

DEPARTMENT OF REAL ESTATE FORUM

Long Beach Convention Center

October 15, 2008

MEETING REVIEW

DRE STAFF IN ATTENDANCE: Commissioner Jeff Davi, Barbara Bigby, Wayne Bell, Bill Moran, Fa-Chi Lin, Steve Ellis, Maria Giuriato and Lisa Stratton.

OPENING REMARKS:

Meeting was opened at 2:00 p.m. by Commissioner Davi. He introduced staff in attendance, and welcomed former Commissioner Paula Friendly, and Walt McDonald, former NAR President, who were both seated in the audience.

Commissioner Davi reported that as a Special Fund department, DRE has been able to avoid, for the most part, the budget cuts required of the General Fund departments. However, the budget for the 2008/2009 fiscal year is down, from \$46 million last year to \$44.7 million this year. The real estate licensee population continues to decline and is now down below 537,000.

Technology, in particular the eLicensing system, is allowing resources to be re-directed from Licensing to the Enforcement area. This is particularly important now as over the last two years, with the decline in licensure and the down turn in the market, our attention has shifted to Enforcement activity. Although still below the peak of 9100 cases in FY 06/07, Enforcement cases are steadily increasing and now involve predominately transactional cases, instead of rap applicant background investigations.

As to disciplinary actions taken in FY 07/08 as compared to FY 06/07:

1131 licenses were denied as compared to 1339 in FY 06/07.

1161 licenses were disciplined as compared to 923 in FY 06/07.

746 audits were conducted as compared to 776 in FY 06/07.

As to Enforcement violations:

36% of violation involved criminal convictions;

20% involved trust fund handling (incl. recordkeeping violations);

9% involved supervision and negligence violations;

4% involved unlawful employment/unlicensed activity; and

31% fall within the 'Other' category – violations other than real estate related.

Specifically as to cases involving mortgage activity:

121 licenses were revoked;

243 licenses were suspended;

136 licenses were revoked/restricted;

24 licenses received public reprovals;

56 licenses were surrendered; and

And 191 actions are pending.

Commissioner Davi expressed frustration with reports of difficulties in completing pending sales on foreclosed or REO properties due to uncooperative lenders. While he has been promoting the willingness of banks to work diligently on these sales, it turns out that the banks really haven't been as cooperative as originally thought. They aren't doing enough to get these properties in the hands of new homeowners, or timely modifying loans before homes go into default.

Commissioner Davi encouraged all licensees to notify him when they come across lenders who are not cooperating so he can try to assist. There are a number of lenders who have signed lender servicer agreements with the Department of Corporations, which agreements state that they will work to facilitate these sales and modifications. If that's not actually what is happening out there, the weight of the DOC can be used to encourage their cooperation.

Commissioner concluded his remarks with a market recovery forecast. Looking back to 1993/94, the turning point of the market recovery was when the number of monthly notices of foreclosures exceeded the number of notices of defaults. Today, notices of defaults have started to decline, while notices of foreclosures are climbing. His expectation is that these number will cross within the next 3-4 months, and if history is any indication, should signal the start of the recovery.

OPERATIONS REPORT:

Chief Deputy Commissioner Barbara Bigby began her report by discussing the department's fiscal status, comparing fiscal year 2007/2008, which began July 1 and ended June 30, 2008, with fiscal year 2006/2007. Overall, revenue has declined, expenditures are steady, and the reserve balance is dropping. Expenditures increased by approximately \$3 million in June, due to money that had been encumbered to pay pending recovery account claims. In the event that those claims are not found to be warranted, or if they are paid at a lesser amount, any money not paid out for this purpose will be returned to the fund.

Revenue received is down 26 percent from \$40.5 million in FY 06/07 to \$29.8 in 07/08. This decline is the result of the downturn in real estate examinations, original licenses, license renewals and subdivision filings.

Net expenditures are down slightly from \$41.4 million in 06/07 to \$40.2 million in 07/08. This reduction in expenditures reflects efforts to keep operations going at a conservative spending pace while continuing to advance in technology.

The reserve fund balance has declined 27 percent, from \$50.1 million to \$36.9 million as of June 30, 2008.

Salesperson examination applications received declined 55 percent, which equates to approximately 84,000 fewer salesperson examinees. This decline is attributable to the removal of the conditional salesperson license. Broker exam applications received also declined, down 28 percent from the same time in FY 06/07. Original licenses issued are also down: salesperson licenses are down 40 percent to approximately 19,000 fewer licensees, while broker licenses issued are down approximately 21 percent from the prior year.

