly part of real estate license law, most would agree that they are not examples of ethical behavior. Ethics tends to deal with what is right. An act can be legal, but unethical. Good ethical practices have to do with *trustworthiness, honesty, and competence*.

The next sections of this chapter will discuss in detail the professional code of ethics that members of the National Association of REALTORS® (NAR) must follow. But membership in NAR is not mandatory

and many real estate agents are not members. It is important to stress that ALL persons in the real estate profession should follow ethical standards, regardless of whether or not membership in an organization requires them to do so. Performing job duties in an ethical manner is good for business.

## Professional Code of Ethics

Many states require licensees to follow a professional code of ethics. Much of the information found in the professional code of ethics in real estate has come from three sources.

- Federal and state laws which focus on anti-discrimination laws and fair trade practices
- Real estate licensing regulation on the state level dealing primarily with agency issues and disclosures
- Self-regulation by real estate associations that set standards for professional conduct

Members of the National Association of REALTORS® (NAR), who are known by the REALTOR® designation, follow a very strict code of ethics. Many state real estate commissions have chosen to incorporate this code into the state-level rules and regulations directing the conduct of licensees in their particular states. This Code of Ethics gives REALTORS® a higher standard than the laws to strive toward.

## History of the Code of Ethics

The National Association of REALTORS® was formed in 1908 as the National Association of Real Estate Exchanges. In 1913, the Association adopted the industry's first code of ethical conduct to protect the public and encourage licensee professionalism and honesty. The National Association of Real Estate Exchanges was renamed The National Association of Real Estate Boards (NAREB) in 1916 and then became the National Association of REALTORS® (NAR) in 1972.

At the time the Code of Ethics was adopted, there were no state licensing laws and no standard of conduct for the industry. NAR established the Code of Ethics as a professional standard of conduct, and through the years the Code of Ethics became a basis for license laws. REALTORS® were among the first professions to adopt a professional code of ethics for their business practices. The code is a promise of professionalism.

The Code of Ethics improves the professionalism and reliability of the real estate industry. It aids consumers by requesting that licensees be truthful and honest in all communications and always place their client's interests above their own. It requires disclosure of material facts concerning properties and transactions. The Code also encourages competition, but at the same time it requires that competition to be less important than the interests of the client.

REALTORS® are subject to disciplinary action and sanctions if they violate the duties imposed by the Code of Ethics.

## Structure of the Code of Ethics

The REALTOR® Code of Ethics holds members of local Associations of REALTORS® to an even higher standard than the law requires. The Code of Ethics is a detailed document that spells out the professional responsibilities of every REALTOR®. The Code consists of seventeen Articles and related Standards of Practice.

The Articles call for professionals to observe the "Golden Rule" and to conduct themselves and their real estate business in accordance with certain standards. The Code itself is comprised of four sections:

- Preamble
- Duties to Clients and Customers
- Duties to the Public
- Duties to REALTORS®

The Preamble contains a number of concepts but no specific requirements for a licensee's conduct. The Duties sections contain all of the Articles dealing with the conduct expected and required of licensees.

**Note:** You can find a copy of the NAR Code of Ethics on the Florida Realtors® website at [www.floridarealtors.org](http://www.floridarealtors.org). Click on the "Legal Center" tab on the left to find the Code of Ethics link. Print a PDF copy of the Code from this location and follow along as we discuss the sections.

## The Preamble

The Preamble contains a number of thoughts as to how licensees should conduct themselves. Based on the ideas put forth in the Preamble, licensees should:

- Endeavor to become and remain informed on issues affecting the real estate industry.
- Make an effort to identify and take action to aid in the elimination of practices that are damaging to the public or those actions which might discredit the real estate industry. They can do this by enforcing the Code and by assisting regulatory agencies.
- Share their knowledge and experience with others.
- Report to the appropriate Board of REALTORS® the knowledge of any actions involving misappropriation of client or customer funds or property, willful discrimination, or fraud.
- Refrain from attempting to gain unfair advantage over their competitors.
- Avoid making unfair comments about other licensees.
- Endeavor to represent clients exclusively.
- Offer an opinion in an objective, professional manner, uninfluenced by any personal motivation or potential advantage or gain.

The Preamble ends with a statement that REALTORS® should pledge to observe the *spirit* of the Code in all of their activities both personal and professional and to conduct their business in accordance with the tenets presented in the Articles.

## The Articles

The Preamble is followed by seventeen (17) Articles divided up under the headings of Duties to Clients and Customers, Duties to the Public, and Duties to REALTORS®.

### Duties to Clients and Customers

Articles 1-9 deal with these duties:

- **Article 1** – REALTORS® protect and promote their clients' interests while treating all parties honestly.
- **Article 2** – REALTORS® refrain from exaggeration, misrepresentation, or concealment of pertinent facts related to property or transactions.
- **Article 3** – REALTORS® cooperate with other real estate professionals to advance their clients' best interests.
- **Article 4** – When buying or selling on their own account or for their families or firms, REALTORS® make their true position or interest known.
- **Article 5** – REALTORS® do not provide professional

services where they have any present or contemplated interest in property without disclosing that interest to all affected parties.

- **Article 6** – REALTORS® cannot accept any commission, rebate, or profit on expenditures made for a client without the client's knowledge and consent and must disclose any fee or financial benefit they may receive from recommending related real estate products or services.
- **Article 7** – REALTORS® receive compensation from only one party except where they make full disclosure and receive informed consent from their client.
- **Article 8** – REALTORS® keep entrusted funds of clients and customers in a separate escrow account.
- **Article 9** – REALTORS® make sure that contract details are spelled out in writing and that parties receive copies.

## Duties to the Public

### Articles 10 – 14 deal with the public:

- **Article 10** – REALTORS® give equal professional service to all clients and customers irrespective of race, color, religion, sex, handicap, familial status, or national origin.
- **Article 11** – REALTORS® are knowledgeable and competent in the fields of practice in which they engage or they get assistance from a knowledgeable professional, or disclose any lack of expertise to their client.
- **Article 12** – REALTORS® paint a true picture in their advertising and in other public representations.
- **Article 13** – REALTORS® do not engage in the unauthorized practice of law.
- **Article 14** – REALTORS® willingly participate in ethics investigations and enforcement actions.

## Duties to REALTORS®

The last three Articles deal with duties to colleagues:

- **Article 15** – REALTORS® make only truthful, objective comments about other real estate professionals.
- **Article 16** – Respect the exclusive representation or exclusive brokerage relationship agreements that other REALTORS® have with their clients.
- **Article 17** – REALTORS® must mediate or arbitrate

financial disagreements with other REALTORS®, provided the clients agree to be bound by any resulting agreement or award.

## Standards of Practice

The Articles of the Code are very broad statements of conduct. Associated with the Articles are one or more Standards of Practice which are designed to support, interpret, and amplify that Article.

When someone files an ethics complaint against a licensee, **only Articles may be named**, never anything contained in the Preamble. Also, REALTORS® **cannot be found in violation of a Standard of Practice**, only in violation of the associated Article. However, Standards of Practice may be referenced to support an alleged Article violation.

Each of the Articles has some number of Standards of Practice associated with it as follows:

- Article 1 – 16 Standards of Practice
- Article 2 – 3 Standards of Practice
- Article 3 – 10 Standards of Practice
- Article 4 – 1 Standards of Practice
- Article 5 – 0 Standards of Practice
- Article 6 – 1 Standards of Practice
- Article 7 – 0 Standards of Practice
- Article 8 – 0 Standards of Practice
- Article 9 – 2 Standards of Practice
- Article 10 – 4 Standards of Practice
- Article 11 – 4 Standards of Practice
- Article 12 – 13 Standards of Practice
- Article 13 – 0 Standards of Practice
- Article 14 – 4 Standards of Practice
- Article 15 – 3 Standards of Practice
- Article 16 – 20 Standards of Practice
- Article 17 – 5 Standards of Practice

You can read the Standards of Practice associated with each article in your printed copy of the Code of Ethics.

## Changes to the Code

When needed, amendments to the Code and the Standards of Practice are made annually at the NAR Midyear Meetings and the REALTORS® Conference and Expo.

NAR has a group of members who belong to an Interpretations and Procedures Subcommittee. This body frequently makes recommendations to the Professional Standards Committee about enhancements to professional standards procedures and to the Code of Ethics.

All changes that are proposed to the Code and to the policies and procedures by which the Code is enforced must be approved by the Board of Directors. Amendments to the 17 Articles must also be approved by the Delegate Body.

## The Code and the Law

It's important to note the following:

- The Code must be reasonably and consistently construed with the law.
- The Code imposes duties above and in addition to the duties imposed by law or regulation.
- The Code restates certain fundamental legal principles, for example those principles dealing with contracts, agency, and fair housing.

## Enforcing the Code of Ethics

Local Associations of REALTORS® are responsible for enforcing the Code of Ethics, both in providing mediation and in holding arbitration hearings.

Only NAR members are subject to the Code of Ethics. Those associations in which REALTORS® are members or use the MLS in some capacity have authority over those persons to receive and decide ethics complaints and arbitration requests.

However, *associations do not determine whether licensees have violated any laws or real estate regulations*. Only the proper regulatory authority or court can make that kind of assessment.

Many times, the difficulties that arise between real estate professionals result from misunderstanding, miscommunication, or lack of satisfactory communication. When those situations arise, they can often be resolved through practical conversation about the matter causing the difficulty, thus reducing or even eliminating the need to take the matter any further.

However, if it happens that the licensees are unable to resolve a difficulty on their own; there are two courses of action available:

- Take advantage of informal dispute resolution.
- File an ethics complaint or an arbitration request.

## Informal Dispute Resolution

There are two avenues for informal dispute resolution:

- Using an ombudsman
- Submitting to mediation

### Ombudsman

The first form of informal dispute resolution is working with an ombudsman. This is a voluntary process. Ombudsmen do not participate in any formal or adjudicative process. They focus on communication and finding mutual, non-coerced agreement between the parties rather than determining who is right and who is wrong. Ombudsmen do not establish whether ethics violations have taken place. They foresee, recognize, and help settle misunderstandings and differences before they become full-blown disputes that can result in charges of unethical behavior.

### Real Estate Ombudsman Programs

Ombudsman programs in real estate are available only if the local association of REALTORS® offers the service. Since the program is voluntary for both REALTORS® and consumers, either or both parties involved in the dispute may refuse to use ombudsmen services.

Persons who serve as ombudsmen in real estate should be familiar with the Code of Ethics, their state's real estate regulations, and existing real estate practices. An ombudsman could be a REALTOR®, a staff member, or any number of other individuals as long as he or she possesses a good knowledge of real estate practices.

An ombudsman can answer questions and research complaints dealing with real estate transactions and issues surrounding ethical practices and the Code of Ethics. Ombudsmen can also reply to inquiries and complaints about members, arrange meetings, and assemble the parties who are having the dispute.

If an ethics complaint is resolved through an ombudsman, the complaint is considered discharged. If a member fails or refuses to comply with the terms of a mutually agreed upon decision, the complaining party can then file or re-file an ethics complaint.

### Mediation

The second form of informal dispute resolution involves submitting to mediation. Mediation is an informal intervention process conducted by a

trained third party, called a mediator. The aim of this process is to bring two parties together to sort out misunderstandings, expose concerns, and achieve a resolution. The process is voluntary, although sometimes it may be advised by an entity or agency.

During the mediation, each side will present its evaluation of the issue. The mediator will work with each party in an effort to work out a settlement. At the end of the process, the mediator can present his or her findings along with a possible solution. The mediation process is **non-binding**. The mediator does not force a decision on the parties, but instead tries to offer a solution that is acceptable to both parties. Mediation is often used to avoid taking a case to court.

Mediation is the preferred dispute resolution method of REALTOR® organizations because it is a way to generate a mutually-acceptable decision regarding a disagreement without having a judgment imposed by a hearing panel.

Mediation is also a voluntary process and one which must be available to all REALTORS®. Local associations have the option of offering mediation to the disputing parties before or after a grievance committee's review of any arbitration requests. If the association offers mediation before a grievance review, then they must offer it again after the grievance committee makes its determination on whether the matter is actually appropriate for arbitration.

In the real estate mediation process, the parties meet with a mediator who is appointed by the association. They follow the same process previously described. Then if they reach an agreement, the parties express the terms of the agreement in a signed document and an arbitration hearing becomes unnecessary.

## Formal Dispute Resolution

The avenues for formal dispute resolution include:

- Ethics complaints
- Arbitration

### Ethics Complaints

Ethics complaints are based on violations of the Code of Ethics. Anyone can file an ethics complaint – a member of the public or a licensee. Filing an ethics complaint through the local association gives members of the public an alternative to legal action, saving time and money for licensees and consumers.

Since complaints are based on Code violations, the person filing the complaint must list the Article or Articles of the Code that were violated. Once a complaint is filed, two groups of people are responsible for dealing with them:

- Grievance committee
- Hearing panel

The **grievance committee** is made up of members of the association. These members conduct a review of the complaint to determine if a possible violation of the Code of Ethics has occurred. This review is **not** a hearing on the merits, but rather a preliminary analysis to determine if the complaint calls for a hearing.

The grievance committee members will confirm the following information:

- The complaint was filed in the proper format.
- The appropriate parties are named in the complaint.
- It was filed within 180 days.
- Specific relevant articles are cited in the complaint, appropriate Standards of Practice are included as support if needed, and no inappropriate articles are cited.
- There is no reason that the Board would be unable to provide an impartial hearing panel.
- The respondent is a member of the local Board and was a member at the time of the alleged violation.
- If litigation or state government agency investigation is pending:
  - In the case of a criminal case, the committee will end any consideration of the violation and hold the file as pending until legal action is completed.
  - In the case of a civil case, the Board will ask its legal counsel to review the complaint and advise whether or not the hearing should proceed.
- Given that the alleged facts are taken as true on their face, a possible violation of the Code of Ethics did occur.

If the grievance committee establishes that a potential violation occurred, and if other requirements of the complaint process are met, the committee will submit the complaint to the Professional Standards Committee for a hearing by an ethics hearing panel.

If the grievance committee decides there was no violation and dismisses the complaint, the notice must contain the reasons for the dismissal. The complainant may appeal the dismissal to the Board of

Directors within 20 days of receiving the dismissal notice, explaining in writing why he or she disagrees with the dismissal. The Directors will review the same material seen by the grievance committee, along with the complainant's explanation of his or her disagreement of the dismissal, and render a final decision. The involved parties are not present at the appeal.

Complaints submitted to the Professional Standards Committee will move on to a hearing. The **ethics hearing panel** is the group that will conduct any full "due process" hearings. A hearing will include sworn testimony, counsel, witnesses, and evidence. A hearing panel is made up of members of an association's professional standards committee.

After a hearing, the panel will decide whether there has been a violation of the Code. Any violation must be supported by clear, strong, and compelling proof. If the panel decides that there was a violation, they must then determine what discipline they will impose on the violator. Discipline could include:

- Letter of warning.
- Letter of reprimand.
- Requirement to attend the ethics portion of a designated course or other appropriate course or seminar.
- Fine not to exceed \$15,000.
- Probation for not less than 30 days or more than one year.
- Membership suspension for not less than 30 days or more than one year, with automatic reinstatement at the end of the suspension period.
- Expulsion from membership for one to three years, with reinstatement by application only.
- Suspension or termination of MLS rights and privileges.

In addition, the panel may also impose an administrative processing fee of up to \$500. However, such processing fees should be the same for all cases, subject to association policy and not based on the specific case itself. Any administrative fee imposed would be in addition to, not part of, any disciplinary fine imposed.

The chief reason for imposing discipline for an ethics violation is to create a keen awareness of and appreciation for the Code. The hearing panel may impose more than one form of discipline. If a person

engages in more serious or repeated violations, the panel might choose to impose more severe forms of discipline or multiple forms of discipline.

Note that the forms of discipline available to the hearing panel do not deal with probation, suspension, or revocation of the REALTOR®'s real estate license. The hearing panel does not determine license violations and is not authorized to discipline those types of violations.

### Arbitration

While ethics complaints are based on violations of the Code of Ethics, arbitration issues are typically monetary disputes among broker members of the Association.

Article 17 of the Code of Ethics says that *"in the event of contractual disputes or specific non-contractual disputes ... between REALTORS® (principals) associated with different firms, arising out of their relationship as REALTORS®, the REALTORS® shall mediate the dispute if the Board requires its members to mediate. If the dispute is not resolved through mediation, or if mediation is not required, REALTORS® shall submit the dispute to arbitration in accordance with the policies of their Board rather than litigate the matter."*

The specific non-contractual disputes covered by this Article are listed in Standard of Practice 17-4. It would be a good idea for all real estate professionals to become familiar with these disputes by reading the content of Article 17 and its associated Standards of Practice.

The grievance committee also plays a role in arbitration. The committee will complete an initial screening similar to the type of screening it does when reviewing ethics complaints. It will confirm a lot of the same information it does for ethics complaints, as well as answering these questions:

- If the claims in the request for arbitration are taken as true on their face, is the matter at issue related to a real estate transaction that could be arbitrated properly; in other words, is there some basis on which an arbitration hearing could base an award?
- If an arbitrable issue exists, are the parties required to arbitrate or is their participation voluntary?
- Is the amount of the dispute too small or too large for arbitration?

- Is the matter too complex legally, involving matters that the arbitrators may not be able to address in a knowledgeable manner?
- Are there enough well-informed arbitrators available to address the issue?

As with mediation, this review is **not** a hearing on the merits, but rather a preliminary analysis to determine if a hearing is necessary.

The **arbitration hearing panel** is the group that will conduct any full "due process" hearings. As with an ethics hearing, an arbitration hearing will include sworn testimony, counsel, witnesses, and evidence. The hearing panel is made up of members of an association's professional standards committee.

After a hearing, the panel will decide who is entitled to an award, as demonstrated by a preponderance of the evidence. The panel uses the NAR's Arbitration Guidelines in the *Code of Ethics and Arbitration Manual* as the basis for its decision. The focus of the decision is typically "procuring cause" because that is the reason for most disputes between brokers.

There are no predetermined rules for deciding which party should receive the disputed commission, but there are several important considerations. Since procuring cause is the primary factor in making a decision, the panel must consider all pertinent events, testimony, and evidence, including the first showing of the property and the writing of an accepted offer.

Other procuring cause considerations could be:

- Starting a series of events without interruption that result in the sale.
- Whether there was a lack of contact and communication of the party to the contract.
- The type of contracts and status of the transaction.
- The relationship of the parties.

No sole consideration establishes procuring cause. The panel must reflect on all relevant conduct of the parties related to the transaction.

After appropriate consideration, the panel will decide which licensee is entitled to the disputed commission. The awards may be judicially enforced when not paid by the non-prevailing party. **Note:** Many associations require that when awards are not paid, an equal amount must be deposited with the



association until the hearing process can be reviewed or during the time any legal challenge is pending.

## Pathways to Professionalism

We have discussed the fact that the Code of Ethics establishes enforceable standards of conduct for REALTORS® to follow. However, the Code does not address issues surrounding courtesy or etiquette. For that reason, a subgroup of the Professional Standards Committee developed a list of professional courtesies that agents should follow. Following these courtesies is **strictly voluntary** and cannot form the basis for a professional standards complaint. Also, this list is not comprehensive. It can be supplemented according to local customs and practices.

The list is divided into three sections:

- Respect for the Public
- Respect for Property
- Respect for Peers

Here is the list as it appears on page 262 of the *NAR Code of Ethics and Arbitration Manual*.

### Respect for the Public

1. Follow the “Golden Rule”: Do unto others as you would have them do unto you.
2. Respond promptly to inquiries and requests for information.
3. Schedule appointments and showings as far in advance as possible.
4. Call if you are delayed or must cancel an appointment or showing.
5. If a prospective buyer decides not to view an occupied home, promptly explain the situation to the listing broker or the occupant.
6. Communicate with all parties in a timely fashion.
7. When entering a property, ensure that unexpected situations, such as pets, are handled appropriately.
8. Leave your business card if not prohibited by local rules.
9. Never criticize property in the presence of the occupant.

10. Inform occupants that you are leaving after showings.
11. When showing an occupied home, always ring the doorbell or knock—and announce yourself loudly—before entering. Knock and announce yourself loudly before entering any closed room.
12. Present a professional appearance at all times; dress appropriately and drive a clean car.
13. If occupants are home during showings, ask their permission before using the telephone or bathroom.
14. Encourage the clients of other brokers to direct questions to their agent or representative.
15. Communicate clearly; don’t use jargon or slang that may not be readily understood.
16. Be aware of and respect cultural differences.
17. Show courtesy and respect to everyone.
18. Be aware of—and meet—all deadlines.
19. Promise only what you can deliver—and keep your promises.
20. Identify your REALTOR® and your professional status in contacts with the public.
21. Do not tell people what you think—tell them what you know.

### Respect for Property

1. Be responsible for everyone you allow to enter listed property.
2. Never allow buyers to enter listed property unaccompanied.
3. When showing property, keep all members of the group together.
4. Never allow unaccompanied access to property without permission.
5. Enter property only with permission even if you have a lockbox key or combination.
6. When the occupant is absent, leave the property as you found it (lights, heating, cooling, drapes, etc.). If you think something is amiss (e.g., vandalism) contact the listing broker immediately.

7. Be considerate of the seller's property. Do not allow anyone to eat, drink, smoke, dispose of trash, use bathing or sleeping facilities, or bring pets. Leave the house as you found it unless instructed otherwise.
8. Use sidewalks; if weather is bad, take off shoes and boots inside property.
9. Respect seller's instructions about photographing or videographing their properties' interiors or exteriors.

### Respect for Peers

1. Identify your REALTOR® and professional status in all contacts with other REALTORS®.
2. Respond to other agents' calls, faxes, and e-mails promptly and courteously.
3. Be aware that large electronic files with attachments or lengthy faxes may be a burden on recipients.
4. Notify the listing broker if there appears to be inaccurate information on the listing.
5. Share important information about a property, including the presence of pets, security systems, and whether sellers will be present during the showing.
6. Show courtesy, trust, and respect to other real estate professionals.
7. Avoid the inappropriate use of endearments or other denigrating language.
8. Do not prospect at other REALTORS®' open houses or similar events.
9. Return keys promptly.
10. Carefully replace keys in the lockbox after showings.
11. To be successful in the business, mutual respect is essential.
12. Real estate is a reputation business. What you do today may affect your reputation—and business—for years to come.

### Sample Case Interpretations

The following cases, taken from the Case Interpreta-

tions section of the NAR website, will give you some idea as to how cases are handled. You can review a number of examples, arranged by Article number, at <http://www.realtor.org/code-of-ethics-and-arbitration-manual/table-of-contents>. Scroll to the bottom of the page under the heading "Interpretations of the Code of Ethics."

### Duties to Clients and Customers

**Related to Article 2:** REALTORS® must refrain from exaggeration, misrepresentation, or concealment of pertinent facts related to property or transactions.

#### Case #2-2: Responsibility for Sales Associate's Error

(Revised Case #9-5 May, 1988. Transferred to Article 2 November, 1994.)

REALTOR® A, a REALTOR® principal, was asked to list a neglected house that obviously needed a wide range of repairs. He strongly advised the owner that it would be to his advantage to put the house in good repair before offering it for sale, but the owner wanted it sold at once on an "as is" basis. REALTOR® A wrote a novel advertisement offering a "clunker" in poor condition as a challenge to an ambitious do-it-yourself hobbyist.

A few days later, Sales Associate B, who was not a Board member, from REALTOR® A's office showed the house to a retired couple who liked the location and general features, and who had been attracted by the ad because the husband was looking forward to applying his "fix-up" hobby to improving a home. The sale was made. Shortly thereafter, REALTOR® A was charged by the buyer with having misrepresented the condition of the property.

REALTOR® A accompanied Sales Associate B to the hearing, armed with a copy of his candid advertisement. The hearing established that the buyer fully understood that the house was represented to be generally in poor condition, but that while inspecting the house with a view to needed repairs, Sales Associate B had commented that since the house was of concrete block and stucco construction, there would be no termite worries since termites could not enter that type of construction. Sales Associate B confirmed this and his belief that the statement was correct. However, after the sale was made, the buyer ripped out a sill to replace it and found it swarming

with termites, with termite damage to floors in evidence. Further questioning established that there had been no evidence of termite infestation prior to the sale, and that the Sales Associate had volunteered an assurance that he thought was well grounded.

REALTOR® A, prior to the conclusion of the hearing, offered to pay the cost of exterminating the building and the cost of lumber to repair termite damage in view of Sales Associate B's failure to recommend a termite inspection, which was the usual and customary practice in this area. The complainant stated that this would satisfy him completely. It was the Hearing Panel's view that while REALTOR® A's actions were commendable, and would be taken into account by the Hearing Panel, REALTOR® A was still responsible for the errors and misstatements of the sales associates affiliated with him. The Hearing Panel concluded that REALTOR® A was in violation of Article 2.

## Duties to the Public

**Related to Article 12:** REALTORS® must paint a true picture in their advertising and in other public representations.

### Case #12-1: Absence of Name on Sign

(Reaffirmed Case #19-3 May, 1988. Transferred to Article 12 November, 1994. Revised November, 2001.)

Prospect A observed a sign on a vacant lot reading: "For Sale—Call 330-5215." Thinking he would be dealing with a For Sale by Owner, he called the number on the sign. He was surprised and offended that the lot was exclusively listed by REALTOR® A, and the telephone number on the sign was the home number of REALTOR-ASSOCIATE® B in REALTOR® A's office.

Prospect A filed a complaint against REALTOR® A and REALTOR-ASSOCIATE® B. REALTOR® A and REALTOR-ASSOCIATE® B alleging a violation of Article 12 of the Code of Ethics.

At the hearing, REALTOR® A stated that he permitted REALTOR-ASSOCIATE® B to put up the sign. REALTOR-ASSOCIATE® B's defense was that the sign was not a "formal" advertisement, such as a newspaper advertisement, business card, or billboard, to which he understood Article 12 to apply.

The Hearing Panel determined that the sign was an advertisement within the meaning of Article 12; that its use violated that Article of the Code; and that both

REALTOR® A and REALTOR-ASSOCIATE® B were in violation of Article 12.

## Duties to REALTORS®

**Related to Article 16:** REALTORS® must respect the exclusive representation or exclusive brokerage relationship agreements that other REALTORS® have with their clients.

### Case #16-1: Confidentiality of Cooperating REALTOR®'s Participation

(Revised Case #21-5 May, 1988. Transferred to Article 16 November, 1994.)

When Client A listed his home for sale with REALTOR® B, he explained that he wanted the sale handled without advertising and without attracting any more attention than was absolutely necessary. He said he understood that he would have to have some contacts with prospective buyers and possibly with other REALTORS®, but that he did not want the property filed with the MLS, advertised, or in any way publicly announced as being on the market. He asked REALTOR® B to impress the same restrictions on any other REALTORS® who might become involved in the transaction.

REALTOR® B, having reason to think that REALTOR® C was in touch with prospective buyers to whom the property would appeal, approached REALTOR® C to invite his cooperation, and explained fully the Client's instructions. REALTOR® B discussed the matter with no other REALTOR® and refrained from any kind of advertising of the property. But a few days later, REALTOR® B learned that REALTOR® D was discussing the property with prospective buyers, knew that REALTOR® C was working on it, knew the price at which the property had been listed, and other details about it. Questioning revealed that REALTOR® C had told REALTOR® D that he was working on the sale of the property.

On the basis of the information from REALTOR® D, REALTOR® B charged REALTOR® C with unethical conduct in a complaint to the Board of REALTORS® specifying that REALTOR® C's breach of confidence under the circumstances was a failure to respect his, REALTOR® B's, exclusive agency, and that this action had jeopardized his relationship with his client.

The complaint was referred to the Board's Professional Standards Committee, a hearing was scheduled, and

REALTOR® C was directed to answer the charge of unethical conduct in violation of Article 16.

At the hearing, REALTOR® B detailed the instructions of the client and the manner in which he had conveyed them to REALTOR® C in inviting his cooperation. REALTOR® D told the Hearing Panel that REALTOR® C had discussed the listing with him. REALTOR® C defended himself against the charge of violating Article 16 by saying that while he had discussed the matter briefly with REALTOR® D, he had not

expressly invited his cooperation, and, therefore, had not violated Article 16.

At the conclusion of the hearing, the panel held that REALTOR® B's complaint was valid; that proper respect for his exclusive agency and the circumstances under which it existed required REALTOR® C to observe the confidence entrusted to him and that REALTOR® C's discussion of the matter with REALTOR® D was in violation of Article 16.

## MODULE 2 REVIEW – BUSINESS ETHICS FOR REAL ESTATE PROFESSIONALS

You are *not* required to answer the module review questions to complete the 14-hour course. They are intended to help prepare you for the Final Exam. Choose the best response to each question. The answers are found in the back of the book.

**1. Which is *not* considered to be unethical behavior?**

- a. taking credit for work you did not do
- b. cheating on an exam
- c. selling a rundown house and disclosing known defects
- d. sexually harassing someone at work

**2. The Articles of the NAR Code of Ethics deal with all of the following duties, EXCEPT:**

- a. Duties to clients and customers
- b. Duties associated with the Brokerage Relationship Disclosure Act
- c. Duties to the public
- d. Duties to other REALTORS®

**3. The sections in Pathways to Professionalism do *not* include:**

- a. Respect for Peers
- b. Respect for the Public
- c. Respect for Pets
- d. Respect for Property

**4. The act of “outing” someone for illegal or unethical behavior is:**

- a. a legal issue that should be dealt with by HR.
- b. an act that normally involves retaliation by the person outed.
- c. generally not recommended due to repercussions that may occur.
- d. called whistleblowing and can be reported internally, externally, to law enforcement, or to a third party.

**5. Good ethical practices have to do with:**

- a. honesty
- b. competence
- c. trustworthiness
- d. all of the above



# **Trending in Real Estate Today**

**Specialty Topics for Today's Real Estate  
Professional (Modules 3-6)**

# Understanding Real Estate and Mortgage Fraud



## LEARNING OBJECTIVES

*Upon completion of this module, the student will be able to:*

1. Identify types and categories of fraud.
2. Describe the kinds of fraud perpetrated by buyers and sellers.
3. Discuss fraudulent schemes perpetrated by investors, builders, real estate licensee impersonators, and appraisers.
4. Explain other types of mortgage fraud.
5. Discuss deed fraud, internet fraud, and real estate wire fraud.
6. Identify helpful government anti-fraud legislation.

## INTRODUCTION

When it comes to business, there's always someone out there trying to take advantage of honest people. This is true in every line of business, but especially when it comes to real estate. Unfortunately, even when you are careful, deceitful characters are ever-present with bad intentions and will do anything to turn a quick profit. In this module, we will look at the different types of mortgage fraud and how fraud is entwined into real estate transactions.

There are two major segments of fraud in the real estate industry:

- **Real estate transaction fraud** deals with dishonest dealings during the listing, showing, and sale of a property.
- **Mortgage fraud** refers to an intentional misstatement, misrepresentation, or omission of information relied upon by an underwriter or lender to fund, purchase, or insure a loan secured by real property. Mortgage fraud should not be confused with **predatory mortgage lending**, which occurs when a consumer is misled or deceived by agents of the lender. However, predatory lending practices often co-exist with mortgage fraud.

Both the State of Florida and the U.S. government have created task forces comprised of investigators, financial analysts, and prosecutors who are targeting fraudulent real estate deals.

Under Florida's mortgage fraud law, (FS 817.545) the crime is defined, in part, as a material misstatement, misrepresentation, or omission relied upon by a lender, borrower, or anyone involved in the mortgage lending process to fund, purchase, or insure a loan.

## Types and Categories of Fraud

The following list defines just a few types of real estate fraud:

- **Mortgage Fraud** – This occurs when material information is misrepresented or crucial data related to a transaction is omitted.
- **Foreclosure Fraud** – This occurs when the home is wrongly foreclosed upon, leading the homeowners to think that they lost ownership which results in them giving up their home.
- **Title Fraud** – This happens when the title of the

property is falsely changed or the property is occupied through fraudulent methods. For example, an individual sells a property that belongs to another by pretending to be the owner of the property.

- **Value Fraud** – This can happen when the actual value of a listed property is inflated in price and a buyer purchases the property. This is often done by misrepresenting or omitting valuable information about the property and its features.

According to the FBI, Americans lose about \$150 million a year to real estate scams.

## Fraud Categories

Fraud can be classified into the following categories:

- **Actual Fraud** – Actual fraud is an intentional misrepresentation without any regard for the actual facts or their suppression. It can also be a promise made without any intention to follow through with that promise. Essentially, the person is outright lying. An example would be if a licensee told a buyer that the foundation of a house was completely fine when he or she knew it was not.
- **Negative Fraud** – Negative fraud is lying through omission. This occurs when someone does not disclose a material fact to an individual in an effort to get that person to enter into a contract. An example would be if a licensee was showing a home with roof issues, and the buyer asked if there were any problems with the roof, and the licensee changes the subject by saying, "Let's look at the backyard pool."
- **Constructive Fraud** – Constructive fraud is lying without knowing you are lying. There does not need to be intent to deceive someone. An example would be if a licensee was showing a home with a drainage problem and the buyer asked if there were any issues with rainwater runoff. The licensee replies, "No, it's fine," without any knowledge of the situation.
- **Negligence** – Negligence is omitting to perform a duty or failing to exercise a standard of care that a reasonably prudent person would have exercised in a similar situation. Negligence is typically due to a lack of time, forgetfulness, or just plain laziness. For example, if a licensee was listing a property and there was a question regarding the boundary lines, the licensee should contact the county building code office for clarification. If the licensee



does nothing, he or she could be found guilty of negligence.

## Perpetrators and Tactics

Fraud can take the form of either misrepresentation or negligence. In either case, a licensee may be liable for civil damages incurred by the purchaser due to the misrepresentation, or the licensee may be subject to disciplinary action against his or her license. In addition, the owner may be vicariously liable for damages for the licensee's misrepresentations, even in cases where the owner was not the source of the erroneous information given to the licensee.

To better understand the nature of fraud and for the purposes of fraud analysis, we will look at this subject from the perspective of who the perpetrators are and what tactics they use to commit fraud.

## FRAUD BY BUYERS AND SELLERS

There are a number of fraud schemes buyers and sellers can perpetrate during real estate transactions.

### Buyers

When seeking a mortgage, buyers can engage in any of these fraud tactics:

- **Occupancy fraud** – An applicant deliberately misstates the intended use of a property as a primary or secondary residence or an investment.
- **Transaction fraud** – The applicant misrepresents the nature of the transaction, such as an undisclosed agreement between parties, falsified down payments, non-arm's-length sale, or use of a straw buyer.
- **Property fraud** – An applicant intentionally misrepresents information about the property or its value.
- **Income fraud** – This occurs when a borrower overstates his or her income to qualify for a mortgage. This was most often seen with so-called stated income mortgage loans (referred to as liar loans), where the borrower, or a loan officer acting for a borrower with or without the borrower's knowledge, stated without verification the income needed to qualify for the loan.
- **Employment fraud** – This occurs when a borrower claims self-employment in a non-existent company or claims a higher position in a real company in

order to provide justification for a fraudulent representation of the borrower's income.

- **Failure to disclose liabilities** – Borrowers may conceal obligations, such as mortgage loans on other properties or newly acquired credit card debt, to reduce the amount of monthly debt declared on the loan application. This omission of liabilities artificially lowers the debt-to-income ratio, which is a key underwriting criterion used to determine eligibility for most mortgage loans. It is considered fraud because it allows the borrower to qualify for a loan which otherwise would not have been granted, or to qualify for a bigger loan than what would have been granted had the borrower disclosed his or her true debt.
- **Cash-back schemes** – This occurs when the true price of a property is illegally inflated to provide cash back to transaction participants, most often the borrowers, who receive a rebate which is not disclosed to the lender. As a result, the lender lends too much, and the buyer pockets the overage or splits it with other participants, including the seller or licensee. This scheme requires appraisal fraud to deceive the lender.
- **Identity theft** – This occurs when a person assumes the identity of another and uses that identity to obtain a mortgage without the knowledge or consent of the victim. In these schemes, the thieves disappear without making payments on the mortgage. The schemes are usually not discovered until the lender tries to collect from the victim, who may incur substantial costs trying to prove the theft of his or her identity.
- **Buy and bail** – This scam becomes increasingly popular during a recession market. Homes become worth less than the outstanding mortgage debt and are then said to be underwater. While still current in their mortgage payments, the homeowner identifies a similar home with a much lower purchase price. The homeowner obtains financing to purchase the new home, while falsely saying that the existing home will be rented out. Shortly after purchasing the new home, the owner makes no more payments on the prior home, which ultimately enters foreclosure.
- **Modification and refinance fraud** – A borrower that is attempting to refinance an existing loan intentionally understates income information in order to persuade the lender to accept the refinance on terms that benefit the borrower.

## Sellers

Sellers have been known to engage in these tactics during a real estate transaction:

- **Under-the-table exchange** – Lenders are reluctant to lend money to people who can't prove that they have the financial means to make regular loan payments. However, a hefty down payment can sway a lender's opinion. If a seller really needs to dump a property, he or she can give the borrower enough money for a down payment under the table. With the money in hand, the buyer can illegally qualify for the loan.
- **Gifting fraud** – It is much like the under-the-table exchange between a seller and a potential buyer, but in reverse. This *gift* is given officially, but then repaid under-the-table. *Note: An individual is allowed to gift part of a down payment for a home on the condition that the gift is not repaid.*

## OTHER REAL ESTATE INDUSTRY PROFESSIONALS

Other real estate industry professionals have also been guilty of perpetrating fraud. These perpetrators include investors, builders, licensees, and appraisers.

### Fraud by Investors

Investors have been involved in several fraud schemes and scams.

- **Document forgery** – To qualify for a loan, an investor may forge key documents to paint a more positive financial picture. This could include altering bank statements and earnings-related documents, such as W-2s. An investor might also misrepresent his or her employment status and the loan's purpose, or fail to disclose assets and liabilities.
- **Phony appraisals** – Some real estate investors might seek out incompetent appraisers to inflate a property's value. Also, an investor might offer the appraiser a kickback to inflate the appraised value. Instead of paying a bribe, an investor might provide the appraiser with altered or overly-optimistic information, such as unrealistically low vacancy rates, low expenses, and high rental rates.
- **Equity skimming** – An investor may use a straw buyer, false income documents, and false credit reports to obtain a mortgage loan in the straw buyer's name. Subsequent to closing, the straw buyer signs the property over to the investor in a quit claim deed, which relinquishes all rights to the property and provides no guaranty to title. The investor does not make any mortgage payments and rents the property until foreclosure takes place several months later.
- **Occupancy fraud** – With occupancy fraud, the borrower is looking to obtain a mortgage to purchase an investment property, but on the loan application he or she states that they will occupy the property as a primary residence or as a second home. The false information provided to the lender results in the borrower obtaining a lower interest rate, because interest rates for non-owner-occupied properties tend to be higher. The act is considered fraud because the borrower provided erroneous information to obtain a lower interest rate, which in turn affected the lender's risk.
- **Illegal property flipping** – Property is purchased, falsely appraised at a higher value, and then quickly sold. What makes property flipping illegal is the fraudulent appraisal information or false information provided during the transactions. The schemes typically involve one or more of the following: fraudulent appraisals; falsified loan documentation; inflated buyer income; or kickbacks to buyers, investors, property/loan brokers, appraisers, and title company employees.
- **Shot-gunning** – In these cases, a real estate investor submits multiple HELOC applications on the same property simultaneously. HELOC stands for **Home Equity Line of Credit**, or simply home equity line. It is a loan set up as a line of credit for some maximum draw, rather than for a fixed dollar amount. For example, using a standard mortgage you might borrow \$150,000, which would be paid out in its entirety at closing. Due to delays in lien filing, multiple bankers approve the borrower. While each banker believes he or she is first in line, in reality, the borrower draws down the HELOC and disappears—leaving the bank with a loss.
- **Working the gap** is similar to shot-gunning. This technique entails excessive lien stacking knowingly executed on a specific property within an inordinately narrow timeframe, via the serial recording of multiple Deeds of Trust or Assignments of Note. When recording a legal document, a time gap exists between when the Deed of Trust is submitted to the recorder of deeds and when it actually shows

up in the data. The precision timing technique of working the gap between the recording of a deed and its subsequent appearance in the recorder of deeds database is instrumental in the perpetrator's deception.

A title search done prior to the respective loan, promissory note, and deed recording would thus erroneously fail to show the alternate liens concurrently in the queue. The goal of the perpetrator is the theft of funds from each lender by deceit, with all lenders simultaneously and erroneously believing their respective Deeds of Trust to be senior in position.

### Investor Fraud Case Study

The following scenario is an example of investor fraud that took place in Florida.

A story appeared in a local newspaper that discussed an investor who would change locks on vacant houses and forge property records to make himself appear as the owner of the properties. The investor fraudulently acquired several properties and made over \$200,000 in rents, mortgage payments and deposits prior to being arrested.

### Fraud by Builders

Builder bailout/condo conversion: Builders facing rising inventory and declining demand for newly constructed homes employ bailout schemes to offset losses. Builders find buyers who obtain loans for the properties but who then allow the properties to go into foreclosure. In a condo conversion scheme, apartment complexes purchased by developers during a housing boom are converted into condos, and in a declining real estate market, developers often have excess inventory of units. So developers recruit straw buyers with cash-back incentives and inflate the value of the condos to obtain a larger sales price at closing. In addition to failing to disclose the cash-back incentives to the lender, the straw buyers' income and asset information are often inflated in order for them to qualify for properties that they otherwise would be ineligible or unqualified to purchase.

### Fraud by Impersonating a Real Estate Licensee

Persons acting as real estate licensees sometimes carry out a fraudulent scheme known as **chunking**. This scheme involves multiple properties or mortgage loans that are chunked together. While acting as a real estate licensee, the scammer convinces an innocent buyer to purchase a property. The scammer obtains the buyer's personal information in order to obtain the loan. Without the buyer's knowledge the scammer submits the buyer's personal information to several different lenders and for several different properties, not just the property that the buyer knows about. A key element of a chunking scheme is that the scammer is the seller of all of these properties. The closings ultimately occur on all of the properties and the scammer pockets all of the proceeds.

### Fraud by Appraisers

Appraisal fraud occurs when a home's appraised value is deliberately overstated or understated. When overstated, the borrower can obtain more money in the form of a cash-out refinance, by the seller in a purchase transaction, or by the organizers of a for-profit mortgage fraud scheme. Appraisal fraud also includes cases where the home's value is deliberately understated to get a lower price on a foreclosed home or in a fraudulent attempt to induce a lender to decrease the amount owed on the mortgage in a loan modification. A dishonest appraiser may be involved in the preparation of the fraudulent appraisal, or an existing and accurate appraisal may be altered by someone with knowledge of graphic editing tools.

## OTHER MORTGAGE FRAUD

Mortgage fraud can also be a criminal enterprise or be perpetrated by unscrupulous providers or imposters.

### Criminal Enterprise

This type of mortgage fraud involves the use of real estate in illegal endeavors, such as money laundering. The goal of money laundering is to conceal where the money came from and its current use. Property flipping is a common way to reach this goal.

## Unscrupulous Mortgage Providers

These dishonest mortgage providers engage in the following fraudulent schemes.

- **Mortgage servicing fraud** – This occurs when a mortgage servicing company diverts principal, interest, or escrow funds from the underlying lender and retains those funds for its own use.
- **Reverse mortgage fraud** – A person obtains title to property and then deeds the property to a fake individual that qualifies for the loan under the age requirements of a reverse mortgage. The swindler then obtains the lump sum cash-out reverse mortgage option or receives monthly payments from the lender until the scam is identified.
- **Double selling** – Double selling involves a conspiring mortgage broker or loan officer. The loan officer obtains a potential borrower's personal information. The loan officer then copies the loan application and sends it to several different warehouse lenders asking that they fund the loan. All of the closings are scheduled within a few days of one other so that each lender is unaware of the other transactions. Each of the different funding lenders ultimately have competing loans against only one property.
- **Fictitious loan** – A bank insider or mortgage broker creates a fake loan application using a real person's identity. The loan is funded and the seller receives proceeds for a property that does not exist.
- **Falsification of a loan application for commission** – A loan officer falsifies a loan application without the knowledge of the borrower, while knowing the borrower does not actually qualify for the loan. However, the loan gets approved and the loan officer gets his or her commission. The borrower struggles to repay the loan and eventually defaults on the loan.
- **Lease-back scams** – Unscrupulous lenders engage in a lease-back scam designed to prey on homeowners who are in financial trouble. In this situation, the lender offers the homeowner an opportunity to sign over a deed with the promise of the lender leasing back the property to enable continued occupancy. Subsequently, the lender will charge a prohibitively high rent to force the victim out of the house, then resell the property for a profit.
- **Credit insurance packing** – The lender adds credit life or disability insurance premiums to the loan. This insurance is expensive and may not be

necessary. It is also sold without regard to the borrower's ability to benefit from the coverage. No lender may require credit insurance as a condition of making a home mortgage loan.

## Mortgage Fraud by Imposters

Imposters can engage in fraudulent practices in the following ways:

- **Straw buyer** – A straw buyer is a person who purchases on behalf of another person. A straw buyer is used when the real buyer cannot complete the transaction for some reason. It is not necessarily illegal to use a straw buyer. The act is considered illegal where the transaction involves fraud or purchasing real estate for someone who is legally barred from making the purchase himself or herself. Straw buyer fraud is a complex scheme that frequently involves real estate licensees, appraisers, and mortgage brokers who make use of the straw buyer for illicit gains.
- **Air loans** – This is a non-existent property loan where there is usually no collateral. Air loans involve brokers who invent borrowers and properties, establish accounts for payments, and maintain custodial accounts for escrows. They may establish an office with a bank of telephones, each one used as the fake employer, appraiser, credit agency, etc., to fraudulently deceive creditors who attempt to verify information on loan applications.
- **Foreclosure rescue schemes** – The perpetrators identify homeowners who are in foreclosure or at risk of defaulting on their mortgage loan and then mislead them into believing they can save their homes by transferring the deed or putting the property in the name of an investor. The perpetrators profit by selling the property to an investor or straw borrower, creating equity using a fraudulent appraisal, and stealing the seller proceeds or fees paid by the homeowners. The homeowners are sometimes told they can pay rent for at least a year and repurchase the property once their credit has been reestablished. However, the perpetrators fail to make the mortgage payments and usually the property goes into foreclosure.
- **Home equity conversion mortgage (HECM)** – A HECM is a reverse mortgage loan product insured by the Federal Housing Administration to borrowers who are 62 years or older, own their own property (or have a small mortgage balance),

occupy the property as their primary residence, and participate in HECM counseling. It provides homeowners access to equity in their homes, usually in a lump sum payment. Perpetrators taking advantage of the HECM program recruit seniors through local churches, investment seminars, and television, radio, billboard, and mailer advertisements. The scammers then obtain a HECM in the name of the recruited homeowner to convert equity in the homes into cash. The scammers keep the cash and pay a fee to the senior citizen or take the full amount unbeknownst to the senior citizen. No loan payment or repayment is required until the borrower no longer uses the house as a primary residence. In the scheme, the appraisals on the home are vastly inflated and the lender does not detect the fraud until the homeowner dies and the true value of the property is discovered.

- **Upfront fee scam** – Upfront fee scams involve the mortgage applicant sending a processing fee along with a loan application. After paying the processing fee, the applicant never hears back from the lender.

## OTHER TYPES OF FRAUD

Deed fraud, internet fraud, and real estate wire fraud are other types of common deception.

### Deed Fraud

One little known aspect of identity theft is deed fraud. Deed fraud occurs when someone steals your identity, forges your name on a deed, and takes title to your home. While it may seem that it should be a simple matter to get your home back after becoming a victim of deed fraud, nothing in the law is very simple.

All fifty states and the District of Columbia demand written documents (primarily deeds) to transfer ownership of real property. These documents must contain, at minimum, the following information in order to effectively convey an interest in property:

- A title clearly stating the nature of the document (warranty deed, grant deed, quitclaim deed).
- The name of the property's owner of record (the grantor).
- A granting clause that states the grantor's intent to convey the property to the grantee.

- The purchaser's name (the grantee).
- A detailed, formal description of the property.
- The signature and printed name of the grantor or an authorized representative.
- An acknowledgement by a notarial officer.

Valid conveyances require that the executed deed be delivered to and accepted by the grantee. Because actual (hand-to-hand) delivery is not always possible, most states also allow constructive delivery, wherein an acknowledged and recorded deed presumes prima facie evidence of due delivery. The delivery requirement exists to ensure that the grantee knows about the transfer of ownership as well as the associated responsibilities such as taxes and maintenance.

Recording the deed, while not expressly required by law in every state, is an important factor in securing interests in real estate. Entering ownership changes into the public record serves as constructive notice to future buyers, who should research the chain of title prior to purchasing property. Even with all the checks and balances regarding deed verification and transfer, deed documents are forged.

There are a number of deed fraud possibilities. Let's just look at a few.

- The deed assignment was executed by a party pursuant to a Power of Attorney but no Power of Attorney is attached to the instrument or filed with the instrument or otherwise recorded with local land registry.
- The deed assignment is executed by a party who claims to be an *attorney in fact* for the assignor.

The parties who executed the assignment and who notarized the signature are in fact the same parties.

- The signor states that he or she is an *agent* for the executing entity.
- The name of one or more of the signors is stamped on the document.
- The document is a form with standard fill-in-the-blank spaces for names and amounts.
- The signature of one or more parties on the document is not legible.
- The document is dated and signed years before the document is actually filed with the register of real estate documents or deeds or mortgages.
- The document includes any type of bar code that

was not added by the local register or filing clerk for such instruments.

- The document includes a reference to an instrument or form number.
- The paragraph numbers on the document are not consistent. For example, the last paragraph on page one is 10 and the first paragraph on page two starts with number 12.
- The document is signed by a bank officer without any designation of the office held by the officer.
- The parties who signed the assignment and the person who notarized the signatures are located in different states or counties.
- The transferor and the transferee have the same physical address including the same street and post office box numbers.
- The assignor and the assignee have the same physical address including the same street and post office box numbers.
- The document bears the following legend: **This is not a certified copy.**

## Internet Fraud

Scam artists have probably been around as long as humans have and their basic bag of tricks has not changed much. However, the Internet is providing new tools for scammers. Now, scammers are found anywhere worldwide and they can fleece buyers and homeowners without even a face-to-face meeting. Here are five common schemes:

- **Third-party brokers** – Third parties, calling themselves brokers, real estate attorneys, financial managers, or other professional sounding titles, offer to help find the best mortgages, locate buyers, and assist with title searches for a fee, of course. Although some are legitimate, many are not – and in most cases their services are not really required anyway. Fraudulent brokers always demand up-front payments.
- **Marketplace listings** – Many posting sites can be a place to find a good property deal. However, these marketplace sites also attract scammers, who pull legitimate home listings from online real estate sites and repost them. They may ask for a deposit to hold the property until the potential buyer can inspect it, then vanish with the deposit money.