As to renewals, and the key is the percentage of licensees up for renewal who actually renewed, salesperson renewals declined by 3 percent from the prior fiscal year to 73 percent; Broker renewals are up slightly over the past year, at 89 percent as compared to 88 percent last year.

As of June 30, 2008, the total licensee population was up approximately 1% from the same time in the prior fiscal year, from 537,038 to 542,267. Today, that number has dropped to 536,614. Since reaching a high of 549,244 back in November 2007, the licensee population has seen a

steady decline each month, resulting from licensees choosing not to renew, licenses lost to disciplinary actions, and fewer and fewer new licensees entering the business.

The eLicensing system continues to be an investment with significant returns: 57 percent of all license renewals, 61 percent of all miscellaneous license transactions, and 71 percent of all examination scheduling requests in Fiscal Year 07/08 were conducted using eLicensing.

Subdivision Activity – Applications for final public reports have declined by 41 percent from 3,603 in 06/07 to 2,114 in 07/08. Applications for amended public reports have increased by 19 percent, from 666 in 06/07 to 795 in 07/08. These numbers reflect what is happening in the real estate market and phased project development.

As to technology projects, Bigby reported that the IT replacement project has been completed on time and on budget.

Electronic Exams – renovation of the Fresno examination facility is almost concluded. Construction of the Oakland facility is almost ready to commence. The construction plans for the Sacramento and San Diego sites are now finalized and work is expected to begin next fiscal year. A demonstration of the electronic exam functionality is being planned for the next DRE Forum.

The Licensing Call Center project remains on target for completion in December. This new Interactive Voice Response (IVR) system utilizes toll-free numbers that will allow increased functionality over the existing system.

Bigby concluded her report with a summary of two DRE sponsored bills which were recently signed into law by Governor Schwarzenegger. Senate Bill 1461, which becomes effective July 1, 2009, requires a real estate licensee to place his or her license identification number on all first point of contact marketing materials and on home purchase agreements that are negotiated. Assembly Bill 2454 increases the Recovery Account payout limits to \$50,000 for any one transaction and \$250,000 per licensee.

SAFEGUARDING AND NON-ABANDONMENT OF BOOKS AND RECORDS:

Wayne Bell, Chief Legal Counsel, discussed the proper retention and disposal of transactional books and records by showcasing two examples of brokers who showed a total disregard for the privacy rights of their clients. The first example involved a case of office abandonment, which occurred without any notification to the DRE and resulted in 160 boxes of client files left unsecured. Action was taken against the corporate broker and designated officer for negligence, failure to maintain records and failure to notify DRE of office closure and other violations of the real estate law. Licenses of both the corporation and the designated officer were revoked.

Second example involved a Fresno brokerage that is currently under investigation for disposing of files containing checking account numbers and other sensitive information in a dumpster behind their building.

A real estate broker is required to maintain records for 3 years, even when a brokerage closes. It is the broker's responsibility to ensure that all records containing personal and sensitive information are retained, safeguarded, returned, transferred and/or disposed of in a secured, confidential manner. Failure of the broker to properly maintain the privacy of his clients with respect to the treatment of personal/confidential information is a basis for disciplinary action and

possible civil liability under federal and state law. Civil Code Section 1798.81.5 requires businesses that collect specified personal information such as name, social security number, driver's license or other state identification number, or financial account numbers on California residents, use reasonable and appropriate safeguards to protect them from unauthorized access. The California Office of Information Security and Privacy Protection is a valuable source for guidance on best practices for businesses, security breach notification, privacy laws, etc. Bell also recommended an article on the proper retention of records, which was written by DRE Legal staff and published in the Fall Real Estate Bulletin.

ENFORCEMENT CASES:

Bill Moran, Assistant Commissioner for Enforcement, discussed the Freedom Capital Mortgage case, which is a prime example of the type of activity that contributed to some of the economic conditions that currently face California. The broker in this case engaged in a scheme to defraud federally insured financial institutions by recruiting straw buyers with good FICO scores to purchase multiple properties. In order to qualify them for stated income loans, they falsified income and employment information. At the same time, they defrauded the straw buyers by convincing them that they were entering into a business transaction wherein they would profit by assisting others in purchasing homes for which they could not qualify.