## CASE STUDIES

- **Mortgage and Foreclosure Rescue Fraud Scheme** – In downturn markets, panicked homeowners fear losing their homes and look for help to stay afloat. Typically, government and private lenders have rolled out refinancing programs to help them out. However, con artists have also moved in, offering refinancing deals for an upfront fee. After a fee is paid, the money and con artist disappear. In Vallejo, California a man was sentenced to four years in prison for conspiracy to commit bank fraud. According to court documents, this individual along with co-conspirators, preyed on homeowners nearing foreclosure. They convinced homeowners to sign over the title to their homes and then spent any equity those homeowners still had on the operational expenses of the scheme and personal expenses.
- **Short sale scams** – Scammers often step in to negotiate a short sale for a fee. Some even help sellers damage the property, rendering it less desirable for a cheaper sale. A real estate licensee in Oviedo, Florida, pleaded guilty to making a false statement to a financial institution. He faces a maximum penalty of 30 years in federal prison. According to the plea agreement, the licensee executed a scheme to influence financial institutions to approve short sales of real estate at a loss by making false statements on various documents.

Refer to:

<https://search.justice.gov/search?query=vallejo+&op=Search&affiliate=justice>

<https://www.justice.gov/usao-mdfl/pr/florida-realtor-pleads-guilty-making-false-statement-financial-institution>

## REAL ESTATE WIRE FRAUD

This scam starts with scammers trolling online Multiple Listing Service (MLS) sites. Thieves identify a pending home sale. Then the fraudsters profile all parties in the transaction and attempt to hack one of the email accounts involved. Once they are in, they bide their time, watching ongoing correspondence until they can step in and send out false wiring instructions to steal away a down payment, closing costs, or mortgage payoff funds.

Authorities say that the sheer number of parties involved in a transaction is part of the problem. Everyone in a transaction is vulnerable: attorneys, lenders, real estate licensees, title companies, sellers, and buyers.

It is estimated that the losses from these fraud schemes is in excess of \$10 billion dollars a year.

## RED FLAGS

It is difficult to stay ahead of scams because of the fluid nature of fraudsters and their ever-changing tactics. However, some red flags that real estate professionals should be aware of when involved in a transaction that may indicate further due diligence include the following:

- Documentation includes deletions, correction fluid, or other alteration.
- Buyer currently resides in the subject property.
- A Power of Attorney was used.
- Owner is someone other than seller shown on sales contract.
- Purchase price is substantially higher or lower than current market value.
- Seller owned the property for short time and buyer has pre-existing financial interest in the property.
- Date and amount of existing encumbrances appear suspicious.
- Chain of title includes an interested party such as realtor or appraiser.
- Buyer and seller have similar names. Property flips often utilize family members as straw buyers.
- Earnest money deposit equals the entire down payment or is an odd amount.
- Real estate commission is excessive.
- Buyer is reluctant to bring good funds to closing.
- Lender or broker request changes that are not in writing and which are contrary to written closing instructions.

## GOVERNMENT ANTI-FRAUD LEGISLATION

State and federal governments have passed many types of anti-fraud legislation. The following are just a selected few.

## Fraud Enforcement and Recovery Act of 2009 (FERA)

In May 2009, the Fraud Enforcement and Recovery Act of 2009 (FERA) was enacted. The law takes a number of steps to enhance criminal enforcement of federal fraud laws, especially regarding financial institutions, mortgage fraud, and commodities fraud. By amending the definition of **financial institution** to include a **mortgage lending business**, FERA gives the Justice Department the capability to prosecute mortgage fraud cases as bank fraud and to seek enhanced penalties under the mail and wire fraud statutes.

As a result, convictions for mortgage fraud can now carry a 30-year maximum prison sentence or a maximum \$1 million fine, or both. Even more importantly, mortgage fraud cases will now have a 10-year statute of limitations, as opposed to the 5-year statute of limitations for other frauds. This will give federal prosecutors much more time to develop such cases.

FERA extends the reach of the statute concerning false statements in mortgage applications to include false statements intended to influence any action by a mortgage lending business. Before the enactment of FERA, the false statements statute applied only to false statements intended to influence the action of federal agencies, banks, and credit associations. This statute also carries a 30-year maximum prison sentence or a maximum \$1 million fine, or both.

## The Dodd-Frank Act

The Dodd-Frank Act (fully known as the Dodd-Frank Wall Street Reform and Consumer Protection Act) is a federal law that places regulation of the financial industry in the hands of the government. The legislation, which was enacted in July 2010, created financial regulatory processes to limit risk by enforcing transparency and accountability.

## The Home Ownership and Equity Protection Act (HOEPA)

The Home Ownership and Equity Protection Act (HOEPA) was enacted in 1994 as an amendment to the Truth in Lending Act (TILA) to address abusive practices in refinances and closed-end home equity loans with high interest rates or high fees. Since HOEPA's enactment, refinances or home equity

mortgage loans meeting any of HOEPA's high-cost coverage tests have been subject to special disclosure requirements and restrictions on loan terms, and consumers with high-cost mortgages have had enhanced remedies for violations of the law.

## The Bank Secrecy Act

The Bank Secrecy Act of 1970 (BSA), also known as the Currency and Foreign Transactions Reporting Act, is a law requiring financial institutions to assist government agencies in detecting and preventing money laundering. Specifically, the act requires financial institutions to keep records of cash purchases of negotiable instruments, file reports if the daily aggregate exceeds \$10,000, and report suspicious activity that may signify money laundering, tax evasion, or other criminal activities.

## Home Mortgage Disclosure Act (HMDA)

The Home Mortgage Disclosure Act requires certain financial institutions to provide mortgage data to the public. Congress enacted HMDA in 1975. HMDA grew out of public concern over credit shortages in certain urban neighborhoods. Congress believed that some financial institutions had contributed to the decline of some geographic areas by their failure to provide adequate home financing with reasonable terms and conditions to qualified applicants.

## Florida Statute Sections 817.545(2) & (5)

Mortgage fraud is defined in Florida Statute Sections 817.545(2) & (5). To prove that a person committed mortgage fraud, the State must prove that the person, with the intent to defraud, knowingly did any of the following:

- *Made any material misstatement, misrepresentation, or omission* during the mortgage lending process with the intent that the misstatement, misrepresentation, or omission would be relied on by a mortgage lender, a borrower, or any other person or entity involved in the mortgage lending process.
- *Used or facilitated the use of any material misstatement, misrepresentation, or omission* during the mortgage lending process with the intent that the material misstatement, misrepresentation, or omission would be relied on by a mortgage lender, a borrower, or any other person or entity involved in the mortgage lending process.
- Received any proceeds or other funds in connection with the mortgage lending process that he or she knew resulted from *the making of* any material misstatement, misrepresentation, or omission during the mortgage lending process that was made with the intent that the misstatement, misrepresentation, or omission would be relied on by a mortgage lender, a borrower, or any other person or entity involved in the mortgage lending process.
- Received any proceeds or other funds in connection with the mortgage lending process that he or she knew resulted from *the use of* any material misstatement, misrepresentation, or omission during the mortgage lending process that was made with the intent that the material misstatement, misrepresentation, or omission would be relied on by a mortgage lender, a borrower, or any other person or entity involved in the mortgage lending process.
- Filed or caused to be filed with the clerk of the circuit court for any Florida county a document involved in the mortgage lending process which contained a material misstatement, misrepresentation, or omission.

## KEEPING UP WITH THE LATEST SCAMS

There are a number of sources you can contact to find out about recent mortgage scams and fraud cases. Two good sources include the Federal Bureau of Investigation and the Financial Fraud Enforcement Task Force.

## Federal Bureau of Investigation

The FBI is committed to aggressively pursuing those who endanger the stability of the banking system and the safety of assets and personal information the public has entrusted to its care. In financial institution fraud (FIF) investigations, the Bureau continues to concentrate its efforts on organized criminal groups that prey on banks and engage in patterns of activity that lead to large aggregate losses. When FIF schemes involve single actors, the FBI prioritizes cases with high losses or significant community impact.



## Financial Fraud Enforcement Task Force

The Financial Fraud Enforcement Task Force was started in November 2009 to wage aggressive and coordinated investigations and prosecutions of financial frauds and maximize the ability both to recover the proceeds of these frauds and obtain just and effective punishment of those who commit them.

## How to Report Fraud

If you believe a fraud scam is unfolding, you can contact one or more of the following regulatory bodies:

- **Federal Trade Commission (FTC)** – The Federal Trade Commission (FTC) is an independent agency that was established in 1914. Its principal mission is the promotion of consumer protection and the enforcement of civil antitrust law through the elimination and prevention of anticompetitive business practices.
- **U.S. Department of Housing and Urban Development (HUD) Office of Inspector General (OIG)** – The OIG maintains a hotline which allows for reporting allegations of fraud, waste, abuse, or mismanagement to HUD. OIG takes all reports seriously and will investigate all complaints.

- **Department of Justice (DOJ)** – This department is responsible for investigating instances of financial fraud, representing the United States government in legal matters and running the federal prison system.
- **Internal Revenue Service (IRS)** – Through federal tax fraud investigations and money laundering charges, the Internal Revenue Service is playing a key role in the fight against real estate fraud.
- **Florida Attorney General's Office** – The Florida Attorney General is an elected cabinet official. The attorney general serves as the chief legal officer of the state and is head of the Florida Department of Legal Affairs.

## SOURCES

[https://search.justice.gov/search?query=vallejo+&op=Search&affiliate=justice\)](https://search.justice.gov/search?query=vallejo+&op=Search&affiliate=justice)

[https://www.justice.gov/usao-mdfl/pr/florida-realtor-pleads-guilty-making-false-statement-financial-institution\)](https://www.justice.gov/usao-mdfl/pr/florida-realtor-pleads-guilty-making-false-statement-financial-institution)

[https://www.fbi.gov/investigate/white-collar-crime/mortgage-frauds:](https://www.fbi.gov/investigate/white-collar-crime/mortgage-frauds)

## MODULE 3 REVIEW – UNDERSTANDING REAL ESTATE AND MORTGAGE FRAUD

You are *not* required to answer the module review questions to complete the 14-hour course. They are intended to help prepare you for the Final Exam. Choose the best response to each question. The answers are found in the back of the book.

- 1. The misrepresentation of material information or the omitting of crucial data related to a transaction is referred to as:**
  - a. value fraud
  - b. title fraud
  - c. foreclosure fraud
  - d. mortgage fraud
  
- 2. Which of the following is a common internet fraud scheme?**
  - a. third-party brokers
  - b. marketplace listings
  - c. refinancing assistance
  - d. all the above
  
- 3. The Fraud Enforcement and Recovery Act (FERA) was enacted in:**
  - a. 2009
  - b. 2011
  - c. 2018
  - d. 2019
  
- 4. The Dodd-Frank Act was enacted in:**
  - a. 2008
  - b. 2009
  - c. 2010
  - d. 2011
  
- 5. The law enacted in 1970 requiring financial institutions to assist government agencies in detecting and preventing money laundering is the:**
  - a. Home Ownership and Equity Protection Act
  - b. Home Mortgage Disclosure Act
  - c. Fraud Enforcement and Recovery Act
  - d. Bank Secrecy Act

**~ NOTES ~**

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# Working With Real Estate Investors



## LEARNING OBJECTIVES

*Upon completion of this module, the student will be able to:*

1. Discuss the benefits of working with investors.
2. Describe the different types of investing.
3. Explain Real Estate Investment Trusts.
4. Discuss different types of financing.
5. Explain crowdfunding.
6. Identify questions to ask before taking on an investor.

## INTRODUCTION

Regardless of what part of the real estate industry you work in, you are surrounded with news regarding major mergers, high-profile acquisitions, and major land development deals that large organizations are transacting. In addition, hardly a day goes by when a real estate investment guru is not promoting his or her get-rich-quick books or seminars. Even reality TV has its share of all manner of flippers and investors.

It is not surprising, because real estate is a vibrant business that creates a lot of buzz and interest with all types of people, from first-time homebuyers to chief financial officers when big projects are announced. However, this module will focus on a niche part of the industry that deals with small-time investors. Essentially, we will look at transactions that occur between a single real estate licensee and a single buyer or small group of buyers. For the sake of study, we will try to focus only on the purchases of residential investment property that sells for \$5 million or less. In this module, we will simply use the term **investor** to denote our targeted audience of small-time investor customers.

Real estate attracts investors because:

- Real estate provides better returns than the stock market with little volatility. Over time, the value of the investment increases as the investor builds equity. The risks in the stock market are numerous and beyond an individual's control. Real estate gives the investor more control of the investment because the property is a tangible asset that the investor can leverage to capitalize on numerous revenue streams, while enjoying capital appreciation.
- Real estate is a highly tangible asset. There will always be value in land. Other investments can result in little to no tangible asset value such as stocks, commodities, futures, and even some pension funds.
- History shows that the longer an investor holds onto real estate, the more money he or she will make. Real estate has always recovered from a boom and bust business cycle.
- A property investment can diversify an investor's portfolio to mitigate financial risk.
- Real estate investing comes with numerous tax benefits, such as tax deductions on mortgage

interest, cash flow from investment properties, operating expenses, property taxes, and insurance.

## Investor's Perception

The first thing that you will notice when working with investors is that investors don't think like homebuyers. Homebuyers typically ask these types of questions:

- Is the house located in a good neighborhood?
- How is the local school district?
- How far is the house to my work?

Investors typically ask these types of questions:

- What is the monthly passive cash flow?
- Is a 1031 Exchange on the table?
- What is the vacancy factor?

Obviously, the needs of an investor are different than those of a homebuyer. To be successful, an a real estate licensee needs to be able to talk-the-talk of investor-speak.

## Educating Investor Customers

A major hurdle to overcome when working with investors is educating them to the benefits of working with a qualified real estate licensee.

It is not your job to teach customers how to invest in real estate. However, you are in an ideal position to assist them with your knowledge, skills, expertise, and access to technology to support their efforts. A licensee working with potential investors has a lot of negative images to overcome, because the teaching of real estate investing has been too often associated with sleazy snake oil salespersons on late night TV and bogus advertisements.

True real estate investing is an art and science of building wealth by meeting customer's needs. A successful real estate licensee must always remember to overcome the investor-hype with honesty, dedication, and professionalism.

## Benefits of Working with an Investor

Courting investors can be a very lucrative strategy. An investor can become an real estate licensee's number one source of income, based on the following criteria:

- **Multiple Deals** – Investors buy a lot of properties. Sure, some investors buy one or two properties per year, but other investors have dozens of deals per year. Just getting a few investors can quickly add to your income.
- **Lots of Investors** – According to a recent study, there over 28 million real estate investors in America. Over seven million claim to be active real estate investors and plan to buy at least one property in the next 12 months. (Source: <https://www.propstream.com/news/3-types-of-real-estate-investing>)
- **Investors Buy and Sell Often** – A typical homeowner may only buy and sell a home every 7-10 years. Investors buy and sell all the time.
- **No-Drama Transactions** – An investor has much less emotional attachment to a property, making the whole process much more systematic. For example, when dealing with a homebuyer, emotional things like a planter, a dog house, or a swing set can make or break a deal. Investors look at objective measures, such as cap rates and income potential.
- **Less Hand-Holding** – Experienced investors know the rules. They won't become unglued over some mold on the bathroom wall. They do their homework before making an offer. They also have financial approval before negotiations start.
- **Referrals** – Investors have a good network in the community. They strengthen those connections by giving out good recommendations. If your services are of high quality, you can expect your investors to tell others.

## Core Investment Factors

A real estate investor generally focuses on two things:

- **A niche** – A niche is a type of investment property, like single-family homes, small multifamily residences, apartments, condos, etc.
- **A strategy** – A strategy is the way the investor makes money, such as fixing and flipping, buy and hold, or wholesaling. Investors may focus on several different niches or strategies at the same time, so it's important to recognize what kind of investing your customer does and how he or she views a potential deal.

## TYPES OF INVESTING

Investment strategies fall into one or more of the following types:

- Fixing and Flipping
- Wholesale
- Buy and Hold
- Buy/Flip/Hold

### Fixing and Flipping

Essentially, a house flipper buys a property that needs repair at a deep discount. The flipper fixes the problems and re-lists the house for a retail sale. Working with a successful flipper can be very profitable, because this type of investor may buy and sell dozens of houses a month. Some investors focus on complete rehabs that can run into thousands of dollars, while others are simply looking to add cosmetic touches and re-list the home.

Flippers need to get incredible deals in order to turn a profit and hedge against costly unforeseen problems. Some investors make hundreds of low-ball offers, hoping to get just a small percentage accepted. Other investors are more methodical and go after only targeted properties. Regardless of the strategy, the real estate licensee needs to expect a high number of rejected offers, simply because an investor must get a good deal. As a licensee, this is clearly a frustrating task, so it is important to decide if you want to work with these types of transactions.

Also, when working with flippers, speed is incredibly important. In a competitive market, flipper properties are snatched up quickly, so a licensee must be prepared to work fast and have a system in place that is efficient.

On the sale side, flippers have *holding costs* tied up in the property. They need to sell as quickly as possible to avoid eating into their potential profits. So, most flippers don't ask for unrealistic selling prices. They would rather price their property competitively, sell it, and then move on.

**Flipper's formula.** As a rule of thumb, flippers use the **70% Rule** when determining a purchase. The 70% Rule says that you should only pay 70% of what the after repair value (ARV) is, less the repair costs. For example: A home which, after being fixed

up, should sell for approximately \$200,000, needs approximately \$30,000 worth of work. Using the 70% Rule, a person should multiply \$200,000 by 70% to get \$140,000. Then subtract the \$30,000 in repairs. The most a person should pay for this property should be \$110,000 ( $\$140,000 - \$30,000 = \$110,000$ ). Remember, the 70% Rule is a rule of thumb and is used as a quick screening tool. If a property passes the formula, it is worth further investigation. Never use the 70% Rule to decide exactly how much a customer should invest.

## Wholesale

The second type of investor falls into the Wholesale group. Wholesalers work to find incredible deals from motivated sellers. Wholesalers sign a contract with the seller and then assign that deal to other investors for a fee. A finder's fee typically ranges from \$2,000-\$10,000. In a way, the wholesaler is brokering a deal by bringing together a buyer and a seller. Most wholesalers buy and sell without involving a real estate licensee, but it is still a good idea to understand what a wholesaler is and how he or she works. You are most likely to work with a wholesaler when one wants to sell a property by listing it on an MLS.

Another way wholesalers make money is to sell the home to an interested party before the contract with the original homeowner closes. This means no money exchanges hands between the wholesaler and the seller, not at least until the wholesaler finds a buyer. In this type of wholesale transaction, the wholesaler makes money by finding a buyer willing to purchase the home at a price higher than the amount agreed upon by the buyer. The difference in price (paid for by the buyer) is the profit, retained by the wholesaler.

Real estate wholesaling requires a lot of time, commitment, and patience. Wholesalers need to have great communication skills, marketing sense, and a deep network of investors with disposable income who are interested in buying properties.

Finding the right kind of property is the key to wholesaling. Homeowners who own distressed properties and are eager to sell make great prospects. These properties can be very attractive to potential investors, especially if they are in the right location, come with already desirable features, and have the right price attached.

Wholesalers must be very precise in the kind of offer they make. If they go too low, they run off potential sellers. If they go too high, they may not be able to find a buyer who is willing to take on the risk of buying and fixing up a distressed property.

The key to wholesaling is to add a contingency to the purchase contract that allows the wholesaler to back out of the deal if he is unable to find a buyer before the expected closing date. This limits the wholesaler's risk.

Real estate wholesaling is similar to flipping. Both use property as a means to invest and make a profit. And both require a purchase contract and selling a home in some form or another. However, there are key differences:

- The time frame with wholesaling is much shorter than it is with flipping.
- The wholesaler does not fix or repair the home.

Since the wholesaler never actually purchases a home, wholesaling is much less risky than flipping. Flipping involves renovation costs, mortgage expenses, property taxes, and insurance.

## Buy and Hold

The third type of investor is the Buy and Hold investor. This investor buys and holds real estate for the long haul. Some of these investors are looking for turn-key dwellings, while others are looking for distressed properties. However, most are looking for something in between. The primary goal of these investors is positive cash flow.

In the most simple terms, cash flow is the extra money left in the investor's bank account after all the bills are paid, including those expenses that don't come on a regular schedule, like maintenance and vacancy. Cash flow is typically reported in terms of monthly cash flow or annual cash flow.

**Calculating cash flow.** To calculate cash flow, take the total income potential for a property and then subtract all the expenses. Seems simple, but let's look at an example:

A single-family home sells for \$100,000. The investor puts down 20% and takes out an \$80,000 mortgage at 5% for 30 years, making the total mortgage payment \$429.46 per month. Taxes are \$1,200 per



year, or \$100 per month, and insurance is \$600 per year, or \$50 per month. The future tenant will be responsible for all utilities and other charges, so the total fixed expenses come to \$579.46 per month (\$429.46 + \$100 + \$50).

If the monthly rental income is \$825, the cash flow should be around \$245.54 ( $\$825 - \$579.46 = \$245.54$ ). However, this may not be the whole story. What if the investor plans on using a property manager? What if there is a 5% or more vacancy rate. What if the maintenance costs are 10% per month? Suddenly, the cash flow is not so positive.

If the rental income equals the rental expenses, then the investment property is said to be at a break-even point. When the expenses are less than the rental income, the investment property is said to have positive cash flow. When the expenses exceed the rental income, then the investment property is deemed to have a negative cash flow. A negative cash flow rental property is one that costs the investor more money than it earns each month. Having negative cash flow means that the investor will be paying for some of the monthly expenses with his or her personal income.

## Buy/Flip/Hold

This type of investment is a hybrid of some of the other strategies noted above. In this case, individuals or companies buy a property, renovate it, and then rent it out at a premium, while maintaining ownership.

## REAL ESTATE INVESTMENT TRUSTS

A real estate investment trust (REIT) is a company that owns, operates, or finances income-producing real estate. REITs provide their investors a chance to own valuable real estate and access dividend-based income.

REITs allow anyone to invest in portfolios of real estate assets the same way they invest in other industries – through the purchase of individual company stock or through a mutual fund or exchange traded fund (ETF). The stockholders of a REIT earn a share of the income produced through real estate investment, without actually having to go out and buy, manage, or finance property. More than 80 million Americans invest in REIT stocks through their 401(k) and other investment funds.

Most REITs operate in a straightforward business model: By leasing space and collecting rent on its real estate, the company generates income which is then paid out to shareholders in the form of dividends. REITs must pay out at least 90% of their taxable income to shareholders, but most pay out 100%. In turn, shareholders pay the income taxes on those dividends.

REITs have historically delivered competitive total returns, based on high, steady dividend income and long-term capital appreciation. Their comparatively low correlation with other assets also makes them an excellent portfolio diversifier that can help reduce overall portfolio risk and increase returns.

## Common Types of REITs

Following are the most common types of REITs:

- **Equity REITs** – The majority of REITs are publicly traded equity REITs. Equity REITs own or operate income-producing real estate. The industry refers to equity REITs simply as REITs.
- **mREITs** – mREITs (mortgage REITs) provide financing for income-producing real estate by purchasing or originating mortgages and mortgage-backed securities and earning income from the interest on these investments.
- **Public Non-Listed REITs** – Public, non-listed REITs (PNLRs) are registered with the SEC but do not trade on national stock exchanges.
- **Private REITs** – Private REITs are offerings that are exempt from SEC registration and whose shares do not trade on a national securities exchange.

To qualify as a REIT, a company must:

- Invest at least 75% of its total assets in real estate.
- Derive at least 75% of its gross income from rents from real property, interest on mortgages, financing real property, or from sales of real estate.
- Pay at least 90% of its taxable income in the form of shareholder dividends each year.
- Be an entity that is taxable as a corporation.
- Be managed by a board of directors or trustees.
- Have a minimum of 100 shareholders.
- Have no more than 50% of its shares held by five or fewer individuals.

As a real estate licensee, working with REITs is similar to working with most other investors. REITs need

investment properties and the savvy licensee will establish a dialogue that surfaces their specific needs and fosters a professional long-term relationship.

## TYPES OF FINANCING

Financing is highly critical to an investment deal, so let's briefly cover the most common finance options:

- **Conventional Residential Mortgages** – Conventional loans are those obtained from traditional lenders, like large banks or credit unions. Typically, these loans require 20% down and need to conform to Fannie Mae or Freddie Mac standards. Conventional mortgages are typically used to finance single-family rentals, duplexes, triplexes, and quadplexes. Loans on properties with more than four units are not allowed.

Due to restrictions from Fannie Mae and Freddie Mac, investors are limited as to the number of conventional mortgages they can have, usually four. For most active investors, conventional mortgages will not be used for the bulk of their investments.

- **FHA Loans** – FHA loans can also be used for small multifamily investment properties up to four units, provided the investor lives in one of the units. Also, the investor can have only one FHA loan in his or her name at a time, so this is not a strategy that most large active investors can use.
- **Portfolio Loans** – Portfolio loans are loans that are not sold to Fannie Mae or Freddie Mac, so, they don't abide by the same standards and are more flexible. Many small community banks offer portfolio loans and are able to customize a loan program for either a homeowner or an investor.
- **Commercial Loans** – Commercial loans are designed for either commercial properties or residential properties that have more than four units. Like a portfolio loan, a commercial lender has some additional flexibility in the terms and structuring of the loan. However, commercial loans typically have higher interest rates and lower term lengths. Most residential loans are amortized over 30 years. A typical commercial loan will usually be amortized for a maximum of 25 years and include some type of balloon payment after five or six years.
- **Hard Money Loans** – Typical hard money loans carry an interest rate between 10% and 15% depending on the lender. This type of loan is targeted towards investors and especially house

flippers. Because the term length is so short, typically less than a year, the high interest rate has no significant effect on the deal, unless the home doesn't sell quickly.

Also, hard money lenders generally charge fees known as **points**. A point is 1% of the loan amount which is often paid upfront and sometimes wrapped into the loan. Hard money loans are one of the most risky ways to invest in real estate.

- **Private Money** – Private money is similar to hard money in many respects, but is distinguishable by the relationship between the lender and the borrower. A private money lender is not a professional lender, but an individual looking to achieve higher returns on his or her cash. Private money lenders are often family members, friends, or co-workers. Private money has fewer fees and points and term lengths can be negotiated more easily to serve the best interest of both parties.

Private lenders provide cash to buy a property in exchange for a specific interest rate. Their investment is secured by a promissory note or mortgage on the property, which means if the investor does not pay, the lender can foreclose and take the house.

- **Equity Partnerships** – If an investor customer cannot finance a property on his or her own, a good solution might be to take on a partner. This can be structured in a number of ways, such as:
  - Both partners split funding and pay cash.
  - One partner supplies all the purchase funding and the other does repairs.
  - One partner supplies the down payment, and the other supplies the ability to get a mortgage.
  - Both partners supply the down payment, but one partner gets the mortgage.

There are numerous ways to structure a partnership deal. Be sure to advise your customer to seek legal assistance when setting up a partnership.

- **Owner Financing** – Owner financing can be an easy way for a real estate investor to fund a deal. Most sellers will not agree to seller financing, but it does not hurt to ask. A seller may not need to finance the entire cost, but can carry back a small portion, just enough so the investor can get a bank loan for the rest. Generally, a seller should own his or her home free-and-clear before selling with seller financing to avoid the *due on sale clause* that most mortgages have in them

## 1031 Exchanges

Another way for investment property to be financed is through a process known as a 1031 Exchange. A 1031 Exchange gets its name from Section 1031 of the U.S. Internal Revenue Code, which allows an investor to avoid paying capital gains taxes when he or she sells an investment property and reinvest the proceeds from the sale within certain time limits in a property or properties of like kind and equal or greater value.

Under section 1031, any proceeds received from the sale of a property remain taxable. For that reason, proceeds from the sale must be transferred to a qualified intermediary, rather than the seller of the property, and the qualified intermediary transfers them to the seller of the replacement property or properties.

A **qualified intermediary** is a person or company that agrees to facilitate the 1031 exchange by holding the funds involved in the transaction until they can be transferred to the seller of the replacement property. The qualified intermediary can have no other formal relationship with the parties exchanging property.

An investor may consider a 1031 exchange because he or she is:

- seeking a property that has better return prospects.
- wishing to diversify assets.
- looking for a managed property rather than managing one themselves.
- wanting to consolidate several properties into one.
- wanting to reset the depreciation clock.\*

\*The main benefit of a 1031 exchange rather than simply selling one property and buying another is the tax deferral. A 1031 exchange allows the investor to defer capital gains tax, thus freeing more capital for investment in the replacement property.

Understanding depreciation is essential in discovering the true benefits of a 1031 exchange. Depreciation is the percentage of the cost of an investment property that is written off every year, recognizing the effects of wear and tear. When a property is sold, capital gains taxes are calculated based on the property's **net-adjusted basis**, which reflects the property's original purchase price, plus capital improvements, minus depreciation.

If a property sells for more than its depreciated value, the investor may have to **recapture** the depreciation. That means the amount of depreciation will be included in the taxable income from the sale of the property.

Since the size of the depreciation recaptured increases with time, the investor may be motivated to engage in a 1031 exchange to avoid the large increase in taxable income that depreciation recapture would cause later on. Depreciation recapture will be a factor to account for when calculating the value of any 1031 exchange transaction.

**Like-kind property.** Like-kind property is defined according to its nature or characteristics, not its quality or grade. This means that there is a broad range of exchangeable real properties. Vacant land can be exchanged for a commercial building, for example, or industrial property can be exchanged for residential. But an investor cannot exchange real estate for a car, for example, since that does not meet the definition of like-kind. The property must be held for investment though, not resale or personal use. This usually implies a minimum of two years' ownership.

To receive the full benefit of a 1031 exchange, the replacement property should be of equal or greater value. The investor must identify a replacement property for the assets sold within 45 days and then conclude the exchange within 180 days.

## CROWDFUNDED REAL ESTATE

The **Jumpstart Our Business Startups Act**, or JOBS Act, is a law intended to encourage funding of small businesses in the United States by easing many of the country's securities regulations. It passed with bipartisan support and was signed into law by President Barack Obama on April 5, 2012. The Act opened up doors for many investors who want to invest in small businesses and real estate projects throughout the country. The Act has drawn the most public attention because it creates a way for companies to use crowdfunding to issue securities, something that was not previously permitted.

Crowdfunded Real Estate investing is the new kid on the block as a result of the passage of the JOBS Act. Real estate crowdfunding is for individuals who want to grow their portfolio through real estate investing,

but don't want to actually own or manage rental property. When investors participate in a crowdfunding plan, they are part of a group of people who pool their money with other investors and then lend or invest that money with experienced real estate investment property owners. Participants stand to profit from experienced investor's with minimal capital and time, depending on the investment.

One of the benefits of this option is that participants can track statistics online to review an investment's earnings history information. Participants can also manage their investment online and get a summary report instantly.

Crowdfunded real estate investing is a very popular option because participants do not have to search for property, get a mortgage loan, screen or manage tenants, or manage the property. More importantly, someone else is responsible for the property loans. A participant's risk and workload are minimized, yet the potential for profit still exists.

## How Crowdfunding Works

Investors generally visit an online marketplace and browse opportunities that vary by investment type, geography, and target returns. Once they have selected an investment that aligns with their goals, their funds are pooled with other investors. The typical group size is held to under 100 members, and the investment is closed.

From there, if all goes to plan, they collect passive income while monitoring the performance of their investment until it exits. Real estate crowdfunding platforms typically share the following types of information with their members:

- **Value-Add** – Some real estate crowdfunding investments have a value-add component which explains a plan for renovations designed to increase the occupancy and/or rental rates for a given property. That way, it may be resold at a higher price point.
- **Illiquid investments** – The target hold time for value-add investments is typically three to five years. They are often also **private placements**, meaning they cannot be traded or resold after the initial investment. It is important for investors to know that they will need to commit their funds for the entire anticipated investment period—or more, if the project does not go according to plan.

With real estate crowdfunding, an investor essentially has two options for investing: debt or equity investments.

- **Debt** – When investing in debt, the investor is investing in a mortgage note secured by a commercial property. As the loan is paid back, the investor receives a share of the interest. This type of investment is considered lower risk than equity, but there is a drawback because returns are limited according to the interest rate on the note. On the other hand, it is preferable to direct ownership because the investor is not responsible for managing the property.
- **Equity** – Investing in equity means the investor receives an ownership stake in the property. In this scenario, returns are realized as a percentage of the rental income the property generates. If the property is sold, the investor would also receive a portion of any gains from the sale. In terms of profitability, equity investments can lead to higher returns, but the investor is taking on more risk if the rental income takes a sudden nosedive.

Like equity crowdfunding, the primary advantage real estate crowdfunding offers to non-accredited investors is its low entry point. Many of the top platforms set the minimum investment at \$5,000, which is much more affordable than the tens of thousands of dollars often required to gain access to private real estate deals.

## Where Investment Properties Come From

Investors don't see an investment opportunity until it is listed on a crowdfunding site, but the process of finding and vetting an investment starts months in advance.

It starts with investment origination, also known as **sourcing**. In this stage, crowdfunding sites work with real estate developers called **sponsors** to identify investment opportunities that may be appealing to investors. What follows is a rigorous evaluation process that includes sponsor evaluation, asset evaluation, underwriting, investment structuring, and approvals. However, some sites choose to skip this step entirely and simply list every opportunity that comes their way.

Generally speaking, real estate crowdfunding sites

use similar legal structures to allow investors to pool their funds and directly invest in individual projects—but that may be where the similarities end. Different sites vary in the kinds of investments they offer, their minimum investment amounts, their fees, and the amount of underwriting they do. These differences can affect how the investments perform.

There are over 75 real estate crowdfunding platforms in the United States.

## Crowdfunded Real Estate v Real Estate Investment Trust (REIT)

Crowdfunded Real Estate differs from a Real Estate Investment Trust (REIT). REITs are professionally-managed funds that usually hold multiple properties. For example, a given REIT might own several grocery-anchored shopping centers in a certain city. When an investor buys in, he or she is buying an indirect interest in each of those shopping centers, and the performance of the investment depends on how much income they produce.

There's a lot to like about REITs. For years, they were one of the only ways the average investor could get into real estate. Many are publicly traded and thus *liquid*, meaning an investor can buy and sell shares at any time.

However, REITs have limitations. Because they can be traded in the marketplace, the performance of REITs typically tracks more closely with the stock market, which may not help as much if an investor is looking for true portfolio diversification. In addition, the investor cannot decide which properties he or she likes within a given REIT and which ones he or she does not like. The investor is either in or out with the fund's properties as a whole.

Crowdfunding is an attractive option, but like all investments, the investor needs to research the company and the options to make sure that the company is legitimate and also a good fit. The investor needs to know the minimum investment amount to make sure that the deal will work for him or her. The investor will want to know how long the company has been in business, as well as their guidelines for borrowers and investors. Lastly, the investor needs to know the fees being charged for their service.

## Crowdfunding and Real Estate Licensee's Role

Crowdfunding can be a new source of capital for commercial real estate projects by bringing in a lot of investors with small amounts of money to invest. This is especially important to smaller projects and in areas that rely on regional and community banks, which may struggle to find financing from traditional lenders. Using a crowdfunding platform to finance a real estate project provides an alternative to working with banks and allows developers to reach a wider audience of potential investors.

However, real estate licensees whose customers choose to go that route must be careful of their involvement in the crowdfunding aspect of a development project. Unless a licensee is registered with the SEC as a licensed broker-dealer, he or she cannot yet host a crowdfunding platform for customers or receive a commission for referrals to and advising done on behalf of one. Crowdfunding for the purpose of securing investment financing is certainly an area to watch for future development and opportunities.

## BEFORE TAKING ON AN INVESTOR

As we said previously, working with investors is time-consuming and challenging. Before taking on an investor customer, you should evaluate your working relationship to make sure it is a good fit. The following questions should help in your decision process.

- **What's Your Experience?** – Begin the discussion with a new investor customer by simply asking what kind of investing experience he or she has. You will want to know if he or she has a background in real estate, finance, or business. Real estate investing is a business, not a hobby or pastime activity. Try to weed out any flash-in-the-pan wannabees.
- **What Are Your Objectives?** – An investor without clearly defined objectives will have trouble deciding what kind of investing he or she wants to pursue, which will waste a lot of your time. Ask probing questions to determine if he or she has a realistic goal in mind.
- **What Are Your Financing Arrangements?** - Knowing how the investor plans to finance the investments is key. Investors who do not have at least the ability to put down 20% should be

suspect. Remember, this is a business and not a pastime. Serious investors will bring serious money to the table.

- **What Kinds of Properties Are You Looking For?** – Focusing on a type of property is important. There is no upside to wasting time by dragging your investor to every possible listing. A bona fide investor will come with a good idea of the type of property he or she is comfortable with investing in.
- **What is Your Budget?** – It is critical to determine the investor's price-point. Is the investor looking for a multi-million dollar apartment complex or a starter home? Serious investors will give licensees a truthful range amount, with a not-to-exceed limit. Less than serious investors will be less truthful and give a ballpark figure that doesn't get you any closer to their actual price figure.
- **What Areas Are You Interested In?** – Most investors have interests in particular areas. Maybe it is close to where they live or that they have other investment properties in the same area. Typically, the average investor is not looking for a trophy home or one that is condemned. Find out from your customers where they plan on buying or selling and those areas that they would not even consider.
- **Who is on Your Team?** – For the most part, investors are a hardy bunch of independent entrepreneurs. However, most investors do not work in isolation. They need back office support to be successful. Ask your potential customer who he or she works with. An investor should have a go-to list of:
  - General contractors
  - Lenders
  - Property managers
  - Attorneys
  - Insurance agents
  - Accountants
  - Title representatives

By looking at the investor's list, you can see how you fit into their needs.

- **What is Your Purchase Strategy?** – As stated previously, some investors shotgun the market with hundreds of offers. Others only submit one or two offers a year. Both strategies have positive and negative aspects. However, the answer to this question will determine your overall work load and how it might match with your working style.

- **What Services Do You Need?** – It should be clear up front exactly what your customer wants from you and the amount of associated fees that he or she is willing to pay you for such services. This must be a frank discussion that spells out the investor's role and your duties, responsibilities, and compensation. These answers will drive towards a transparent working agreement that meets everyone's needs so there are no gotchas down the line.

## PROFESSIONAL ORGANIZATIONS

For those real estate licensees who wish to increase their professional expertise, there are two organizations that offer programs that lead to a real estate investment certificate.

### Certified Commercial Investment Institute

Many licensees choose to pursue certification as a Certified Commercial Investment Member (CCIM). A CCIM is a recognized expert in the commercial and investment real estate industry. CCIM is part of a global real estate network with members across North America and more than 30 countries.

CCIM offers a training curriculum that provides an essential skill set for real estate investment professionals, which includes:

- Ethics
- Negotiation Skills
- Financial Analysis
- Market Analysis

Over 15,000 commercial real estate professionals have earned the CCIM designation. To earn the CCIM designation, one must meet the following curriculum requirements:

- Financial Analysis for Commercial Investment Real Estate
- Market Analysis for Commercial Investment Real Estate
- User Decision Analysis for Commercial Investment Real Estate
- Investment Analysis for Commercial Investment Real Estate
- Online Ethics Course

- Preparing to Negotiate or Advanced Negotiation Workshop

In addition, the candidate must:

- Earn two elective credits from other sources.
- Submit a portfolio of qualifying experience before taking the final exam.
- Pass the comprehensive exam.

## National Association of Realtors®

The National Association of Realtors® offers courses under their Commercial Real Estate Investment and Analysis curriculum which include the following:

- **Advanced Analytics for Real Estate Investment** – This course will dissect the net operating income statement and study in detail its component parts. Students will learn how the financial projections for a property reflect requisite strategic management planning, and how possible deficiencies can arise therein.
- **Analysis of Commercial Real Estate Opportunities** – This course presents issues and methods that will enable Realtors® to understand how key legal and financial factors (in particular, mortgage financing and taxation) external to the underlying economics of the property can significantly influence purchase decision-making, whether for investment purposes or owner-occupant reasons.
- **Corporate Facilities Planning and Transactions** – This course will introduce the student to the issues and tasks involved in a corporation's decision to potentially modify its facilities profile by either acquiring or disposing of properties in its collection of land and buildings that are used as factors of production.
- **Commercial Real Estate Acquisition Management** – In this course, the student will learn the full range of issues and tasks involved in the acquisition of fee interests in real estate, a usually complex and challenging endeavor for real estate professionals.
- **Commercial Real Estate Portfolio Strategy** – This course examines commercial real estate investing in a multi-asset and commercial real estate investment portfolio context. Modern Real Estate Portfolio Theory (MREPT) is applied and portfolios are analyzed.

## MODULE 4 REVIEW – WORKING WITH REAL ESTATE INVESTORS

You are *not* required to answer the module review questions to complete the 14-hour course. They are intended to help prepare you for the Final Exam. Choose the best response to each question. The answers are found in the back of the book.

**1. Real estate is what type of asset?**

- a. Intangible
- b. Tangible
- c. Progressive
- d. Marginal

**2. What type of investor uses the 70% rule?**

- a. In and Out
- b. Buy and Hold
- c. Wholesalers
- d. Flippers

**3. Select a method in which interest is held in a REIT.**

- a. Company stock
- b. Bonds
- c. Letter of Credit
- d. Lien

**4. What Act ushered in real estate crowdfunding?**

- a. Small REIT Act
- b. Investors Act of 1999
- c. JOBS Act
- d. Real Estate Access Act

**5. What is the minimum percent a serious investor should be willing to put down on a property?**

- a. 5%
- b. 10%
- c. 20%
- d. 30%



# From Contract to Closing: Don't Derail Your Sale!



## LEARNING OBJECTIVES

*Upon completion of this module, the student will be able to:*

1. Identify sources of problems in real estate transactions
2. Understand the real estate licensee's role in the transaction
3. Analyze requirements of sales contracts and seller's property disclosure statements, and understand how to explain them to a consumer
4. Describe steps a real estate licensee can take to negotiate, neutralize, or mediate issues in a transaction
5. Summarize steps a real estate licensee can take proactively in transactions.

## INTRODUCTION

In this course, we will be discussing all the things that can happen between the contract and the closing that either derail the sale, or have the potential to do so. Experienced real estate professionals realize that getting the buyers to agree to write a contract is generally the easiest part of the transaction. It's what happens next that can cause problems, and requires the licensees to use their skills of analyzing, negotiating, and brokering solutions.

## COMMON ISSUES TO DERAILMENT

Take a moment as you read this and think about the last problem you had with a real estate transaction. Can you identify what it was? Did more than one thing go wrong? Have you ever had a transaction fall apart, seemingly because of the "last straw?" It's not unusual for a real estate transaction to fall apart because of the stresses on both parties. The National Association of REALTORS® polls home buyers and home sellers every year who have completed a transaction. The poll results are then published in the *NAR Profile of Home Buyers and Sellers*. The report reveals that for the past several years, negotiation is something both parties want licensees to be good at. Negotiation is not just negotiating the contract, it is also addressing the problems that, if not negotiated, can potentially derail a sale.

Let's take a look at the most common issues that can derail a sale:

- **Contract issues:** These can mean that the contract, as written, is easily voided, or allows one or both parties an 'easy out.' It also includes situations such as a seller or buyer passing away before the contract is closed.
- **Financing issues:** This can be everything from a buyer who was not, in fact, pre-approved, or lied about funds available to him, or it can involve a lender who "discovers" a problem well into the transaction.
- **Inspection issues:** We know these run the gamut. A partial list would include: HVAC issues, roof issues, mold, termites and other infestation, foundation issues, wiring issues, subsidence issues (limestone sinkholes), plumbing issues.
- **Title issues:** Title is not clear, or there are restrictive covenants in place which the buyer believes he was not informed about.
- **Appraisal issues:** The appraised value does not equal the agreed upon sales price. In the case of an FHA appraisal, it has a life of four months before FHA will order another appraisal.
- **Final walk-through issues:** things are missing which are supposed to be there, junk which isn't supposed to be there hasn't been removed, appliances and/or systems are not working.

We could add buyer or seller changing their minds about proceeding with the sale, but we're not going to cover that. The goal of this course is to give you ways to constructively solve the problems enumerated; if a party to the transaction wants out, usually, no skill we have will convince them otherwise. One thing every real estate licensee needs to figure out is when a transaction is a lost cause, meaning it is a waste of time and energy to continue. At that point, you cut your losses and move on, all while trying to preserve your professional reputation!

## Section 1

In this section, we will look at contracts, title, the two prevalent forms used in Florida, especially the "as is" contract, the seller property disclosure, and fraud.

**Contract issues:** Contract issues can include a contract which is poorly drawn, which builds in loopholes for either party, or a common clause in the contract which gives one party (generally the buyer) the ability to get out of the contract. Contract issues can also include a breach of contract, where the party getting out has no legal reason to do so, but is going to breach regardless. Contract issues can also include last minute items which surface at a walk-through, such as which personal property was to be included in the sale, and whether or not the premises are as promised in the contract "broom-clean, free of debris." And of course, any contract can be breached by either party either being unable or unwilling to perform as the contract requires.

**Contract clauses:** There are many clauses in most real estate contracts, but let's focus on the ones which are most likely to cause us a problem.

**Financing:** The financing clause will state how much money the buyer needs to borrow, the type of mortgage, when the buyer will apply for the loan, and when the approval for the loan will be given by the lender. It will also state how much earnest money is being put down, and whether or not additional

earnest money is required at a specific point in the contract, such as after acceptance by the seller. Failure on the part of the buyer to miss any one of these dates, or to make an additional deposit as required, is a breach. Another issue we have in the era of electronically signed contracts is whether or not the buyer actually makes the initial deposit as promised. A big part of the real estate professional's role is staying on top of all the dates and details in the contract, and reminding buyers that if they don't apply for the loan in a timely manner, or make additional earnest money payments as required by the contract, they are in breach of the contract, and risk losing the house.

**Title:** Sellers are representing that they can produce good and marketable title to the property. If they cannot, they are in breach of the contract. Title can get very problematic when you have an issue develop between contract and closing. Here is an example: elderly property owners signed a sales agreement, and before closing, the husband suffered a massive stroke, which left him alive, but seriously impaired. His wife did *not* have a durable power of attorney for him. This meant that she had to go through the necessary legal steps of having him declared incompetent, and herself made his personal representative, in order to sell the property. Another issue can be a seller dying between contract and closing. Let's use an example of an elderly homeowner, where the listing contract was signed by a person who has power of attorney. The standard listing contract in Florida (paragraph 11) states it is binding upon the

"Seller's heirs, personal representatives, administrators, successors and assigns." Let's further assume that our elderly homeowner passes away, and the executor of the estate is not the person who had power of attorney. First of all, the power of attorney's authority terminated upon the death of the owner. They have no more rights to conduct any business. Second, the executor is now bound by law to get the will probated and carry out the instructions in the will. Let's suppose that the will left the property to the executor, or another heir, and they don't want to sell. We are now in a situation where if the parties decide to fight, the main winners will be the attorneys. Another thing to be aware of, and avoid at all costs, is having an elderly homeowner who lacks the mental capacity to enter into a contract to sign one anyway. There have been many cases where a family member has intervened, stating that "my father had

no idea what he was doing when he signed that contract, he has dementia!" If you ever have any doubts about any customer or principal having the capacity to enter into a contract, do *not* have them sign a contract. Try to find out if they have given a Power of Attorney to someone else, or if they have a family member, or an attorney who can step in.

Remember that regardless of how an issue appears straightforward to you, or to a buyer, *nothing* will stop a lawsuit if someone wants to file one. In the above described situation, the buyer has to decide if fighting this to make the estate sell the house is worth the time and aggravation, not to mention the money spent on an attorney. Buyers will often state: "We already have \$XXXX of money in this property, between application, appraisal, home inspection, and now, legal fees." Often buyers are too close to a situation to realistically evaluate it. Yes, they will have lost money. A real estate professional should try to negotiate not only the return of the deposit, but to receive some or all of the compensation for the money spent. It may not be possible, depending upon the situation. Good advice often includes telling buyers when it is time to cut their losses and move on. As an attorney once told me: "You are right, and I can prove it. But do you want to spend \$XXXX proving you are right?"

**Personal property:** Personal property can easily become an issue in a real estate transaction, with both parties interpreting what "stays" and what "goes" differently. This should be handled at the beginning of the listing, at the beginning of the sales contract, and at the final walk-through by being very specific. Let's say the owners have two refrigerators, one is an almost new, French-door stainless refrigerator with a bottom freezer, and in the laundry room, they have their old refrigerator, which is a basic freezer on top, white finish model. They use that one for overflow items. The licensee who listed the property should specify in the listing contract which refrigerator is being included, and even, if possible, use model number and serial number. The same thing should happen with the sales agreement. More than one seller has tried to take the newer refrigerator and leave behind the other one, arguing that they *are* leaving a refrigerator.

Another issue that occasionally surfaces is verbal promises either party makes about personal property. Here's a scenario I've seen many times: the buyers want to return to the house to measure for paint or

draperies, see it again, etc. The sellers are home. The buyers split up, and the two men go to the garage and the two women go out to the pool with the real estate licensee. The women are discussing the plants around the pool, but back in the garage, the husband of the buyers is commenting that he will have to buy a lawn mower when they move. The husband of the sellers generously says: "Hey, I'll leave this one for you. We're going into a condo, and we won't need it." The buyers and the licensee leave. Moving day comes, and the husband says: "Leave that mower here." The wife says: "Leave it here? We can't leave it here—I promised it to our friends down the street." The husband responds: "Well, I told the buyer he could have it." You know how this ends; happy wife, happy life, so the mower goes to the friends down the street. At the final walk-through, the buyer asks the licensee about the mower. The licensee frantically searches the paperwork, there's no mention of the mower. The story is told to the licensee, but it is too little, too late. It's not in writing, the licensee can't make the seller include it, and the buyer has learned the lesson of "get it in writing."

The standard contracts used in Florida, both the "as is" and the standard contract, have a pre-printed paragraph of items included. It reads as follows:

Personal property: Unless excluded in Paragraph 1 (e) or by other terms of this Contract, the following items which are owned by Seller and existing on the Property as of the date of the initial offer are included in the purchase range(s)/oven(s), refrigerator(s), dishwasher(s), disposal, ceiling fan(s), intercom, light fixture(s), drapery rods and draperies, blinds, window treatments, smoke detector(s), garage door opener(s), security gate and other access devices, and storm shutters/panels ("Personal Property").

This is followed by a line for other items included in the sale, and then there is a standard comment:

Personal property is included in the Purchase Price, has no contributory value, and shall be left for the Buyer. The following items are excluded from the purchase.

A "suspenders and belt" approach would be to not only cross out items not included, but to specify them again in the exclusions. However, because we are typically doing contracts electronically, we can't cross things out. Vigilance is very important! Many times a licensee who has listed a property has not

read a contract carefully, only to find out, that despite the comments in the MLS "Dining room chandelier is excluded from sale," the contract itself did not specify that, and as such, many a licensee has had to purchase a chandelier! When a licensee receives an offer on a listing, it is their responsibility to thoroughly review all contracts before the seller signs any of them. If you get a poorly prepared contract, do not hesitate to start over with a 'clean' contract from the seller to the buyer. And, in the above mentioned situation, it could be that the buyers are trying to negotiate the chandelier. However, the licensee who is working with the buyers should review the MLS sheet *with* them, and if they don't want to exclude that chandelier, as per the listing contract, the contract should mention the chandelier as 'items included', so that it is very clear to the sellers and their real estate professional that this is a negotiation.