At the conclusion of its investigation, the DRE revoked the corporation license of Freedom Capital Mortgage, Inc., as well as the broker license of Joseph Gallo; Mario Fellini surrendered his license pending discipline; and James Martin and Gabriel Viramontes, both unlicensed, were issued Desist and Refrain Orders (D&Rs) to stop further licensed activity. The FBI, with cooperation from the DRE, had conducted a parallel criminal investigation into this matter. As a result, Federal indictments were levied against the respondents and charges included 14 counts of bank fraud, 18 counts of making false statements, 18 counts of conspiracy, and 7 counts of mail fraud.

The two unlicensed individuals who were issued D&Rs subsequently secured employment with another company that operated under a Consumer Finance Lender license issued by the Department of Corporations. As the D&Rs only stopped them from conducting activities that required a real estate license, due to a loophole, they were able to go to work for a lender who was exempt from the real estate license requirements without being in violation of the D&R order. As a direct result of this case, Senate Bill 1737 was introduced by Senator Machado. This bill gives the department the ability to bar individuals from any position of employment, management or control of any real estate brokerage, and the engagement of related business activity, including performing acts of a consumer finance lender, residential mortgage lender, or acts associated with banks, credit unions, escrow companies, title companies or underwritten title companies. This new Bar Order should help to curb mortgage fraud by keeping individuals previously involved in fraudulent activity out of the business altogether.

AUDIT CASES:

Fa-Chi Lin, Chief Auditor, reported on a recent audit case involving trust fund embezzlement. The company negotiated an average of 54 loans per year totaling approximately \$7.1 million, and had a servicing portfolio of 136 loans totaling approximately \$12.9 million. The broker created phony deeds of trust and forged required signatures, ultimately leaving investors without any security interest for their investments. The broker also perpetrated a ponzi scheme, keeping for himself the loan payoffs of approximately 71 loan transactions. At the conclusion of his

examination, the DRE auditor was successful in tracking \$4.7 million of \$5.8 million in misappropriated funds that had been deposited into the broker's business account rather than the trust account. The broker was arrested and ultimately accused of stealing \$43 million in trust funds. Bail was set at \$10 million. Broker pled no contest to 173 criminal charges, including embezzlement, grand theft, forgery and elder abuse, and was sentenced to 28 years in state prison. DRE revoked both the broker license and the corporation license.

REO TOOLKIT:

Maria Giuriato, the DRE's Real Estate Industry & Consumer Liaison, discussed the Department's new REO – Road to Economic Opportunity Outreach Program. Ms. Giuriato suggested that licensees should look to real estate owned (REO) properties as a new way to make money in today's down market, as well as a way to help stimulate California's economy. The REO program is the Department's statewide outreach plan to encourage the quick sale of lender-owned properties to qualified borrowers. It encourages the use of existing city, county and state loan programs, and initiates collaboration with non-profit housing providers, real estate agents and lenders. The REO toolkit, which is available for downloading from the DRE's website (www.dre.ca.gov), walks the recipient through the process of organizing an REO outreach meeting in their own community.

Commissioner Davi added that the purpose behind creating the REO toolkit was to help get foreclosed properties back into the hands of consumers, restore neighborhoods and improve the economy. With the wide variety of programs now available and dramatically reduced selling prices, more opportunities for homeownership are available to those hopeful buyers previously priced out of the market. REO properties offer these buyers another opportunity for homeownership and should be promoted along with other available options.

OPEN FORUM:

Q) Your opening statement mentioned a list of lenders who had signed a lender servicer agreement. Where can that list be found?

Davi) That list is located on the Department of Corporations (DOC) website, which is www.corp.ca.gov, and includes those lenders who signed a lender servicing agreement back in the Fall of 2007, at the encouragement of Governor Schwarzenegger. The agreement basically sets forth what those lenders will do to assist homeowners in need of loan modifications. DOC also publishes the results of a survey of Mortgage Servicers operating in the State which sets forth detailed information about the loan workouts that have been completed so far.

Q) My company was recently involved in a transaction with an Internet-based real estate company that was representing the buyer in the transaction. The agent representing the buyer never personally saw the property and when it came time to fill out the transfer disclosure statement, the broker of the company said their business model is such that they aren't required to do a physical visual inspection of the property. When we questioned him further, he kept saying you don't understand our business model.

Davi) Turn him in. I want the name of that company.