Of course, as the licensee with the listing, our preference is that the sellers *remove* this chandelier before putting the house on the market, and replacing it, so that this doesn't become an issue.

**Damage or condition:** The other issue that comes up at a final walk-through is damages and condition of the property. Common things include a vinyl floor being ripped when a heavy appliance is moved, mold is discovered behind another heavy object, trash is left behind, etc. Both the 'as is' and the standard Agreement of Sale from the Florida REALTORS® Association stipulate removal of "all personal items and trash" [Paragraph 6 in both Agreements]. Paragraph 11 in both contracts requires homeowners to maintain the property in the condition existing as of Effective Date of the contract. Both contracts allow for a pre-settlement walk-through. We know as real estate professionals that houses look less appealing after the owners have moved out their personal belongings. It's helpful to remind buyers when they look at houses that many things are very typical, such as traffic patterns in rugs, nail holes, dirt marks on walls where pictures have hung, etc. Sometimes, everyone is surprised. The author sold a large Victorian home with a huge (16' x 12') mirror in the dining room. The buyers knew that all personal property was being auctioned off, as did the seller. What no one knew until the auction was that the deceased homeowner had thriftily decided *not* to put wallpaper behind the mirror. It was expensive wallpaper, it was above a chair rail, and there was only one wall in her house where the mirror could hang!

The buyers took it as is, wondering aloud what they would hang in the place of the mirror, or if they would just redecorate.

**“As is” Contract or Regular:** The standard forms used in Florida are typically either the “As Is” contract or the standard residential contract. Both contracts contain clauses regarding inspection and close-out of building permits. There are slight differences in the wording, but both contracts require the seller, if the inspection reveals open or needed building permits to “promptly deliver to Buyer all plans, written documentation or other information in Seller’s possession, knowledge, or control relating to improvements to the Property which are the subject of such open permits or unpermitted improvements.” Although the standard contract contains different language, both contracts give the buyer a way out of the contract, if the issues cannot be resolved. The buyer gets the money back and both parties are released. You should note that sometimes an appraiser will pick up on an unpermitted improvement, because appraisal clients often ask the appraiser to verify that permits were obtained for the alterations and improvements. The Seller’s Real Property Disclosure Statement used in Florida also addresses this, to a degree in paragraph 6, Zoning, and in paragraph 9(c), which asks if the homeowner is aware “of any improvements or additions to the property, whether by you or others, that have been constructed in violation of building codes or without necessary permits” and in paragraph 9(d) which asks if you are aware of “any active permits on the property which have not been closed by a final inspection.” One of the biggest problems that happens with Seller Property Disclosures is that licensees do not read them thoroughly, look for “yes” answers which require an explanation (but there is no explanation), and fail to review this with the seller to get the disclosure filled out properly. On the other side of the transaction, the licensee working with the buyer must thoroughly review the disclosure, and ask questions. The licensee with the listing should never fill out a seller’s disclosure form for a seller. If you have a seller who needs assistance, they should use a family member or close friend. The buyer should review the seller property disclosure *before* entering into a contract. Remind buyers that a seller property disclosure is not a substitute for a home inspection. When it comes to permits, bear in mind that permits are public record.

This link will take you to a website where these

can be looked up: [www.stateofflorida.com/permits-and-licensing/](http://www.stateofflorida.com/permits-and-licensing/)

Take five minutes and do some investigation of your own, before you invest lots of time and energy into a problematic listing or sale.

Speaking of appraisers, licensees and sellers should know that appraisers will not lie for anyone. If an appraiser discovers that there is no permit, or if there is an unpermitted use, such as someone renting out an illegal apartment on the property, and zoning doesn’t allow it, the appraiser will report it. If you list a property which appears to have an unpermitted use, you need to get to the bottom of the situation *before* the house goes on the market. The author had a listing, which included a small efficiency apartment for a family member. This fell into a hazy area with the zoning in the town where it was located, because it was a family member and the unit was not separate from the main house. Another buyer bought it and did not use it as an efficiency apartment, but used the kitchenette for a laundry room and overflow cooking at holidays. When they relisted it, we suggested that they remove the stove and refrigerator, so that there would be nothing to suggest “illegal second unit” to the appraiser. They did so, and the kitchenette then presented as a laundry room with a sink and cupboards, which many laundry rooms have.

The “Property Maintenance, Condition, Inspections and Examinations” section of the Standard Agreement of Sale is very specific about the condition the property should be in when the buyer does the final walk-through before closing. It includes, but is not limited to: “lawn, shrubbery, and pool” as well as the property. This section in paragraph 12(b) stipulates the requirements of the seller to repair or replace items discovered in the home inspection. Paragraph 12(b) ii is an exhaustive list of what must be free of leaks, in working condition, and even specifies that torn screens, fogged windows and missing roof tiles or shingles shall be repaired or replaced prior to closing. “Cosmetic Conditions” is defined as “aesthetic imperfections that do not affect Working Condition of the item, including, but not limited to: pitted marcite; tears, worn spots and discoloration of floor coverings, wallpapers, or window treatments; nail holes, scrapes, scratches, dents, chips or caulking in ceilings, walls, flooring, tile, fixtures, or mirrors; and minor cracks in walls, floor tiles, windows, driveways, sidewalks, pool decks and garage and patio floors.

Cracked roof tiles, curling or worn shingles, or limited roof life shall not be considered defects Seller must repair or replace, so long as there is no evidence of actual leaks, leakage, or structural damage.” The time to review this list with the sellers is *before* they list the property, and decide which contract to use. If you are handling, for example, an estate where the executors live out of town, chances are they will only sign an “as is” contract, because they don’t have the time, inclination, and possibly money to fix fogged windows, torn screens, and other issues. If your seller has made the decision to only accept an “as is” contract, that should be clearly stated in the MLS.

Which contract gets used? Clearly, this can be negotiated along with everything else. If you are a seller, you would prefer an “as is” contract. If you are a buyer, you want the standard contract which requires sellers to make repairs.

Let’s get into the “what ifs?” that we know exist in real estate. One “what if” is “What if the sellers refuse to make the repairs, citing the cost of them, or another excuse?”

Sellers can refuse, and both contracts give the buyer a way out, with earnest money returned to them. But what is the seller’s position now? The seller may now have knowledge of a material fact which was previously unknown to them. This must be disclosed to subsequent buyers. Even if the sellers fix the problem, they need to amend the seller property disclosure. Let’s use as an example a property on a private well. When the seller fills out the Seller Property Disclosure, in paragraph 11, they state that their water source is a private well. Let’s then say in answer to the question “When was your water last checked for safety and what was the result of the test?” the seller puts ‘unknown’, and tells the real estate licensee they have never tested the water. The property goes pending, and the buyer conducts, among other things, a well test, which reveals E. coli bacteria in the water. Often, the easiest fix is to install a UV light. But, let’s say the buyer backs out anyway. The licensee who listed the property will tell the seller that they can fix the water now, or disclose it, and be prepared for the next buyer to ask them to fix it, or discount the price by the cost to fix it themselves. If the sellers opt to fix this, they need to amend the Seller Property Disclosure to show that they fixed this, who did it (licensed plumber, we hope!) when, and was the water tested again after the problem was resolved. Many sellers erroneously

believe that if they have corrected a problem, they don’t need to report it on the disclosure. This is not only not true, but not helpful to the next owner. If something creates a problem, which is correctable, the sellers should tell the new owner. An example might be a buried pipe that takes away rain water from the gutters and down spouts. If it gets clogged, water backs up and pools against the foundation. This was a problem in the past, so the sellers have both resolved the issue, and noted it, so that if the new owner notices water pooling against the foundation, they know to check the pipe for a clog.

Sellers, and sometimes real estate licensees, often think that somehow seller disclosure laws have obviated fraud. This is not true. Fraud laws still exist in all states, and failure to disclose a known material fact is fraud. A Florida couple found this out the hard way when they both lied about a previous sinkhole, and that they had not only submitted an insurance claim for it, but had not used the money to repair the sinkhole. Here’s a link to the article: [www.justice.gov/usao-mdfl/pr/secret-sinkhole-sellers-guilty-wire-fraud](http://www.justice.gov/usao-mdfl/pr/secret-sinkhole-sellers-guilty-wire-fraud)

**Sum Up:** An ounce of prevention is worth a pound of cure! Research the property before you list it. Public records are easily searched to verify ownership, and some of the liens. We are not suggesting that a licensee should attempt to perform a title search, but to be vigilant about who the owners are. More than one person has tried to sell a property with co-owners without involving those co-owners. If selling an estate, you will need proof the person died, and authority of the person who is the executor or administrator to act as such. Also, keep in mind that the title company will want to be certain any federal estate taxes have been paid, or are escrowed for payment. When writing contracts, be specific as to items included, with either a model or serial number, or at least, a description “stainless steel refrigerator in kitchen.” When receiving a contract from another licensee, if it is carelessly or ambiguously written, either correct it or rewrite it before allowing your customer or principal to sign it. Set up calendar reminders to stay on top of dates. Pay attention to red flags! Some sellers will actually ask you to lie for them. You need to walk away from that listing! Finally, do **not** give legal advice to a buyer or seller.

## Section 2

In this section, we specifically discuss financing issues, wire transfer fraud, appraisal issues, and walk-through and personal property issues.

**Financing Issues:** Financing issues are another source of problems for real estate licensees. Buyers search the internet for good deals on mortgage lending. What buyers do not always realize is that most companies are offering on the internet their best deals for great credit, stable employment, and a cookie cutter house. A buyer without all of the above may not get that "great deal." Additionally, every licensee has a story about the buyer who insisted on using "Fly-By-Night Internet Lender" who turned out to have one or more of the following issues: problems with communication, (meaning unreturned calls and emails), "pre-approval" that was in fact just a pre-qualification, changing of terms at the very last minute, excessive closing costs, and last minute denials or delays. Another issue is that licensees who've gained experience with property listings are savvy about the issues with online lenders, and will either insist that a buyer bring a pre-approval letter from a local, bricks and mortar lender, or will discourage their sellers from accepting an offer from a borrower using an unknown lender. When a buyer broaches the issue of using a lender you are not familiar with, a good suggestion is to talk about your experiences with lenders you use on a regular basis. If you have had a negative experience with a lender, tell your buyer what happened. "We were scheduled to close and at the last minute, we ended up with a five day delay. The sellers could have cancelled the sale. My buyers had already sold their previous home, and would have been homeless." When you can be positive, be specific: "Lender A met all of the deadlines in the contract, and kept both me and the buyer informed about the progress. They delivered on all their promises in a timely manner."

Sometimes, the fault is not the lender, it's the buyer. Pre-qualified buyers may have "forgotten" about some debts or other obligations, and when they move to an actual pre-approval, these materialize and affect the outcome. We all need to explain, probably repeatedly, to buyers that they should *not incur new debt, or take out a new credit card*, between applications and closing. We've all seen this happen, where the building store is offering "0% financing for 24 months" and they decide to go buy their new appliances *before* closing. Buyers also need to be very

cautious about changing jobs. Some lenders are able to make this work, within certain parameters, but sometimes it's a sale stopper. Lenders want documentation of everything that affects the financing. So, if your buyer is selling his classic car to come up with down payment money, the lender will want to see a receipt for that sale. Lenders also want proof of funds. Occasionally, we run into true "cash buyers," meaning people who literally have been saving cash in their home, or back yard, or some place. With the federal regulations for banks to report large cash deposits, this can be very troublesome. Their best bet is to "come clean" with the lender, and follow the lender's advice about how to get that money into an account. And, of course, there is the buyer who insists she has the funds, but doesn't want to verify them. This is a big red flag. Even if you personally know the buyer, and feel confident that the funds are there, you can tactfully handle this by reminding them that others involved in the transaction need to have this verified.

Financing misinformation is another source of problems with buyers. Credit experts will tell you that many buyers believe certain myths about credit and financing. One of the pervasive myths is that checking a credit score will lower it. This hasn't been correct for several years. Credit agencies have for some time recognized that a buyer contemplating a major purchase, such as a house or a vehicle, will check with more than one lender. FICO recognizes a 45-day rate shopping window, which is how long it typically takes a consumer to check various rates and terms, and decide who to borrow money from. Checking your own credit is a "soft inquiry," and should not affect credit at all.

Another myth about credit is that all debt is the same. This is false. \$100,000 on a mortgage is vastly different to a credit agency than \$100,000 in credit card debt. Lenders look at the amount of debt, and the term, as well as how much debt the person has, which the credit companies call debt utilization. This is why closing an unused credit card can actually hurt your credit. Let's say you have two credit cards, each with a limit of \$10,000. You have a zero balance on one card, because you never use it, and a balance of \$2000 on the other card. From the credit companies' perspective, you have \$2000 of debt out of your \$20,000 possible debt utilization (credit limit). So, you are at 10%. If you cancel the unused card, you now have \$2000 of debt against a total limit of \$10,000.

You are now using 20% of your potential debt, which will lower your score. Paying debts off does not erase them from your credit report. In fact, negative information can remain on a credit card report for seven years, or up to ten years for a bankruptcy. If your borrower has been making timely payments, and paid off all debts according to the agreement with the lender, that is a very positive part of a credit report. On the other hand, the debts paid late remain, as noted, for a long time.

Another myth is that third parties can “fix” or “repair” credit. These hucksters promise an increased credit score, but they will charge money, and often not deliver. Your borrower needs to talk to a lender, who can review their situation and give them advice as to what they need to do. I interviewed a person who had worked for one of these companies, and quit when, in her words, “I realized what a giant scam it was.” Continuing in her words: “Most of the time, people didn’t even realize their calls were getting transferred to us. They had called the credit card company they owed money to, and were transferred to us. My job was to get their \$129, *never* promise them anything and just tell them it would ‘probably help.’ It was a giant lie.”

Another situation we often encounter is one where initially, two buyers want to purchase the property, however during the application process, the lender discovers that one of them has great credit, but the other one has awful credit. Providing that the one with great credit can afford the mortgage payments on their income alone, the lender will often ask you for a revised sales contract which removes the other party from the contract.

**Wire Transfer Fraud:** The best place to discuss this is in the section on financing, because it impacts that aspect of the transaction the most. Wire transfer fraud, per Forbes magazine, has jumped 1000% since 2015, and it is estimated that consumers lost \$150 million in 2018 from wire transfer fraud associated with real estate. Quoting from the REALTOR® magazine, in an article published November 8, 2019: “From June 2016 to May 2018, FBI data shows there was a loss of more than \$1.6 billion in the U.S. alone. What’s more, cybersecurity company eSentire reported in October that real estate was the second highest industry hit with malware events in the second quarter of 2018.” The methodology for wire transfer fraud is generally the same. The crook

hacks into the email of someone associated with a real estate transaction, often the real estate licensee, and begins monitoring emails regarding closings. They wait until the transaction is ready to close and send “new wiring instructions” to the buyer. The author of the Forbes article, Aly Yale, related how it almost happened to her. Quoting from the article: “It all started with an email. Just days before closing on a home, I got a message from my escrow officer—or at least someone pretending to be her. Our closing costs needed to be wired to the title company right away, she said, or our closing date would be pushed back. Considering the six weeks I’d spent waiting to close on the property—not to mention the disdain I had for our current rental home—the message sent my heart racing. The font was right. The signature was right. There was even a CC to my real estate agent. But something seemed off. A closer look at the header revealed the problem. Each email address—one for my agent, one my mortgage broker and one for my escrow officer—was a single character off.” (To read the full article go to: <https://www.forbes.com/> and search for *real-estate-wire-fraud-is-real-and-it-almost-happened-to-me*.)

This person escaped wire transfer fraud, but she almost took the bait. It’s important to note she’s a financial writer and a well-educated person. Sadly, many less educated and sophisticated buyers fall for these scams. It is important to tell your buyers, and remind them (several times!) that ***no one associated with the transaction*** will email them changes to the wire transfer instructions. Should they receive an email with these directions, they should call *you*, or the title company at the phone number you give them. They should never, under any circumstances, call the phone number contained in the email. That call will be answered by the crooks, who will assure the buyer that things have changed. The FBI estimates that a buyer *might* get their money back if the fraud is detected within the first 48 hours. After that, it is probably irrevocably lost to them.

**Appraisal Issues:** We’ll discuss these now, because they become a financing issue some of the time. Some buyers will make a sale, even a cash sale, contingent upon a satisfactory appraisal. Buyers who are borrowing money will discover that the lender will typically lend upon the lower of either the sales price *or* the appraised value. Appraisals are in a state of flux, with lenders offering appraisal waivers to borrowers, and either using an automated



valuation model (AVM) such as Fannie Mae's proprietary Collateral Underwriter (CU), or using a hybrid appraisal, or using a combination of these with potentially a full appraisal. Let's talk about how these work. The first thing to recognize is that the lending world for some time has been moving toward basing the loan much more on the borrower's credit, character and capability, as opposed to the collateral (value of the home). Lenders realize that a borrower with a high credit rating, a good character (they have always paid all of their debts, and in a timely manner) and a capability to repay the loan will pay the loan, regardless of the fluctuations in value in the property. So, both Fannie and Freddie now have the following position with respect to lending: first, does the property qualify for an appraisal waiver? If Fannie and Freddie have enough information in their database that makes them believe they don't need an appraisal, a waiver will be offered to the borrower. If there isn't sufficient information there, the next step is a hybrid, or bifurcated appraisal. These are appraisal assignments split in two parts: the inspection part and the valuation part. The Property Data Collector (PDC) visits the property, takes photos, makes notes, and uploads this information to the cloud. The Appraisal Management Companies (AMCs) ordering these products have proprietary smart phone apps, so the PDC is doing this completely on their smart phone. Who collects the data? Initially, Fannie and Freddie talked about using real estate licensees, or insurance inspectors, or possibly home inspectors, but ads for these jobs have been seen on craigslist, with no qualifications listed as being required. Licensees taking this course who have been approached to be a PDC for an AMC for a hybrid appraisal should *not* accept this assignment without first checking with the broker of the office, to see what the brokerage's policy is, and checking their Errors and Omissions Insurance to see if they are covered for this activity. Once the data is uploaded to the cloud (by whomever!), a certified appraiser performs a desktop appraisal, relying upon the data being true and correct. So, the appraiser never sees the property. Many appraisers are refusing to do these assignments, the fees offered are very low, and the liability is seen as great. Why does this matter to you? If you are representing the buyer, chances are that the buyer believes that a formal appraisal is being completed by an independent appraiser, who will physically inspect the property and form an opinion of value. If this is not what is happening, the buyer should be made aware

of what is really happening.

Let's suppose though, that we had a traditional appraisal, one where the appraiser inspects the subject, inspects the comparables from the street, and renders an opinion of value. We hope that the appraiser is a local appraiser with geographic competency. However, in today's world, appraisal orders are sent out as blast emails to many certified appraisers, and the truth is that the assignment goes to the person who accepts the offer before others, and agrees to both the turn-around time, which may be short, and the fee, which may be low. So, you now have an appraiser who agreed to work quickly and cheaply appraising your buyer's house, or your listing.

Many times the appraisal is fine, and we proceed with the sale. Sometimes, it is over the sales price, which isn't a problem. I will note that the plethora of inexperienced people working for AMCs has resulted in appraisers actually being asked why the appraisal came in *higher* than the sales price! The appraiser develops an independent opinion of market value. The market participants may agree on a different number. It could be higher, it could be lower, it could be the same. The buyer is entitled by law to a copy of the appraisal, and buyers often share them with their real estate professional. It is not necessarily a good idea to share with the seller that the appraisal came in high. First of all, it's not the seller's business. They are not a client of the appraiser, nor are they an intended user of the appraisal. In fact, even the buyer is not an intended user of the appraisal; they only get a copy of the appraisal because of federal lending laws.

Let's talk about the most frequent appraisal problem, which is an appraised value less than sales price. Likely, as the real estate licensee, the buyer will share the appraisal with you. Do **not** just scan to the price and proceed to have a melt down! **Read** the report! Does it make sense? Is it logical? Are the comparables selected and used appropriately? Were the adjustments made consistently? Do the adjustments make sense? Keep in mind that appraisers must defend all adjustments they make, and that most adjustments are *market-based*, not *cost-based*. A seller, if they get their hands on the report, is likely to be upset, e.g. "The appraiser only adjusted \$2000 for my extra bathroom, and you can't install an extra bathroom for \$2000!" The appraiser is not saying you can; the appraiser is saying that's how much more a

*typical purchaser* will pay for an additional bathroom, *for that age, type and price range of home*. It is important to understand that adjustments vary depending upon price range, location, type of home, etc. Adjustments will tie into what appraisers call “typical purchaser expectations.” What does this mean? At a particular price point, buyers expect certain things. It could mean a three-car garage, as opposed to a two-car garage, or granite instead of Formica for a countertop. So, take a deep breath and read through the appraisal. *Any factual errors in the appraisal must be corrected by the appraiser, under the Dodd-Frank Law*. Because you are not the client of the appraiser, nor an intended user of the report, the appeals must be made by the buyer to the lender. The buyer is not the appraiser’s client, but they are the lender’s client. The lender *cannot* demand that an appraiser change a value, this is also a violation of Dodd-Frank.

What steps can be taken? Read the appraisal to determine if there are any factual errors, which as noted, must be corrected. Review the comparables used. They should be, in accordance with Fannie Mae guidelines “physically, functionally and locationally as similar to the subject as possible.” If there are comparables the appraiser did not use which are: more recent sales, more similar in size, closer geographically, etc. and which were not used in the report, the buyer should send these comps (which you have provided) to the lender and ask why they were not used. The appraiser is required to consider all market data available to him/her in the normal course of business, but they are **not required** to use any comparables you or the other real estate licensee provides. See if the adjustments made to the comparables are consistent. They should either be consistent, or the appraiser should have explained why they are not consistent. An example might be an adjustment for lot size. Suppose two of the comparables have “Florida rooms”, e.g. finished, enclosed porches. But the adjustment for this feature isn’t the same. There should be a comment explaining why. It might read: “Both Comparable 1 and Comparable 2 had enclosed porches, described as “Florida Rooms.” The “Florida Room” in comparable one was recently updated with new thermal windows, with built in blinds within the windows, new ceramic tile flooring, and new ceiling and wall material. This space was also heated and air conditioned. The “Florida Room” in comparable two was original jalousie windows, original Masonite paneling which has warped, original ceiling showing stains

from a previous roof leak, and dated indoor-outdoor carpeting.” This explanation would make it clear why the adjustment amount differed. It is logical, and shows that the appraiser reflected upon the differences between the two properties, and how these differences might have impacted both the appraiser’s adjustment, and the contributory value of the feature to buyers in the marketplace.

Often, despite best efforts to appeal an appraised value, or the comparables used, or the adjustments made, the appraiser will not modify the value. At this point, it is fair to ask the lender to have the appraisal reviewed. A review appraisal is performed by another certified appraiser, who thoroughly reviews both the appraisal and the market data available to ascertain if the appraisal has been performed to appropriate standards. What are appropriate standards? First of all, there is the Uniform Standards of Professional Appraisal Practice (USPAP), which is a federal law embedded in all state appraisal laws. When an appraiser violates USPAP, he or she is violating both state and federal law. The review appraiser will check to see, among other things, whether or not the appraiser complied with USPAP by “considering all market data available to the appraiser in the normal course of business” and considered all “relevant characteristics of the property.” The appraiser will also look at the additional requirements of the appraisal assignment, such as Fannie Mae, Freddie Mac, FHA, VA, etc. When an appraiser accepts an assignment with guidelines from a specific lending program (such as FHA), the appraiser must follow the protocol and requirements of that program. A review appraiser will be more thorough than the lender or you as the licensee can be. If the lender refuses the request for an appraisal review, you may want to consider whether the borrower should seek another lender. If the appraisal was done for FHA purposes, FHA will not order another appraisal for four months, so that appraisal, and that value, sticks to the property for that time period. It should also be noted that all VA appraisals can be appealed by the veteran. VA also has a program called “Tidewater.” Tidewater requires the appraiser, before finalizing the report and uploading it to the VA portal, to inform the lender involved that, based on the comparable data the appraiser can find, the value will not be the same as sales price. The lender reaches out to the real estate licensees involved so that they can help resolve the issue.

A PDF outlining the Tidewater process can be viewed at [benefits.VA.gov](https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_17_18.pdf). See link below:  
**[https://www.benefits.va.gov/HOMELOANS/documents/circulars/26\\_17\\_18.pdf](https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_17_18.pdf)**

Let's talk about what you can do proactively *before* you end up with a bad appraisal. With a few exceptions, most appraisals are ordered by Appraisal Management Companies (AMCs). The ostensible reason for AMCs is to keep a barrier between the lender and the appraiser, so that the lender cannot influence the appraiser. What also happens is that the AMC takes a hefty portion of the appraisal fee for their services, which involve assigning the appraisal, doing an initial review, and forwarding it to the lender. Because it is in the best interest of the AMC to keep as much of the total appraisal fee as possible, the AMCs will send out a blast email to appraisers all over the state (and possibly, appraisers in neighboring states if they are certified to do appraisals in your state) about the assignment. This blast will be an order with specifics, for example a "1004," which is a full interior inspection appraisal, with a fee of \$XXX and a turnaround time of two days. There is more than an even chance that the most qualified local appraiser who understands the market will either not jump on this quickly enough (whoever accepts it first gets it), or will decline it due to a low fee or a ridiculous turnaround time. So, who gets the assignment? It goes to someone who is willing to work quickly and cheaply, as opposed to someone who wants to do the best job, and get compensated accordingly for it. This means we often get "traveling appraisers," meaning appraisers from outside the area, who do not understand the nuances of the local market, may or may not have access to the local MLS system, may or may not have a lock box key, etc. Let's talk first about how you combat this if you get a request from a traveling appraiser who clearly doesn't know your market. They will generally tip their hand in a variety of ways, including statements like "I don't have a lockbox key for your MLS" or "where exactly is this property?" At this point, you can try to stop them. I would ask them, "Oh, so do you plan to violate #11 in your limiting conditions?" What are limiting conditions? At the end of every appraisal done for a lender, there are two pages of limiting conditions. The appraiser signs these limiting conditions, stating, among other things, that they are true and correct, and they understand that if they violate them, they are breaking a federal law and can

be subject to fine, imprisonment, or both. Here's the actual text of #11 in the limiting conditions:

11. I have knowledge and experience in appraising this type of property in this market area.

An appraiser either *has* knowledge and experience, or they do not. If an appraiser has never actually appraised property in this area, or property of this type, they are lying by signing the limiting conditions statement, which reads, in full:

25. Any intentional or negligent misrepresentation(s) contained in this appraisal report may result in civil liability and/or criminal penalties including, but not limited to, fine or imprisonment or both under the provisions of Title 18, United States Code, Section 1001, et seq., or similar state laws."

I would simply ask the question, "Do you plan to violate #11 in your limiting conditions?", and see what they say.

The other tip off, of course, is if the appraiser admits a lack of access to MLS data and actually asks you to provide comparable sales data. No appraiser should do this! As both a broker and an appraiser, I can assure you that first of all, I don't ask real estate licensees for comparables at the time of inspection, and second of all, as a broker, if an appraiser asks me for comps, they are absolutely going to get comparables which support the sales price of the property. This allows you to then ask, "Do you plan to also violate #12 in your limiting conditions?"

Here's how #12 reads:

12. I am aware of, and have access to, the necessary and appropriate public and private data sources, such as multiple listing services, tax assessment records, public land records and other such data sources for the area in which the property is located.

If you get an appraiser who is clearly clueless about your area, and wants an appointment, tell them you have to get back to them. Then contact the lender if you are working with the buyer, or contact the licensee who is working with the buyer. Ask them why they are sending an appraiser who clearly lacks geographical competency. They will stutter around and tell you that there is a panel of appraisers, they have no control over who is picked, etc. etc. This is

fundamentally nonsense, because there is a *contract* between the lender and the AMC. That contract can be as tight as the lender makes it, to ensure geographic competency. So, for example, some lenders require the AMC to only ask for appraisers within a specific distance of the subject property, such as 10 to 15 miles. Some AMCs will only allow appraisers to accept assignments in specific zip codes. Better yet, *before* the buyer makes application through the lender, call the lender and ask them how they ensure that the AMC will only hire local appraisers with geographic competency. You'll get the same stuttering and stammering, but at this point, you have the upper hand, and can say: "I'm really not comfortable with your answer. I want my customer to have an appraisal performed by a local, competent appraiser. I think I will have to recommend a different lender to my customer."

If possible, control who gets into the house by either removing the lockbox, or putting it in a location other than the door, so that whoever is trying to get in has to contact you for instructions. This can stop the appraiser (or licensee) who disregards the instructions: "Vacant, but call for appointment" and goes right on in. That way, you can be there when the appraiser gets there. There is a pervasive myth that real estate licensees cannot talk to appraisers. This is false. Appraisers can talk to real estate licensees, and vice-versa. However, real estate licensees cannot coerce, threaten or try to influence appraisers. Appraisers are sponges for information. Meet the appraiser at the property, and by the way, be on time. Most appraisers work by scheduling a number of inspections, in geographical order, for either a full day or part of a day. If you are tardy, you will throw them off course, and annoy them. They are already annoyed by the changes in the industry, which include lower fees and quicker turn-around times, so don't add to it!

Bring along any and all information you have about the subject property. This will include survey maps, home inspections, lists of upgrades, comparables you used, in short anything relevant to the property. If there is a sale in the neighborhood that is a low sale, do not use the "hope and pray" method that the appraiser will not discover this sale. They will find it. Instead, tell the appraiser why it should not be used. Maybe, for example, it wasn't truly an arms' length transaction, meaning that the buyer and seller were related, for example. Maybe one of the parties had

more than typical motivation, for example, they were facing foreclosure, or possibly it was an estate sale, and the out of town executor just wanted to sell the house quickly. Perhaps there was an issue not readily apparent in MLS. Tell the appraiser what you know, such as "That house looks okay in the pictures, but the owners had 18 cats and the smell was terrible. Most buyers thought all of the flooring would have to be replaced." Share anything you know about the subject property or potential comparables with the appraiser. Some things told to appraisers will put the property in the "do not use" pile. Here's another example: An appraiser found a comp which stuck out by being on the low side for the neighborhood, so the appraiser called the licensee who listed it. The licensee related that when the property was under contract, she called the elderly homeowner to get an addenda signed. No answer, so she went to the house, where she discovered he had died, probably several days previous to her visit. The buyer was willing to go through with the sale, but the estate made a large financial concession by completely remodeling the bathroom where the owner had died. This showed up in MLS as "call agent for details of seller concession." Upon hearing all of this, the appraiser decided not to use the property as a comparable. One thought was that although the buyer opted to continue with the sale, had the property gone back on the market, there would have been a stigma attached. This is also the kind of information that neighbors generally know, and are eager to share!

Another consideration is this: if you haven't taken a pricing course, take one! Often real estate licensees are unhappy with an appraisal for no other reason than it "killed the sale." If the appraisal is properly done, if it is credible, if the comparables are appropriate, and adjusted appropriately, then the value is probably correct. Licensees often say: "Well that's what a buyer was willing to pay, so that's market value!" No, not necessarily. Appraisers have a couple of phrases for this. The more polite phrase is "one sale does not a market make," which simply means that we need more than one buyer and one seller to establish a trend. The less polite, but funnier phrase is "Two fools met: one for asking it and one for paying it." Appraisers value property for the typical purchaser, not the one-in-a-million buyer. This plays out on the listing side, when a seller says to you "For just the right person, my house would be perfect!" If that *right person* wants a 12-car garage and a home

bowling alley, the seller is correct. The problem is, we can't as real estate professionals find that *perfect person*. We price and sell to the typical purchaser. The typical purchaser has expectations relating to location and price range, and homes which either do not meet those expectations, or include things the buyer isn't interested in, will not be valued as highly by buyers than that *typical house*. The reason that the market sticks to *typical purchaser* and *typical purchaser expectations* is that the lender knows if they take the property back in foreclosure, they don't want to be trying to find that *perfect buyer*, they want to be able to sell the house quickly and at, or close to, the value the appraiser placed on it.

Finally, if an appraiser calls you, please take or return the call. When we call you, we are seeking additional information, and almost always trying to help you. As someone who is an appraiser, I consider real estate licensees to be on the front lines of changes in the market.

**Walk-Through Issues:** The final walk-through is, unfortunately, the stage for many a melodrama or drama! Buyers are taking their last look at the house to make certain it is what they thought they were buying, and in the condition that it was in when they agreed to buy it. The items included in the sale need to be there, the seller's "stuff" that the buyers don't want needs to be removed, and the mechanicals need to be in working order. Sounds simple, doesn't it? Yet every real estate professional out there with any experience in the business knows that all of the above can and will go wrong.

**Personal Property:** If the contract, or a separate written agreement, calls for personal property to be included, it should be there. It should be in the same general condition, less normal wear and tear, as it was on the day when the buyer agreed to purchase the property. Keep in mind when drawing contracts, that some lenders, specifically FHA, do not want the contract loaded up with personal property. In fact, FHA usually requires that the phrase "at no value"

be included with a list of personal items. If you are selling a second or vacation home where the sellers are including the furnishings, your first defense is to have a thorough list of what is included. This list should be very specific, some examples might be:

1. 3-cushion couch, brown, in the living room
2. 2 wooden end tables, in the living room
3. 1 table lamp, living room, on one end table
4. 1 floor lamp, living room, near chair
5. 1 recliner, brown plaid in the living room
6. 1 wall-mounted Samsung TV, 50"

If you are selling a property with a list like this, have a duplicate for a check list as you go through for the final walk-through. You want to avoid vague lists like "all personal property except for the mounted Blue Marlin on the wall."

We've discussed damages and other walk-through issues previously in the course, but let's address a huge (and thankfully, rare) problem: the seller isn't out. The usual solution is to postpone closing until the seller is out and the buyer has keys to a vacant property. If the property is *tenant occupied*, this should be addressed in the sales agreement. Change of ownership does not invalidate a lease. If the tenant is on a month-to-month lease, the prudent thing for the licensee working with the buyer to suggest is that the tenant be out on or before closing, unless the new owner wants to continue to rent the property to that tenant.

**Wrap-Up:** Most problems can be resolved. Some problems *cannot* be resolved. As real estate professionals, we want to be proactive, anticipate where we might have problems, and try to address them early in the transaction to protect our buyers and sellers. Remember to always keep your broker and/or manager in the loop about problems with the transaction.

## MODULE 5 REVIEW – FROM CONTRACT TO CLOSING: DON'T DERAIL YOUR SALE!

You are *not* required to answer the module review questions to complete the 14-hour course. They are intended to help prepare you for the Final Exam. Choose the best response to each question. The answers are found in the back of the book.

1. **Which of the following could potentially derail a sale?**
  - a. contract issues
  - b. financing issues
  - c. inspection issues
  - d. all of the above
  
2. **Two refrigerators exist on the property a buyer wants to purchase. However, she only wants to keep the newest one. What specific information regarding the newest refrigerator should be included in the sales agreement?**
  - a. model and serial number
  - b. energy efficiency
  - c. original purchase price
  - d. consumer ratings
  
3. **The purpose of Appraisal Management Companies (AMCs) is to ensure that the:**
  - a. lender can set the appraised value of the property.
  - b. lender does not influence the appraiser.
  - c. appraiser obtains lender approval of the appraised value prior to submitting the appraisal.
  - d. buyer selects their appraiser of choice.
  
4. **A buyer is purchasing a property where a month-to-month tenant resides, and the buyer does not wish to continue renting to the tenant. The licensee working with the buyer should suggest that the tenant be out of the property:**
  - a. on or before the day of closing.
  - b. 10 days after closing.
  - c. 15 days after closing.
  - d. 30 days after closing.
  
5. **During the final "Walk-Through" the:**
  - a. items included in the sale need to be there.
  - b. seller's "stuff" that the buyers don't want needs to be gone
  - c. mechanicals need to be in working order.
  - d. all the above

# Impact of Gentrification on Real Estate



## LEARNING OBJECTIVES

*Upon completion of this module, the student will be able to:*

1. Identify the causes of gentrification.
2. Explain the effects of gentrification.
3. Describe the social and economic impacts of gentrification.
4. Discuss the backlash to gentrification and some established control tactics.
5. Identify types of gentrification.
6. Discuss measures for dealing with gentrification.

## INTRODUCTION AND BACKGROUND

In this module we will analyze the social phenomena known as gentrification, look at examples, explore the impact that gentrification has on a community, and provide insight as to how a licensed real estate professional can seek opportunities in such a changing market place.

Gentrification is a process of changing the character of a neighborhood through the influx of more affluent residents and businesses. This is a common and often controversial topic in politics and in urban planning. Gentrification often increases the economic value of a neighborhood, but can force out low-income residents due to the increased cost of rent and higher cost of goods.

Gentrification often shifts a neighborhood's racial/ethnic composition and average household income by developing new, more expensive housing, businesses and improved resources.

The gentrification process is typically the result of increasing attraction to an area by people with higher incomes spilling over from neighboring communities. This transition is fueled by:

- Increased investments
- Real estate development projects
- Local government's desire to improve neighborhoods
- Community activists seeking safer housing and lower crime rates

Gentrification has been viewed as a double-edged sword. There are potential benefits, but gentrification can also lead to population migration and displacement.

### Background

Gentrification is certainly not a new social trend. Historians say that gentrification took place in ancient Rome, when large villas were replacing small shabby shops. In England during the 1700's, **landed gentry** denoted the social class, consisting of gentlemen who took over castle grounds and turned them into estates.

Sociologist Ruth Glass was the first to use gentrification in its current sense. She used it in 1964 to describe the influx of middle-class people displacing lower-class worker residents in urban neighborhoods.

In the U.S., the conditions for gentrification were first generated by the economic transition from manufacturing to post-industrial service economies. The post-World War II economy experienced a service revolution, which created more white-collar jobs and larger opportunities for women in the workplace. This increased the demand for inner-city homes, which were readily available after the abandonment of the central city in the 1950s, resulting from the movement known as **white flight**.

The second wave of gentrification occurred in most major cities in the late 1990s and was driven by large-scale developments, public-private partnerships, and government policies. According to a *Gentrification in America Report* done in 2015, the top five cities with the highest rate of gentrification in the decade from 2000 to 2010 included:

- Portland, Oregon 58%
- Washington, D.C. 52%
- Minneapolis 51%
- Seattle 50%
- Atlanta 46%

The term **gentrifiers** is given to those individuals who are moving into urban areas and remodeling and redeveloping real estate for personal housing.

## CAUSES OF GENTRIFICATION

There are four major theories that help explain the spread of gentrification:

- Demographic Change
- Attitudinal Change
- Political Change
- Social Change

### Demographic Change

The first theory, demographic change, attempts to explain gentrification through the analysis of demographics. This theory refers to the growing number of people between the ages of 25 and 35 in the 1970s, known as the baby boomers. Because the number of people that sought housing increased, the demand for housing also increased.

These households were typically composed of young,



affluent couples without children. Because these couples were child-free and were not concerned with the conditions of schools, parks, and playgrounds, they elected to live in the inner city in close proximity to their jobs. Because these more affluent white-collar workers migrated into urban neighborhoods to live closer to work, they became the majority of homeowners in the neighborhood. This migration process priced blue collar workers out of the higher-priced homes in their own neighborhoods

## Attitudinal Change

This analysis focuses on the changing attitudes, lifestyles, and values of the middle- and upper-middle-class of the 1970s. They were becoming more pro-urban than before, opting not to live in rural or even suburban areas anymore. These new pro-urban values were becoming more salient, and more and more people began moving into the cities.

The first people to migrate into the cities were called **urban pioneers**. These urban pioneers demonstrated that the inner city was an appropriate and viable place to live, resulting in what is coined as **inner-city chic**.

## Political Change

The third theoretical explanation of gentrification has to do with political changes. The changing political and legal climate of the 1960s and 1970s ushered in new civil rights legislation and anti-discrimination laws in housing and employment. Desegregation had an unanticipated role in the gentrification of neighborhoods. As society decreased its acceptance of racial prejudice, more black citizens moved to the suburbs and more white citizens no longer rejected the idea of moving to the city.

## Social Change

This theoretical approach is focused on the analysis of leader-follower relationships. Those who support gentrification are encouraged by leaders such as urban pioneers, land developers, lending institutions, urban business owners, and even the Federal government. These factions, who support reviving neighborhoods, have the strongest voices and control the purse strings when comes to urban renewal and infrastructure improvements.

## EFFECTS OF GENTRIFICATION

While the exact causes for gentrification are still being debated, let's look at what effect gentrification has on neighborhoods. Typically, areas to be gentrified are deteriorated and old, though structurally sound, and often have some obscure amenity such as historically significant homes or dominant industrial buildings, that attract the potential gentrifiers.

These buyers purchase and restore such bargain mansions, mostly for personal single-family homes. Also, a phenomenon known as **loft conversion** occurs when an industrial building or run-down apartment building is rehabbed into rent-producing units.

While the upgrade of housing values is the keynote to the gentrification process, there are a number of less-visible changes that gentrification brings to the community.

Gentrification shifts the role of the state from previously providing social welfare to now providing business services and amenities and increasing the tax base. Gentrification has been extensively advocated by local governments, often in the form of urban restructuring policies.

The goal of these policies includes dispersing low-income residents out of the inner city and into the suburbs, as well as redeveloping the city to foster mobility between the central city core and suburbia. The strain on public resources that often accompanies concentrated poverty levels is relaxed by the gentrification process, a change that is favorable for state and local governments.

## Positive Results of Gentrification

The gentrification movement to improve urban habitats has been somewhat successful at restoring the old and deteriorated housing that is readily available in inner cities. This rehabilitation effort is seen as a better alternative to expansion because the central city offers an already intact infrastructure that should be taken advantage of such as:

- streets
- public transportation
- sewers and water lines

In addition, gentrification can provide access to health resources to some deprived communities that have

previously been largely ignored. Gentrifiers provide the political clout needed to draw more government funding for improvements in physical and social areas.

Urban spaces previously deemed dangerous or unlivable have suddenly become desirable to upper-class citizens. As a result, these spaces are undergoing cataclysmic changes. Following are some of these positive changes noted in gentrified neighborhoods:

- **Economic Boost** – As wealthier people move into an area, they bring higher incomes, thereby providing more money for community and business investment. Over a period of time, more businesses are built. More businesses mean more jobs, which helps everyone in the community.
- **Preservation of Historic Buildings** – The process of gentrification leads to more ownership of existing properties. Historic buildings are rehabbed and fewer vacant properties fall into disrepair.
- **New Retailers** – When the gentrification process begins, you will find that new storefronts and buildings begin to pop up. This shift in perspective can provide new opportunities for restaurants, bars, coffee shops, and boutiques.
- **New Housing Opportunities** – Gentrification creates a new environment for the neighborhood. You will see new buildings begin to rise from the old, creating an upscale look that encourages recycling and reduces waste. This change can also encourage the crime rate to drop in some areas.
- **More Attractive Neighborhoods** – A byproduct of gentrification often includes cleaner streets and better sanitation services.
- **Creation of New Activities** – Gentrified neighborhoods typically see an increase in the mixture of interest-centered clubs, events, art fairs, street fairs, and open air concerts that are family-friendly.
- **Improved Public Safety** – The gentrification process encourages new resources to come into the community that can pay for additional police, neighborhood watch programs, and advanced security systems which protect everyone.
- **Better Life Styles for Hold-Over Residents** – There are some distinct advantages available to those who decide to stay. There may be more job opportunities, increases in home values, and even an increase in residents' credit scores.
- **Increase in Growth Opportunities** – Cities with

the highest rates of neighborhoods that are gentrifying see the highest levels of home equity growth, new job opportunities, and population increase. According to a report that appeared on realtor.com in January of 2017, Charleston, South Carolina saw a 77.5% increase from 2000-2015 in their median home value, rising from \$152,100 to \$270,000. This process brought in better living facilities and higher-paying jobs which encouraged people with needed skills to move into the city.

- **Reduction in Suburban Sprawl** – When communities begin to grow, there tends to be a land grab that occurs. As each project begins, it stretches the boundaries of the community even further. That can eventually lead to high levels of sprawl that can become challenging to navigate for everyone. The process of gentrification reduces this issue because it encourages the improvement of current structures through upgrades.

## Negative Results of Gentrification

The displacement of low-income residents is seen as the major negative aspect of gentrification. Existing neighborhood residents undergoing the gentrification process fear displacement by eviction or the increased costs of area real estate. This displacement can threaten to change an inner-city working-class area into a bourgeois playground.

Displacement of lower-income families as a result of gentrification has been a major issue for decades. However, research has shown that sometimes the opposite is true. Some low-income families in gentrifying neighborhoods remain in place and are less likely to be displaced than in non-gentrifying neighborhoods.

## Impact on Homelessness

During gentrification, the disregard for homeless individuals is highly apparent. The homeless contingent in low-income areas is often pushed out. The homeless are thus removed for the sake of profits. City officials identified lack of affordable housing as the lead cause of homelessness. Gentrification as a whole is forcing the underprivileged to fight for limited housing thus continuing the cycle of homelessness.

Opponents state the following negative social changes of gentrification:

- Decrease in political participation
- Loss of affordable housing
- Commercial/industrial displacement
- Unsustainable property prices
- Community resentment and conflict
- Increased cost and charges to local services
- Loss of economic diversity

## OTHER IMPORTANT ASPECTS OF GENTRIFICATION

It's important to understand several other aspects of gentrification and its effects on our society.

### Social Interaction in Gentrified Neighborhoods

Since gentrification has been around for a number years, there have been studies to observe what is actually going on in these new social settings. Housing confers social status, and the changing norms that accompany gentrification translate to a changing social hierarchy. The process of gentrification mixes people of different socioeconomic strata, thereby congregating a variety of expectations and social norms.

Gentrification can result in class distinction and contribute to **residential polarization** by income, education, household composition, and race. These differing norms can lead to conflict, which potentially serves to divide changing communities. This type of polarization often leads to sub-group isolation, increased security measures, increased police surveillance, and a general rise in paranoia. Some gentrifiers find themselves ensconced in their own homes or apartments.

Conversely, there is also evidence to support that gentrification can strengthen and stabilize a community when there is a consensus about the community's objectives. Gentrifiers with an organized presence in deteriorated neighborhoods can demand and receive better resources. A characteristic example of this kind of effort is when a combined community effort wins historic district designation for the neighborhood.

## Economic Changes

The economic changes that occur as a community goes through gentrification are often favorable for local governments. Affluent gentrifiers expand the local tax base as well as support local shops and businesses. The increase in property values can work to stabilize a previously struggling community and restore interest in inner-city life.

Home ownership is a significant variable when it comes to the economic impacts of gentrification. People who own their homes are much more able to gain financial benefits of gentrification than those who rent their homes and therefore can be displaced without much compensation.

However, one economic phenomenon has occurred that few have predicted. It is called **post-gentrification**. Post-gentrification happens when even the gentrifiers can't afford to live in the neighborhood they've gentrified.

## Impact on Voter Turnout

Common thought would indicate that gentrified areas would have a strong, single-voice voter turnout. However, it's interesting to note that gentrified communities see significantly less voter turnout during election years when compared to more stable neighborhoods. Areas that are not experiencing extreme forms of gentrification are able to maintain a concept of **old neighborhood ties** that represent the familiarity and culture within a community. In a sense, they know who they are and they know the people they are electing to represent them. New residents are unfamiliar with the area and its previous cultural traditions and don't know who should represent them in government.

The increased rate of gentrification has a negative correlation to voter turnout because new residents sometimes refuse to interact with other neighbors. These new residents will not vote simply because of their lack of connection with the community. They don't know current neighborhood issues or who local politicians are.

## Measuring Gentrification

Scholars have identified census indicators that can be used to reveal when gentrification is taking place

in a given area. The following indicators are collected, measured, and analyzed:

- Drop in the number of children per household
- Increased education among residents
- Number of non-traditional types of households
- Upward shift in income

## Stages of Gentrification

There seems to be a natural progression of stages in the gentrification process that can be determined by who is actually moving into or living in an area.

**Early stage.** Artists, writers, musicians, affluent college students, homosexuals, hipsters, and political activists move in to a neighborhood for its affordability and tolerance.

**Transitional stage.** Upper-middle-class professionals, often politically liberal-progressive, such as teachers, journalists, and librarians, are attracted by the vibrancy created by the first arrivals.

**Late stage.** Wealthier people, for example private sector managers, lawyers, doctors, business owners, move in and real estate prices increase significantly. By this stage, high prices have excluded traditional residents and most of the types of people who arrived in the earlier stages.

## Women and Gentrification

A reservoir of potential gentrifiers have been found in single women who hold higher education degrees and are seeking good paying jobs. The inner city can give women access to these employment opportunities and lifestyle.

There are also theories that suggest the inner-city lifestyle is important for women with children because of the proximity to professional childcare. This attracts single parents to the inner city as opposed to suburban areas, where resources are more geographically spread out.

## Backlash to Gentrification

As we noted earlier in this chapter, not everyone is happy with the gentrification process. There are cases where residents formally organized to resist neighborhood development. During the dot-com boom of the late 1990s, the gentrification of San

Francisco's predominantly working class Mission District led some long-term neighborhood residents to create what they called the **Mission Yuppie Eradication Project**. This group allegedly destroyed property and called for property destruction as part of a strategy to oppose gentrification.

There are even some municipalities that enacted counter-gentrification measures. One such measure is called **inclusionary zoning** or **inclusionary housing ordinances**. Inclusion zones require setting aside some new housing in a community for the original low- and moderate-income residents. Many Florida communities that have previously passed local inclusionary zoning laws have come under pressure from state legislation that has questioned the legal validity of such rules. Only time will tell how these differences of opinion will shake out.

**Other control tactics.** There are some other tactics that have been developed when gentrification comes to a community:

- **Community Land Trusts** – A Community Land Trust (CLT) is a nonprofit corporation that develops and stewards affordable housing, community gardens, civic buildings, commercial spaces and other community assets on behalf of a community. CLTs balance the needs of individuals to access land and maintain security of tenure with a community's need to maintain affordability, economic diversity, and local access to essential services.
- **Rent Control** – Rent control restricts the amount of rent that can be charged, so that incumbent tenants are not forced out by rising rents. Some local governments have the power to control rent regulations.
- **Black Market Housing** – Black Market Housing occurs when landlords withdraw houses and apartments from the market, making them available only upon payment of additional fees or bribes. This type of action undermines the rent control law. Many rent control laws allow for vacancy decontrol, which releases a dwelling from rent control upon the tenant's leaving. This causes a domino effect, resulting in a steady loss of rent-controlled housing which ultimately renders rent control laws ineffective in communities with a high rate of resident turnover.

## Gentrification Examples

The following list indicates how the gentrification process evolved in a few select cities.