Q) I've been doing short sales for approximately 18 months. For our clients who want to keep their homes, we have been automatically doing free modifications and have been successful in

getting them approved. I have a problem with companies charging for services that can be done for free. How do you feel about companies taking advance fees to do this for customers? They're charging \$3500-\$5000 to do these modifications.

Davi) What you describe is an advance fee scenario, where fees are taken in advance of doing the modification. To do this type of work, an approval by the DRE of the advance fee agreement is required.

Moran) We recently included on the website a list of names of all the companies, to date, who have received 'no objection' letters from the DRE on their advance fee agreements, allowing them to legally accept advance fees for loan modification services. The link to this list is located under the heading 'Newsflash'. At present, there are probably only about 9 companies that currently are lawfully collecting advance fees for loan modifications. The DRE is going after companies who are trying to circumvent the law, as we find out about them.

Davi) Be aware that the Foreclosure Consultant Law prevents an advance fee from being collected from an individual if a notice of default has already been filed against them, regardless of whether or not the company has an approved advance fee agreement. You are correct that modifications can be done free of charge and we have tried to promote that information through the foreclosure townhalls.. But ultimately, the law does allow people to charge a fee for the service. If you do come across somebody who is charging an advance fee but does not currently have a "no objection" letter from the DRE, please file a complaint it with the Department. We can't stop this activity if we aren't aware of it.

Q) To Wayne Bell, with respect to the photos of the abandoned files, couldn't those files have been copied into digital form and then the hard copy destroyed? What is the policy?

Bell) Yes, originals documents can be destroyed if they have been digitally copied in accordance with the rules set forth in Regulation 2729 of the Regulations of the Real Estate Commissioner. There is a right way to close an office: provide advance notice, follow legal requirements, electronically store the records so that there is a permanent way to see them, and destroy the paper documents in an appropriate manner.

Q) What is the best way to report cases of fraud to the DRE?

Davi) The best way is to download the complaint form, complete it, attach related documentation and mail to the DRE. DRE cannot act upon an anonymous complaint or a phone call – it must be in writing. Within 4 weeks or so, a written confirmation will be sent to you that your complaint has been received and that we've determined that it will either be set up for investigation or that the evidence doesn't warrant an investigation.

Q) Are you going to be issuing any regulations based upon the legislation that went into effect regarding requiring license ID numbers on all first point of contact materials?

Davi) Clarifying regulations will be issued in the early part of 2009.

Q) The Orange County Board of Realtors would like to thank you for coming to their area to address their membership.

Q) There was recently a big case in the Bakersfield area where the DRE came in and revoked the licenses of the individuals involved. There is a process going on now, however, that still

allows these individuals to operate within the real estate field. Do you have any statistics on the number of department sanctions that are overturned civilly?

Bell) I don't have a statistic, but very, very few cases where the Commissioner has adopted the Decision to revoke, suspend or issue a restricted license have ever been reversed. After a decision is proposed by an Administrative Law Judge, it goes to the Commissioner for either adoption or not adoption (rejection). In the particular case you're referring to, the Commissioner adopted the decision that was proposed by the ALJ, which was to revoke the licenses of both real estate licensees – one a salesperson, the other a broker. One of the individuals was granted a 30-day stay. The next step is that he, and perhaps the other individual, will petition the Superior Court for a Writ of Mandate. In reviewing this petition, the Superior Court will look to see if evidence was improperly excluded at the hearing and if the Commissioner abused his discretion, among other things. If the Court finds such improprieties, it will remand the matter to the Department commanding us to set the decision aside and/or to reconsider the decision in light of the Court's opinion. The Commissioner would then issue a Decision After Remand. That Decision could then go up again through the Superior Court, and then to a Court of Appeal and then the California Supreme Court. This is part of the California civil procedure and it provides the due process licensees are guaranteed under the laws of California. I would expect that this particular case will be upheld by the Superior Court.

Moran) – The 30-day stay for the individual you're referring to is part of the due process procedures but once it gets to Superior Court, the court may or may not stay the decision pending the outcome of the Superior Court proceeding. Chances are that once this individual files for a Writ, he'll probably ask for a Stay, and that may or may not be granted by the court. His license may immediately go into revoked status pending his appeal of the department's decision.

Q) When can we expect a new reference book? Also, I understand there is a study going on right now of the real estate exam. Do you have any idea when that will be completed?

JD) The reference book will be updated and available sometime in 2009. The Department began an 18-month internal exam study in August. Once completed, we will have an all-new, updated real estate examination.

Closing Remarks

Next meeting is scheduled for January in Monterey.