**Atlanta.** Gentrification in Atlanta has been taking place since the 1970s. Many of Atlanta's neighborhoods experienced the urban flight that affected other major American cities in the 20th century, causing the decline of once upper and upper-middle-class neighborhoods located on the east side of town. In the 1970s, when neighborhood opposition blocked two freeways from being built through the east side, this became the starting point for the city's gentrification wave. First affordable neighborhoods attracted young people and by 2000 more affluent areas attracted people from across Metro Atlanta.

**Washington, D.C.** Gentrification in Washington, D.C. is one of the most studied examples of the process, as well as one of the most extreme. The process in the U Street Corridor and other downtown areas has become a major issue. The resulting changes have led to African-Americans dropping from a majority to a minority of the population as they move out and middle-class whites and Asians move in. Gentrification has resulted in a significant problem of displacement for marginalized city residents. A decrease in the stock of affordable housing for needy households as well as for low-income workers has had a burdensome effect on individuals and families.

**San Francisco.** A major driver of gentrification in San Francisco has been attributed to the strong demand for skilled tech workers from local startups and nearby Silicon Valley businesses. A large influx of new workers in the internet and technology sector began contributing to the gentrification of historically poor immigrant neighborhoods such as the Mission District. During this time, San Francisco began a transformation, eventually culminating in it becoming the most expensive city in which to live in the United States.

**New York City.** In the early 1970s, the first instances of the term gentrification that was applied to a U.S. city was reported in a news article stating that a renaissance was occurring in New York City, as the rich moved in and the poor were moving out. New York City is a common example of gentrification, especially when it comes to discussions about rising rents and low-income residents moving out. Also, the onset of AIDS was a determining factor in

the rapid gentrification of many homes and communities in many different neighborhoods of Manhattan. Because of how widespread the disease was, many homes and apartments were left unoccupied after the tenants died, leaving room for gentrification to occur.

## Gentrification Examples in Florida

Florida urban areas have certainly seen their share of gentrification.

**Tallahassee.** As Florida State University continues to grow its enrollment, the demand for student housing steadily increases. Nearby Frenchtown residents have cited concerns over pressures to gentrify the area. City leaders, school officials and community members are all analyzing differing viewpoints on the subject with hopes of devising appropriate policies for addressing citizen concerns.

**Orlando.** In the 1970s, thousands of Vietnamese war refugees fled their native land, desperately seeking a new beginning. Many of those refugees settled just north of downtown Orlando and began opening businesses and revitalizing a fairly lackluster part of the city. Now, dozens of Asian restaurants, shops, and markets line a 10-block stretch of Orlando's Colonial Drive near Mills Avenue. This area once was called **Little Vietnam** by locals and visitors. Recently, however, the neighborhood was rebranded the **Mills 50 District**, as part of the Orlando Main Street Program.

The Orlando Main Street Program was designed to spur economic development in and attract new residents to some of Orlando's commercial districts. While this seems wholly beneficial on the surface, some residents of Little Vietnam are concerned that not enough is being done to highlight the distinctive culture and history of the area.

**Little Haiti.** Little Haiti is known historically as Lemon City, Little River, and Edison. A 2015 New York Times article helped spark a migration to these areas, by alerting art collectors and real estate developers that Little Haiti had a hot scene. Since then, the property values have been climbing. Rents in Little Haiti jumped 15 percent over 2018 figures. With the steep rise of rents, some Haitian immigrants don't feel at home in their own neighborhood.

## TYPES OF GENTRIFICATION

We can describe several types of gentrification that have taken place.

### Climate Gentrification

The term climate gentrification was first used by Harvard professor Jesse M. Keenan. Climate gentrification refers to a new urban crisis affecting cities all over the world. The basic idea is that substitute investments in less vulnerable or highly-resilient urban areas will operate to accelerate speculative investment, fueling gentrification and displacement. As the impacts of climate change drive people away from afflicted areas, these residents relocate to—and gentrify—less vulnerable neighborhoods. In short, properties at higher ground that have less risk from sea level rise are becoming more valuable, and that is going to mean more speculation in high-elevation neighborhoods.

One of the regions most impacted by both climate change and gentrification is Miami-Dade County. Miami's priciest real estate has historically been located on the coastlines due to the scenic beach views. The poorer residents and new immigrants typically could only afford to live in mainland Miami. However, with climate change causing an increase in the number of natural disasters and sea level rise, residents on the coastlines are beginning to move inward and flee from their beach homes to higher ground.

The average elevation of the Miami area is 6 feet above sea level, with the highest elevation on the mainland at 25 feet above sea level. As the sea levels rapidly rise, Miami becomes more at risk of experiencing devastating floods, with the coastlines being most vulnerable. This new reality is causing the property values and rents of neighborhoods in mainland Miami to skyrocket, and new developments with wealthier residents are beginning to take over these once culturally-diverse communities.

### Rural Gentrification

The concept of rural gentrification may seem like an oxymoron. However when gentrification occurs in rural areas, it is not always recognized as such. Rural gentrification occurs when wealthier households move into a rural area for retirement or to seek

outdoor recreation interests. The analysis of census data identifies three common scenarios for rural growth:

- Urban sprawl migration
- High-amenity-driven migration
- Retirement-driven migration

**Urban sprawl.** Urban sprawl or suburban sprawl mainly refers to the unrestricted growth in many urban areas of housing, commercial development, and roads over large expanses of land, with little concern for urban planning. The term urban sprawl is highly politicized and almost always has negative connotations. It is criticized for causing environmental degradation, intensifying segregation, and undermining the vitality of existing urban areas. Due to the pejorative meaning of the term, few openly support urban sprawl as such. The term has become a rallying cry for managing urban growth.

There is a lack of a clear agreement as to what defines sprawl. However, most definitions often associate the following characteristics with sprawl:

- **Single-Use Development** – This refers to a situation where commercial, residential, institutional and industrial areas are separated from one another. Consequently, large tracts of land are devoted to a single use and are segregated from one another by open space, infrastructure, or other barriers. As a result, the places where people live, work, shop, and recreate are far from one another, usually to the extent that walking, transit use, and bicycling are impractical. So all these activities generally require a car.
- **Job Sprawl** – Job sprawl is another land use symptom of urban sprawl and car-dependent communities. It is defined as low-density, geographically spread-out patterns of employment, where the majority of jobs in a given metropolitan area are located outside of the main city's central business district and located in the suburban periphery. Many companies desire to locate in low-density areas that are often more affordable and offer potential for expansion. Job sprawl impacts poor urban workers who are left without easy access to entry-level jobs.
- **Low-Density Development** – A common example of low-density development is a single-family home on a large lot. These homes usually have

fewer stories and are spaced farther apart, separated by lawns, landscaping, roads, or parking lots. In the United States, 2-4 houses per acre might be considered low-density. The impact of low density development in many communities is that developed or urbanized land is increasing at a faster rate than the population is growing.

- **Agricultural Land Conversion** – Land for sprawl is frequently taken from fertile agricultural lands, which are often located immediately surrounding cities. The extent of modern sprawl has consumed a large amount of the most productive agricultural land, as well as forest, desert, and other wilderness areas.
- **Subdivisions** – Subdivisions are large tracts of land consisting entirely of newly-built residences. Housing subdivisions are sometimes called villages, towns, and neighborhoods by their developers, which is misleading since those terms denote places that are not exclusively residential.
- **Commercial Developments** – In areas of sprawl, commercial use is generally segregated from other uses. This often takes the form of strip malls, which refer to collections of buildings sharing a common parking lot usually built on a high-capacity roadway. These developments tend to be low-density; the buildings are single-story and there is ample space for parking and access for delivery vehicles. This character is reflected in the spacious landscaping of the parking lots and walkways and clear signage of the retail establishments.

**High-amenity-driven migration.** High-amenity-driven migration occurs when second-home-buyers move to a place because of the proximity to recreational opportunities that have driven up prices so much that no one else can afford to either buy or rent homes in these places. Usually these migrants, also known as **equity refugees**, rely on outside sources of income, either cash from investment earnings or salaries from work in another community, to buy into the community. The communities' actual workers, such as firefighters, police, teachers, cooks, and housekeepers are left with a long commute or workforce housing which isn't exactly affordable.

Many communities have been transformed from economies that were sustained by the labor of local residents to ones that rely on stock market dividends reaped by folks who might only have a part-time home in the community.

**Retirement-driven migration.** Retirement migration has the ability to boost private spending, broaden the tax base, and improve the local economy's service sector. However, not all senior migrants generate positive economic stimulus since retirees are not a homogenous population. The literature shows that the elderly have three different motivations for migrating:

- **Retirement Amenity Movers.** Typically includes the "young old," pension-rich, married, and in better health.
- **Moderate Chronic Disability Movers.** Generally individuals with less income, widowed, older, and in need of informal care giving. This group will often return to their place of birth or to live near their children.
- **Major Disability Movers.** Generally, those who are moving to a formal care institution.

Regardless of the classification of movers, access to health services is most important to all groups. Migrants consistently want to be closer to high-quality health care access. This includes trauma centers, hospitals, clinics, pharmacies, and retirement communities. Rural gentrification occurs when a sizeable group of retirees populate an area and new services are provided to meet their needs. Land values increase due to the construction of new buildings and home prices elevate due to the shortage of acceptable housing. However, local service providers with low-paying wages are forced to seek housing in the peripheral areas of the community.

## DEALING WITH GENTRIFICATION

A number of programs and strategies exist that might mitigate the negative aspects of gentrification.

- **Community Benefits Agreements** – Under such agreements, a community group supports an upcoming development project in exchange for the developer providing a community need, such as affordable housing, green space, or jobs for local residents. For example, SPARCC (Strong, Prosperous, and Resilient Communities Challenge) is an initiative to improve the environment, health, and racial equity of vulnerable communities in six U.S. cities, including Atlanta, Chicago, Denver, Los Angeles, Memphis, and the San Francisco Bay area.

- **Homeowner and Tenant Protections Programs** – Programs like rent control, just-cause evictions, tax freezes, and community land trusts have all been implemented to allow for lower-income residents to remain in their neighborhoods.
- **Stabilization Vouchers** – Some community development advocates propose that the federal government create a new type of housing voucher to be awarded to long-time residents of low-income communities to help them stay when gentrification poses a risk.
- **Housing Linkage Fees** – Housing linkage fees are development impact fees assessed on new construction of commercial and residential buildings. The funds from construction fees of new units goes under deed restrictions to tenants with qualifying incomes.
- **Community Action Groups** – Community action groups can be a powerful tool for displaced residents. For example, organizations in Miami, such as Miami Homes for All (MHFA), Miami's People Acting for Community Together (PACT), and Struggle for Miami's Affordable and Sustainable Housing (SMASH) have created campaigns across distressed communities to give residents a voice.

## Real Estate Licensee's Role

As a real estate professional, you know your customer's needs are your number one priority. However, anyone who has been involved in the real estate profession also knows that real estate licensees have a civic duty to support the communities in which they serve. Balancing these two ideals can become tricky when it comes to gentrification.

Assisting investors who want to purchase properties in areas which are likely to gentrify, while simultaneously taking action to curtail the negative effects of gentrification on current residents could prove challenging.

It's unlikely there is a solution in which everyone involved will be completely satisfied. However, outcomes for both residents and investors looking to buy in these neighborhoods can be improved upon if measures are taken to identify areas that will become gentrified before gentrification takes place.

If a real estate licensee can successfully identify gentrification before it occurs, he or she can provide valuable housing tips to customers and also provide

city leaders with information to take preemptive actions to secure a range of housing options for current residents who might otherwise experience only the negative effects of a forced move.

Indicators that can predict the future gentrification of a neighborhood include:

- **Predictive Home Pricing** – A few major real estate tech companies are experimenting with predictive home pricing by using a statistical analysis of home trends. They can accurately assess the worth of homes even in markets where no homes have been sold. From this data, a benchmark of home value trends can be computed which can indicate which areas are suitable for investment and growth.
- **Hipster Population** – The hipster subculture is stereotypically composed of young adults who reside primarily in gentrified neighborhoods. Hipsters frequently flaunt a variety of non-mainstream clothing, such as wearing vintage and thrift store-bought clothing. The subculture typically consists of mostly white young adults living in urban areas.

There is a lot of joking when discussing the correlation between hipsters and gentrification. However, data shows that the correlation is in fact a strong social occurrence. For example, dubbed **coffeehouse gentrification**, certain Manhattan neighborhoods have seen real estate investors transform long-abandoned storefronts into java joints that had little hope of attracting mainstream tenants and making the units upstairs more attractive to renters and buyers in return. The results have generally shown a 21% increase in wealth of residents in just under ten years after the completion of the first new coffee shop.

## Seeking Out Favorable Taxes

These days, companies are very mobile. Gone are the days when capital assets were huge and stationary and remained in one place. A change in tax laws can sometimes deter a business from starting or expanding operations in one state, and encourage relocation to another state that has more favorable tax laws. As companies move in bulk, the result is often a large shift in value from one state to another, resulting in gentrification.

For example, Utah has seen such a prolific increase in tech companies that cities along the Rocky Mountains have been given the nickname **silicon**



**slopes.** Low taxes, cheap real estate, a pool of young engineering talent from the University of Utah, Utah State and Brigham Young, and a business-friendly environment have all converged to make Utah the top business start-up location.

In a 2016 study of all 50 states, the U.S. Chamber of Commerce ranked Utah number one in innovation and entrepreneurship, number two in high-tech performance, and number three in economic performance. Perhaps the most telling predictive element for determining future gentrification can be found in the comments and actions you and others take on social media on a daily basis.

### **Following Digital Footprints**

Think about how much personal data gets entered into social profiles. Those profiles provide a descrip-

tion of where you've been, what you've done, who you've seen, and why you did what you did. By analyzing these patterns, it is possible to see a signal that gentrification is starting to occur, as people who normally would not be visiting a neighborhood begin making more frequent appearances. The increase in cellphone calls, credit card transactions, and social media posts hold the promise of allowing data scientists to see hidden patterns in gentrification.

After identifying a neighborhood that's likely to gentrify based on the above measures, communities can take preventative action to ward off the negative effects of gentrification. Cities can take it upon themselves to construct affordable housing close by, strengthen the rights of current tenants, and reduce property taxes for long-time residents.

## MODULE 6 REVIEW – IMPACT OF GENTRIFICATION ON REAL ESTATE

You are *not* required to answer the module review questions to complete the 14-hour course. They are intended to help prepare you for the Final Exam. Choose the best response to each question. The answers are found in the back of the book.

- 1. What type of economic shift occurs during gentrification?**
  - a. Rents are decreased.
  - b. More lower income families move in.
  - c. Decrease in more expensive housing.
  - d. Increase in more expensive housing.
  
- 2. A stabilization voucher is a:**
  - a. housing voucher awarded to long-time residents of low-income communities to help them stay when gentrification poses a risk.
  - b. housing voucher system designed to attract mid-to-upper income renters to a distressed area.
  - c. voucher system designed to attract businesses to a distressed area.
  - d. voucher system designed to reduce real estate taxes of long-time residents living in a distressed area.
  
- 3. Which of the following best describes the impact on voter turnout in areas experiencing gentrification?**
  - a. Gentrified communities see significantly higher voter turnout during election years when compared to more stable neighborhoods.
  - b. Gentrified communities see significantly less voter turnout during election years when compared to more stable neighborhoods.
  - c. Voter turnout is similar in both gentrified communities and stable neighborhoods.
  - d. Gentrified communities see a significantly higher number of Independent voters during election years when compared to more stable neighborhoods.
  
- 4. When the majority of jobs in a given metropolitan area are located outside of the main city's central business district, the area is experiencing:**
  - a. High Migration
  - b. Land Conversion
  - c. Job Sprawl
  - d. Transitional Development
  
- 5. Restricting the amount of rent that can be charged, so that incumbent tenants are not forced out by rising rents is referred to as:**
  - a. urban sprawl.
  - b. rent control.
  - c. loft conversion.
  - d. residential polarization.

**~ NOTES ~**

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**~ NOTES ~**

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## MODULE REVIEW ANSWER KEY

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### Module 1 — Real Estate Core Law

1. In a mandatory homeowners' association the required disclosure must be provided by the:  
**a. developer or seller.**
2. A fiduciary duty is owed by:  
**b. a single agent.**
3. A broker who owns a brokerage firm and a referral company may be issued upon request:  
**d. multiple licenses.**
4. A real estate license is required when acting as a/an:  
**d. leasing agent who is paid on a transactional basis.**
5. Under the license law, it is presumed that all licensees are operating as:  
**b. transaction brokers.**

### Module 2 — Business Ethics for Real Estate Professionals

1. Which is *not* considered to be unethical behavior?  
**c. selling a rundown house and disclosing known defects**
2. The Articles of the NAR Code of Ethics deal with all of the following duties, EXCEPT:  
**b. Duties associated with the Brokerage Relationship Disclosure Act**
3. The sections in Pathways to Professionalism do *not* include:  
**c. Respect for Pets**
4. The act of "outing" someone for illegal or unethical behavior is:  
**d. called whistleblowing and can be reported internally, externally, to law enforcement, or to a third party.**
5. Good ethical practices have to do with:  
**d. all of the above**

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## MODULE REVIEW ANSWER KEY

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### Module 3 — Understanding Real Estate and Mortgage Fraud

1. The misrepresentation of material information or the omitting of crucial data related to a transaction is referred to as:  
**d. mortgage fraud**
2. Which of the following is a common internet fraud scheme?  
**d. all the above**
3. The Fraud Enforcement and Recovery Act (FERA) was enacted in:  
**a. 2009**
4. The Dodd-Frank Act was enacted in:  
**c. 2010**
5. The law enacted in 1970 requiring financial institutions to assist government agencies in detecting and preventing money laundering is the:  
**d. Bank Secrecy Act**

### Module 4 — Working with Real Estate Investors

1. Real estate is what type of asset?  
**b. Tangible**
2. What type of investor uses the 70% rule?  
**d. Flippers**
3. Select a method in which interest is held in a REIT.  
**a. Company stock**
4. What Act ushered in real estate crowdfunding?  
**c. JOBS Act**
5. What is the minimum percent a serious investor should be willing to put down on a property?  
**c. 20%**

---

## MODULE REVIEW ANSWER KEY

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### Module 5 — From Contract to Closing: Don't Derail Your Sale!

1. Which of the following could potentially derail a sale?  
**d. all of the above**
2. Two refrigerators exist on the property a buyer wants to purchase. However, she only wants to keep the newest one. Which information regarding the newest refrigerator should be included in the sales agreement.  
**a. model and serial number**
3. The purpose of Appraisal Management Companies (AMCs) is to ensure that the:  
**b. lender does not influence the appraiser.**
4. A buyer is purchasing a property where a month-to-month tenant resides, and the buyer does *not* wish to continue renting to the tenant. The licensee working with the buyer should suggest that the tenant be out of the property:  
**a. on or before the day of closing.**
5. During the final "Walk-Through" the:  
**d. all the above**

### Module 6 — Impact of Gentrification on Real Estate

1. What type of economic shift occurs during gentrification?  
**d. Increase in more expensive housing.**
2. A stabilization voucher is a:  
**a. housing voucher awarded to long-time residents of low-income communities to help them stay when gentrification poses a risk.**
3. Which of the following best describes the impact on voter turnout in areas experiencing gentrification?  
**b. Gentrified communities see significantly less voter turnout during election years when compared to more stable neighborhoods.**
4. When the majority of jobs in a given metropolitan area are located outside of the main city's central business district, the area is experiencing:  
**c. Job Sprawl**
5. Restricting the amount of rent that can be charged, so that incumbent tenants are *not* forced out by rising rents is referred to as:  
**b. rent control.**

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~ NOTES ~

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# INDEX

1031 Exchange, 72-73

## – A –

address, change of, 8  
 adjudication, 9-11  
 administrative complaint, 9, 11  
 administrative fine, 8, 12, 17  
 advance rent, 21, 27  
 advertising, 8-9, 14, 18, 32, 40, 44, 51  
     brokerage, 18  
     nicknames, 18  
     point of contact, 18  
     real estate schools, 14  
     trade names, 18  
 air loan, 60  
 anti-fraud legislation, 63  
 appraisal issues, 80, 86-88  
 Appraisal Management Companies, 87, 89  
 appraiser  
     bad, 89  
     working with, 89-90  
 arbitration, 9, 10, 35, 36, 46, 48  
 arbitration hearing panel, 48  
 articles, 35, 44  
 authorized brokerage relationship, 3

## – B –

Bank Secrecy Act, 63  
 Black Market Housing, 98  
 branch office fees, 8  
 BRDA (See *Brokerage Relationship Disclosure Act*)  
 breach of contract, 80-81  
 broker, 2  
     discipline, 8-11  
     gifts and kickbacks, 18  
     office, 17  
     sign requirements, 7  
     transaction, 3-4, 12-13  
     vacancy, 17  
 broker associates, 2, 6  
 brokerage  
     advertising, 18  
     business records, 15  
     Inspect and audit, 15  
     partnership, 2, 5  
     relationship change 12-13  
 Brokerage Relationship Disclosure Act (BRDA), 12-13  
 business address change, 8  
 business ethics, 35, 37  
 buy and bail fraud, 57  
 buyer beware, 24

## – C –

CDD (See *Community Development District*)  
 calculating cash flow, 70  
 cash-back schemes, 57  
 cease to be in force, 8  
 Certification  
     Certified Commercial Investment Member (CCIM),  
     76  
 change of address, 8  
 chunking, 59  
 climate gentrification, 100  
 code of conduct, 35, 38  
 code of ethics, 35, 38  
     changes, 45  
     enforcing, 45-46  
 coffeehouse gentrification, 102  
 commercial loans, 72  
 commission, share, 18  
 community action groups, 102  
 community benefits agreements, 102  
 Community Development District (CDD), 21-22  
     disclosure language, 22  
     legal overview, 21  
 Community Land Trusts, 98  
 compensation, out-of-state, 10  
 complaint, licensee, 9  
 condominium disclosure, 23  
 confidentiality, 3-4  
 conflicting demands, escrow, 9, 19, 28  
 constructive fraud, 56  
 continuing education, 6-7  
 contractor, 3, 5, 26  
 contract(s)  
     "as is", 83, 84  
     clauses, 80  
     issues and problems, 80  
     "items included", 82  
     regular, 83  
     standard,  
     unlicensed person, 13  
 Conventional Residential Mortgages, 71  
 corporate social responsibility, 35, 38  
 corporations, 17  
     director, 17  
     FREC, 17  
     Officer, 17  
 cosmetic conditions, 83  
 counting days, 8  
 credit card debt, 85-86  
 credit insurance packing, 60  
 credit life  
     credit insurance packing, 60

criminal enterprise, 59-60  
crowdfunded real estate, 73-75  
    how it works, 74  
    licensee's role, 75  
    versus Real Estate Investment Trust (REIT), 74  
crowdfunding (See *crowdfunded real estate*)  
customer, 3

- D -

debt investing, 74  
deed fraud, 61  
Department of Justice (DOJ), 41  
designated sales associate, 4, 12  
disability insurance, 60  
discipline, 8-11  
disclosure, 3-4, 12-13, 18, 21-25, 27-28, 31-32  
    brokerage relationship, 3, 4, 12-13, 51  
    material facts, 23  
    property tax, 21, 23, 25  
    seller's, 24  
dispute resolution, 35  
document forgery, 58  
Dodd-Frank Act, 63  
double selling, 60  
duties to REALTORS®, 44  
duties to the public, 44

- E -

ECC (See *Ethics Codes Collection*)  
employees, salaried, 5  
employment, 2-3, 5, 14  
    multiple 2  
    relationship, 3  
    sales associate, 2-3  
employment fraud, 57  
energy-efficiency rating, 22  
equity skimming, 58  
escrow  
    account reconciliation, 19  
    agent, 19  
    conflicting demands, 19  
    deposits, 19  
    disbursement order, 9, 19  
    dispute options, 10, 11, 19  
    funds, 19  
    property management account, 19  
    violation, 20  
ethics, 37  
    complaint, 35  
    Ethics Codes Collection (ECC), 38  
    hearing panel, 47  
    history of, 43  
    in real estate, 42-43  
    officers, 39

    structure of, 43  
ethical business culture, 41-42  
Ethics Codes Collection (ECC), 38  
equity investing, 74  
equity partnerships, 72  
equity refugees, 102  
equity REITs, 71

- F -

failure to disclose liabilities, 57  
falsification of loan application, 60  
FHA Loans, 72  
fictitious loan, 60  
fiduciary duties, 3  
final inspection, 26  
final walk-through issues, 80  
financial fraud, 64  
financing  
    clause, 80  
    issues and problems, 80, 85  
    types of, 71-72  
finder's fee, 5  
flipper's formula, 69  
Florida Attorney General's Office, 65  
Florida Real Estate Commission (FREC), 16  
    discipline, 19-20  
        Notice of noncompliance, 20  
        Citations, 20  
        Mediation, 20  
        Revocation, 20  
        Probation, 20  
    rules, 16-20  
Florida Residential Swimming Pool Safety Act, 26  
formal dispute resolution, 46-49  
    arbitration, 48  
        hearing panel, 48  
    ethics complaints, 47  
    ethics hearing panel, 47  
    grievance committee, 47  
foreclosure fraud, 56  
fraud, 55-65  
    actual, 56  
    anti-fraud legislation, 63  
    buy and bail, 57  
    cash-back schemes, 57  
    chunking, 59  
    constructive, 56  
    deed, 61  
    double selling, 60  
    employment, 57  
    failure to disclose liabilities, 57, 86  
    financial, 64  
    foreclosure, 56  
    gifting, 57  
    how to report, 64

identity theft, 57  
 income, 57  
 internet, 62  
 known material fact, 84  
 modification and refinance, 57  
 mortgage, 55, 56  
 negative, 56  
 negligence, 56  
 occupancy, 57  
 property, 57  
 real estate wire, 62  
 title, 56  
 transaction, 55, 57  
 value, 56  
 working the gap, 58  
 Fraud Enforcement and Recovery Act of 2009 (FERA), 63  
 fraud perpetrated by:  
   appraisers, 59  
   builders, 59  
   buyers, 57  
     buy and bail, 57  
     employment fraud, 57  
     failure to disclose liabilities, 57  
     identity theft, 57  
     income fraud, 57  
     modification and refinance fraud, 57  
     occupancy fraud, 57  
     property fraud, 57  
     transaction fraud, 57  
     unscrupulous mortgage providers, 59  
   impersonation, 59  
   imposters, 60  
     air loans, 60  
     foreclosure rescue schemes, 60  
     Home Equity Conversion Mortgage (HECM), 60  
     straw buyer, 60  
     upfront fee scam, 60  
   investors, 58  
     document forgery, 58  
     equity skimming, 58  
     illegal property flipping, 58  
     occupancy fraud, 58  
     phony appraisals, 58  
     shot-gunning, 58  
     working the gap, 58  
   sellers, 57, 84  
     gifting fraud, 57  
     known material fact, 84  
     under-the-table exchange, 57  
 unscrupulous mortgage providers, 59  
 FREC (See *Florida Real Estate Commission*)  
 full disclosure, 3, 18  
 funds  
   entrusted to brokers, 19

- G -

gentrification, 93-103  
   backlash to, 98  
   causes of, 94-95  
   city examples  
     Atlanta, 98  
     Little Haiti, 99  
     New York City, 99  
     Orlando, 99  
     San Francisco, 99  
     Tallahassee, 99  
     Washington, D.C., 99  
   dealing with, 101-102  
   economic changes, 97  
   effects of, 95-97  
   gentrifiers, 94, 95, 97  
   impact on homelessness, 96  
   licensee's role, 102  
   measuring, 97  
   negative results, 96-97  
   positive results, 95-96  
   post-gentrification, 97  
   residential polarization, 97  
   social interaction, 97  
   stages of, 97-98  
   types of, 100-101  
     climate, 100  
     high-amenity-driven migration, 101  
     retirement-driven, 101  
     rural, 100  
     urban sprawl, 101  
   voter turnout, 97  
 gifting fraud, 57  
 gifts and kickbacks, 18  
 government anti-fraud legislation, 63-64  
 grievance committee, 35, 47

- H -

hard money loans, 72  
 hearing panel, 35, 47  
 hipster population, 102  
 history of code of ethics, 43  
 Home Ownership and Equity Protection Act, The (HOEPA), 63  
 homeowner and tenant protections programs, 102  
 Home Mortgage Disclosure Act (HMDA), 63  
 homeowners' association disclosure, 23  
 housing linkage fees, 102

- I -

income fraud, 57  
 identity theft, 57  
 illegal property flipping, 58  
 illiquid investments, 74

impersonation, fraud perpetrated by, 59  
 imposters, 60  
   air loans, 60  
   foreclosure rescue schemes, 60  
   Home Equity Conversion Mortgage (HECM), 60  
   straw buyer, 60  
   upfront fee scam, 60  
 inactive  
   Involuntarily, 7  
   voluntarily, 6  
 inclusionary housing ordinances (See *inclusionary zoning*)  
 inclusionary zoning, 98  
 informal dispute resolution, 46  
   mediation, 46  
   Ombudsman, 46  
   programs, 46  
 inner city chic, 95  
 inspection issues, 80  
 internet fraud, 62  
 investing  
   buy and hold, 70  
   buy/flip/hold, 71  
   fixing and flipping, 69  
   types of, 69  
   wholesale, 69-70  
 investing in real estate, 68  
 investors  
   benefits of working with, 68  
   core investment factors, 69  
   definition, 68  
   fraud perpetrated by, 58  
   working relationship, 75-76  
 involuntarily inactive, 6

- J -

job sprawl, 100  
 Johnson v. Davis, 24  
 Jumpstart Our Business Startups Act (JOBS), 73

- L -

landed gentry, 94  
 Landlord-Tenant Act  
   advance rent, 27-28  
   disposition of deposit money, 27  
   landlord obligations, 29  
   prohibited provisions, 30  
   restoration of possession, 29  
   retaliatory conduct, 29  
   security deposit, 27-28  
   termination of rental agreement by servicemember, 29

landlord-tenant regulations, 27-30  
   residential tenancies, 27  
 latent material defects, 24  
 lead-based paint disclosure, 22  
 lease-back scams, 60  
 lender, 71, 72, 76, 85, 86  
   online, 85  
 licenses  
   multiple, 2, 7  
   operating as a broker without a valid license, 17  
   reactivation, reactivate, 7  
   registered, 6-7  
   requirements, 5-6  
 license law violation and penalties, 13  
 license renewal, 6  
 license requirement, salaried employee, 5  
 like-kind property, 73  
 limited confidentiality, 4  
 limited representation, 3, 4, 12  
 loans  
   Air Loans, 60  
 loft conversion, 95  
 low-density development, 101

- M -

major disability movers, 101  
 material facts, 43  
 mediation, 9, 35  
 Mission Yuppie Eradication Project, 98  
 moderate chronic disability movers, 101  
 modification and refinance fraud, 57  
 moral turpitude, 10  
 mortgage fraud  
   by imposters (See also *imposters*)  
   defined by Florida Statute, 64  
   how to report, 64  
 mortgage servicing fraud, 59  
 mREITs, 71  
 multiple licenses, 2, 7

- N -

NAR Profile of Home Buyers and Sellers, 80  
 National Association of Realtors®  
   Commercial Real Estate Investment and Analysis curriculum, 76-77  
 negative fraud, 56  
 negligence fraud, 56  
 net-adjusted basis, 73  
 no brokerage relationship, 4, 12  
 non-existent property loan, 60  
 nonresident licensure, 20  
 notice of non-compliance, 20  
 null and void, 6, 7

## - O -

obedience, 3  
 occupancy fraud, 57  
 office, real estate  
     brokerage, 15, 17  
     signage, 7  
     branch office fees, 8  
 Office of Inspector General (OIG), 64  
 officer, director, 2, 5, 6, 17  
 Ombudsman program, 35  
 out-of-state compensation, 10  
 owner financing, 72

## - P -

partnership, brokerage, 2, 5-7, 13, 16  
 party of the transaction, 18  
 pathways to professionalism, 35  
 permit(s), 83  
 personal funds  
     escrow property management account, 10  
     escrow sales account, 10-11  
 personal property, 81, 90  
 phony appraisals, 58  
 point of contact information, 18  
 pool safety features, 21, 26  
 portfolio loans, 72  
 post-gentrification, 97  
 post-license education, 6  
 power of attorney, 61, 81  
 preamble, 35, 44  
 predatory mortgage lending, 56  
 predictive home pricing, 102  
 prima facie, 1, 10, 11  
 principal, 3-4  
 private money, 72  
 private placements, 74  
 private REITs, 71  
 professional code of ethics, 43  
 professional standards committee, 45, 47-49, 50  
     courtesies, 49-50  
 promulgate, 1  
 property condition, 25  
 property disclosure  
     seller's, 84  
 property fraud, 57  
 Property Maintenance, Condition, Inspections and  
     Examinations  
 property management, 2, 5, 10, 11, 15, 19  
 property tax  
     disclosure, 22  
 public non-listed REITs, 71

## - Q -

qualified intermediary, 73

## - R -

radon gas, 22  
     disclosure, 22  
 Rayner v. Wise, 24  
 real estate developers, 74  
 real estate investment, 68  
 real estate transaction, 3, 8, 12, 14, 46, 48  
 real estate wire fraud, 62  
 recapture, 73  
 referral fee  
     commission, 10  
     property management, 5  
 registered trade name, 7, 13, 18  
 registration and licensing  
     company, 5-6  
     corporation, 5-6  
     partnership, 5-6  
 rent control, 98  
 RIETs, 71, 74-75  
     equity, 71  
     mREIT, 71  
     Private REIT, 71  
     Public Non-Listed REITs, 71  
 renewal of license, 6-7, 8, 13  
 rent, 5, 21, 27, 29  
 rental information list, 14  
 reporting fraud, 64-65  
     sources:  
         Department of Justice (DOJ), 64  
         FBI, 64  
         Federal Trade Commission (FTC), 64  
         Financial Fraud Enforcement Task Force, 64  
         Florida Attorney General's Office, 64  
         Internal Revenue Service, 64  
         U.S. Department of Housing and Urban  
             Development (HUD) Office of Inspector  
             General (OIG), 64  
 residential polarization, 97  
 residential swimming pool safety act, 26  
 residential transient occupancy, 5, 22, 27  
 retirement amenity movers, 101  
 retirement-driven migration, 101  
 reverse mortgage fraud, 59  
 rural gentrification, 100

## - S -

sales associate(s), 6  
 Sarbanes-Oxley Act of 2002, 39  
 scams (See also *Fraud*)  
     buy and bail, 57  
     document forgery, 57  
     equity skimming, 58  
     illegal property flipping, 57  
     internet fraud, 62

- lease-back scams, 60
- occupancy fraud, 57
- phony appraisals, 57
- real estate wire fraud, 62
- red flags, 62-63
- shot-gunning, 57
- upfront fee scam, 60
- working the gap, 57
- screen maintenance, lease, 29
- security deposit
  - claim on, 28
  - disclosure, 27
  - notice of claim, 28
  - rental, 27-29
- Seller's Disclosure, 24
- seller's property disclosure, 83-84
- servicemember
  - canceling contract, 29
  - change in duty station, 29
- shot-gunning, 58
- signage
  - office, 7
- silicon slopes, 103
- single agent(s), 3
- single-use development, 100
- sinkholes, 24
  - claim, 24
  - disclosure, 25
- social contract, 38
- sourcing, 74
- sponsors, 74
- stabilization vouchers, 102
- Standard Agreement of Sale, 93
- standards of practice, 35, 45
- stigmatized property
  - death on the property, 25
- straw buyer, 60
- structure of code of ethics, 43
  - preamble, 44
  - duties to clients and customers, 44, 50
  - duties to the public, 44, 51
  - duties to REALTORS®, 44, 51-52

- T -

- tangible asset, 68
- tenant occupied property, 91
- termination, servicemember contract, 29
- termite(s), 83
- Tidewater, 88
- title
  - fraud, 56
  - issues, 80
  - marketable, 81
- The Home Ownership and Equity Protection Act (HOEPA), 63

- transaction broker, 3
  - limited representation, 3, 4, 12
- transaction fraud, 57
- Truth in Lending Act (TILA), 63

- U -

- under-the-table exchange, 57
- unethical behavior, 35, 39
  - businesses, 39-40
  - causes, 40
  - elected and government officials, 40
  - individuals, 39
  - professionals, 40
- Uniform Community Development Act, 21
- unscrupulous mortgage providers, 60
  - credit insurance packing, 60
  - double selling, 60
  - falsification of loan application, 60
  - fictitious loan, 60
  - lease-back scams, 60
  - mortgage servicing fraud, 59
  - reverse mortgage fraud, 59
- urban pioneers, 94-95

- V -

- vacancies of office, 12
- value, 4, 23, 24, 25
- value-add, 74
- value fraud, 56
- violations, 7, 12, 13, 14, 15, 17, 18, 20,
  - escrow, 20
- voluntarily inactive, 6

- W -

- walk-through issues, 80, 91
- whistleblower, 35, 40-41
- white flight, 94
- wire transfer fraud, 86
- working the gap, 58
- working with investors, 67-76



# Final Examination

## Section

# EXAM 21A

**The following pages include:**

- Final Examination Guidelines and Instructions – pages 120-121
- The Final Examination – pages 122-126
- Registration Form Instructions – page 128
- Registration Form and Answer Sheet – page 129

See our License Renewal Checklist on back of registration form.



# Final Examination Guidelines and Instructions

## Part I: FREC Guidelines

1. According to *Florida Administrative Code*, 61J2-3.009,(1)(a), all active or inactive sales associates, broker associates, and brokers must complete a minimum of 14 hours of continuing education during each license renewal period, excluding the first renewal period of their current license.
2. **Is this your first license renewal?** Sales associates, broker associates, and brokers must complete **post-license education** during their first license renewal period. Call our school for more information: 941-378-2900.
3. The Florida Real Estate Commission (FREC) has approved this final examination for 14 hours of real estate continuing education (including both the mandatory three-hour Core Law update and the newly required three-hour Business Ethics) for sales associates, broker associates, and brokers. The FREC course approval #0023660 / #0023661 expires June 24, 2022.

4. The Final Exam begins on page 122. After completing the final exam, carefully transfer your answers to the Registration Form on page 129.
5. FREC Rule 61J2-3.009 regulates the format of final examination questions. This rule states:

- The 14-hour course examination consists of 30 multiple choice questions with four answer choices each. There is only one correct answer for each question.
- The examination questions may not follow the order of the material.
- A minimum of 21 questions must be Application Level. Students must apply the knowledge they have acquired during the course to answer the questions correctly.
- A passing score is 80% or higher. You must answer a minimum of 24 questions correctly to attain satisfactory course completion.
- Students who have failed the final examination may take a complimentary re-exam. The re-exam is an alternate version of the original exam.

### GRADING POLICY

Questions Missed	Grade %
0.....	100
1.....	97
2.....	93
3.....	90
4.....	87
5.....	83
6.....	80
7+.....	Re-Exam



FREE re-exams are available if you do not pass the Final Examination on your first attempt.



## Part II: Exam Instructions



important

This information will help you achieve your best possible score. Please read it **BEFORE** completing the final examination.

1. Review the FREC Guidelines on the previous page.
2. If you need assistance while taking the final examination, contact our instructor via email at [REinstructor@BertRodgers.com](mailto:REinstructor@BertRodgers.com) or by phone 941-378-2900, ext. 8898.
3. After answering all 30 questions, choose one of our convenient methods to submit your completed final examination:
  - **Mail, fax, or email** – Registration Form Instructions are on page 128.
  - **Online** – Go to [www.BertRodgers.com](http://www.BertRodgers.com) for more information.

Be sure the exam number on your Registration Form or E-Grading Exam matches the exam number you completed (i.e., Students completing Exam 21A will complete the Exam 21A Answer Sheet or 21A eGrading).

### Helpful Test-Taking Tips

- Read each question carefully and identify the learning objective that is being tested.
- Review **ALL** of the answer choices and eliminate those you know are incorrect. Some application level questions may have two answer choices that are similar but only one is correct. Choose the **BEST** answer.
- Keep a record of your responses by marking your answer next to each exam question.
- This is an **open-book exam**. Use the index in the back of the book or the search feature in the e-book to look up key terms and **check your answers**. Unanswered questions are scored as incorrect.
- If you are unsure of an answer, use the answer choices to turn the question into a true or false statement. Looking at the question differently may remind you of something you have read.



Instructor support is available during office hours at [REinstructor@BertRodgers.com](mailto:REinstructor@BertRodgers.com) or 941-378-2900 ext. 8898.



## Final Examination 21A

- 1. A buyer signed a contract to buy a home in a community which requires membership in its homeowners' association. A few days after signing the contract, the developer gave the buyer the required homeowners' association disclosure. The buyer may now:**
  - void the contract in writing within three days of receipt of the disclosure.
  - void the contract verbally 10 days prior to closing.
  - delay closing until she has had a chance to review the disclosure.
  - proceed with the sale and be exempt from membership in the homeowners' association.
- 2. A broker is reconciling her escrow account. What information is she required to record?**
  - Date used to reconcile balances
  - An itemized list of the buyers and sellers
  - Projected income for the next 30 days
  - The date the bank statement arrived
- 3. A Broker managing a rental property needs to make a claim on a tenant's security deposit. The broker must notify the tenant within what period of time?**
  - 15 days
  - 25 days
  - 30 days
  - 45 days
- 4. Logan is the broker for Classic Florida Realty. He also plans to become the broker for its new sister company Shoreline Realty. To do this he will need to apply for a:**
  - group license.
  - multiple license.
  - duplicate license.
  - dual license.
- 5. Sales associate Craig placed the following advertisement in the local paper for a new listing: Property for sale by XYZ Real Estate, Inc. Newly renovated 3 bed/ 2 bath/ 2 car garage/ List price \$350,000. For details call Craig at (777)777-7777. To be in compliance with FREC rules, what additional information must Craig also include in the advertisement?**
  - the street address.
  - the total square footage
  - his brokerage firm's web address.
  - his name as licensed with the FREC.
- 6. A seller wants Broker Steve to fully represent him in the sale of his home. To honor the seller's request, Broker Steve will need to enter into which brokerage relationship with the seller?**
  - single agent
  - transaction broker
  - dual agency
  - no brokerage



- 7. A seller in a single agency relationship with his broker, reveals to the broker in confidence that he is having financial difficulty and must sell his home very quickly. The broker must:**
- share the information only with serious buyers.
  - withhold the information from everyone.
  - include the information in the MLS advertisement.
  - share the information with any broker who presents an offer.
- 8. Broker Jill has received an offer from a buyer on Jack's home. Jack instructs Jill not to mention the fact that his home flooded the previous year due to a heavy rain. Jill should:**
- disclose the information to the buyer.
  - obey Jack's request.
  - share the information only if asked.
  - make sure there are no signs of damage from the flooding.
- 9. A newly licensed broker recently opened her first real estate brokerage firm. She also opened up a sales escrow account. The maximum amount of personal funds she is permitted to maintain in the sales escrow account is:**
- \$5,000.
  - \$1,000.
  - \$200.
  - \$0.
- 10. A tenant residing in an apartment community occasionally refers prospective tenants to the property management firm. In return, they pay him a \$50 referral fee if the prospect becomes a resident. According to Florida real estate license law:**
- the tenant will be subject to a fine of \$5,000
  - the tenant may legally receive the \$50 referral fee.
  - the property management firm will be subject to a \$10,000 fine.
  - this activity is not legally permissible.
- 11. Enforcement of the code of ethics is the responsibility of the:**
- Florida Real Estate Commission.
  - local Association of Realtors.
  - Florida Realtors Association.
  - National Association of Realtors.
- 12. The term "business ethics" came into common usage in the:**
- 1920s
  - 1950s
  - 1970s
  - 2000s



- 13. Over the years, business ethics has expanded to ensure a level of trust between businesses and consumers. An example of a corporate social responsibility project is a company:**
- hosting dinner for employees.
  - encouraging its employees to volunteer in the local community.
  - picnic for employees and families.
  - hosting an annual shareholder meeting.
- 14. A new CEO wishes to create a stronger, more ethical business culture. Which of the following strategies could he/she utilize?**
- Reward unethical behavior
  - Model undesirable behavior
  - Investigate only serious complaints
  - Hire ethical/fire unethical employees
- 15. Examples of unethical behavior may include:**
- taking credit for work you did not perform.
  - keeping two sets of accounting books.
  - dating clients or patients.
  - all of the above.
- 16. Which of the following is not a generally accepted cause of unethical behavior?**
- Trust
  - Power
  - Hubris
  - Fear
- 17. A code of conduct is:**
- adopted by a profession to help regulate its activities.
  - addressed to employees to set out restrictions on behavior and rules.
  - used by organizations to deal with internal issues in the organization.
  - a reference that sets out values that underpin the code and describes obligations to stakeholders.
- 18. Select the true statement regarding Florida real estate licensees and the Realtor Code of Ethics:**
- All real estate licensees must become members of NAR and adhere to the Realtor Code of Ethics.
  - All members of NAR agree to abide by the Realtor Code of Ethics.
  - The Realtor Code of Ethics is incorporated into Chapter 475, F.S.
  - The Realtor Code of Ethics is incorporated into Chapter 61J2, F.A.C.
- 19. Which statement is correct concerning changes to the Realtor Code of Ethics?**
- The code is firmly set and does not change.
  - Individual Realtor Associations make changes to the code as needed.
  - State Realtor Associations make changes to the code as they see fit.
  - Changes to the code are made annually at the NAR midyear meetings.



**20. Business ethics is:**

- a. a well-established system of laws and guidelines.
- b. defined in Chapter 475 F.S. and Chapter 61J2 F.A.C.
- c. a standardized method of operation that all business owners, regardless of occupation, must adhere to.
- d. an ever-changing subject because it is rooted in the fluid nature of laws and guidelines.

**21. A consumer believes he has witnessed financial fraud. Which agency hotline should he call to report the allegation?**

- a. Home Mortgage Office
- b. Office of Inspector General (OIG)
- c. Internal Revenue Service (IRS)
- d. Florida Attorney General's Office

**22. A law which was passed to amend the Truth in Lending Act (TILA) to address abusive practices in refinances and closed-end home equity loans with high interest rates or high fees is:**

- a. The Bank Secrecy Act
- b. Home Mortgage Disclosure Act
- c. The Home Ownership and Equity Protection Act (HOEPA)
- d. Florida Statute Sections 817.545(2) & (5)

**23. A broker knows there are issues with the roof of a home he is showing to a potential buyer. The buyer inquired with the broker about the roof's condition, but the broker changed the subject by replying "Let's go out back and see the lake view you will have if you buy this property." The broker's actions are best described as:**

- a. unintentional misrepresentation
- b. negative fraud
- c. actual fraud
- d. passive misrepresentation

**24. The NAR Profile of Home Buyers and Sellers reveals that consumers prefer their real estate professional to:**

- a. provide detailed mathematical explanations of how amortization works.
- b. be good at negotiation.
- c. provide physical assistance in staging and/or moving.
- d. provide emotional support.

**25. A seller in contract with a buyer has changed his mind about selling his home. Although he has no legal reason to back out of the deal, he refuses to close on the transaction. If the seller does back out of the deal, his actions would be best described as:**

- a. fraud
- b. substantive misrepresentation
- c. breach of contract
- d. caveat emptor



**26. A home inspection reveals a termite infestation in the basement. The seller should:**

- a. omit the infestation from the seller's property disclosure.
- b. correct the problem and amend the seller's property disclosure to reveal the infestation and how it was remedied.
- c. not report the problem, because the seller is not a termite infestation expert.
- d. instruct the listing broker not to say anything about the infestation to potential buyers.

**27. While filling out a seller's disclosure form, the seller intentionally left out the fact that during heavy rains his roof often leaks. The seller's behavior is an example of:**

- a. unintentional misrepresentation
- b. fraud
- c. puffing
- d. passive misrepresentation

**28. The home Zac wants to buy has very expensive patio furniture on the lanai. Zac expects the patio furniture to be included with the purchase of the home. So that everyone is aware of Zac's expectation, the patio furniture should be noted on the contract as:**

- a. "items included"
- b. "items for rent"
- c. "items for auction"
- d. "items for display"

**29. Individuals who move into urban areas to remodel and redevelop real estate for personal housing are referred to as:**

- a. Squatters
- b. Demographic Changers
- c. Urban Lobbyists
- d. Gentrifiers

**30. The certification which recognizes an individual as an expert in the commercial and investment real estate industry is a/an:**

- a. Advanced Real Estate Investor (AREI).
- b. Certified Commercial Investment Member (CCIM).
- c. Commercial Real Estate Buyer (CREB).
- d. Corporate Planning Member (CPM).





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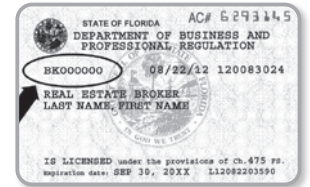


# Registration Form Instructions: Mail, Fax, or Email Submission

## STUDENT INFORMATION

Using blue or black ink, print your license number, name, and contact information on the Registration Form. We use this information to report your education to the DBPR.

If you have more than one license number, use your primary number. If you don't know your license number, contact the DBPR at <http://www.myfloridalicense.com/dbpr> and click on: VERIFY A LICENSE. Your license number is seven digits or less (not the AC#).



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After answering all 30 questions on the final examination, carefully transfer your answers to the Answer Sheet. Use blue or black ink and mark only one choice per question.

If you mark more than one answer or do not mark any answer on the Answer Sheet, you will not receive credit for that question. **If you make a mistake on the Answer Sheet, place an X over the wrong answer; then bubble in and circle the correct answer.**



Example of a changed answer.

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**Review** the License Renewal Checklist on back of answer sheet.

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See Instructions on page 128. Print clearly using blue or black ink on all items.

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Enter your SL or BK license # - 7 digits or less (not the AC#).

	<b>SALES ASSOCIATE</b>		<b>BROKER OR BROKER ASSOCIATE</b>
<b>SL</b>	<input type="text"/>	<b>OR</b>	<b>BK</b>

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Example:

(A) (●) (C) (D)

1. (A) (B) (C) (D)
2. (A) (B) (C) (D)
3. (A) (B) (C) (D)
4. (A) (B) (C) (D)
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26. (A) (B) (C) (D)
27. (A) (B) (C) (D)
28. (A) (B) (C) (D)
29. (A) (B) (C) (D)
30. (A) (B) (C) (D)

## EXAM 21A ANSWER SHEET

Credit Card #

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16

Exp. Date

(Month) (Year)

CVV#

3-digit code on back of card (4-digit code on front of AMEX)



CARDHOLDER SIGNATURE (REQUIRED)



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- Complete your renewal requirements early** – Allow yourself enough time to complete your continuing education well before your license expiration date. Continuing education requirements may be completed any time during your two-year license period.
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- Pay your license renewal fees to the DBPR** – Once you have met all license renewal requirements including payment of license renewal fees and any applicable late fees, the DBPR will email your new license to you.
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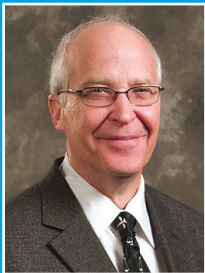
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