

DEPARTMENT OF REAL ESTATE FORUM

June 5, 2009

MEETING REVIEW

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

OPENING REMARKS:

Commissioner Davi gave welcoming remarks, and introduced DRE staff in attendance. He stated that the theme of the Forum was Combating Loan Modification and Foreclosure Scams, and that all staff reports will focus on some aspect of that subject. The Department is currently focused on enforcement efforts due to the skyrocketing of complaints received regarding loan modification and foreclosure rescue scams. There are an increasing number of unlicensed predators taking advantage of consumers, particularly in the area of loan modifications. Current statistics reflect that 1,000 homeowners are receiving a Notice of Default, and 600 homeowners lose their homes to foreclosure every day. Loan modification and foreclosure rescue scams have become the number one consumer protection challenge for the department, and DRE is proud that it has taken the lead in terms of being a proactive enforcement agency in California in this area. In an ongoing effort to increase consumer protection and awareness, the department has expanded the information available on its website to include expanded foreclosure and loan modification fraud information and guidance; public service announcements (PSAs) and consumer alerts have been published and widely distributed; and staff continues to participate in consumer outreach events. Commissioner Davi reported that he has also formed an internal DRE task force focused which focuses staff efforts on loan modification and foreclosure rescue scams and assisting local law enforcement pursue criminal charges against the individuals/entities found to be conducting these illegal acts. The Department's jurisdiction is limited to license discipline, including the suspension or revocation of a license, but staff is working closely with local law enforcement to assist them in pursuing criminal charges against these scammers. A Strike Force Team within DRE has been set up to process the very high profile cases. This strike team consists of Legal, Audit, and Enforcement staff who will work together to quickly process the investigation and issue the Accusation in as timely a manner as possible. Enforcement staff is working with the FBI, District Attorneys, and the U.S. Attorney to assist them in pursuing criminal actions against some of these companies. To date, several cases have been referred to local district attorneys in Sacramento, Orange County, Monterey and Los Angeles, five cases have been referred to the US Attorney, and over 35 complaints of attorney misconduct have been referred to the State Bar. The Commissioner reminded and encouraged everyone to 'Log on, Look' em Up and Check em Out!' before enlisting the services of, and paying any upfront fee to, any individual or company for loan modification services.

In conclusion, the Commissioner provided an update on Assembly Bill 33. The status of the bill is currently not resolved and it is uncertain what the final result will be, but it is the DRE's opinion that the function and oversight of the Department of Real Estate should stay as is, and not be combined with agencies that regulate financial institutions.

OPERATIONS REPORT:

Chief Deputy Barbara Bigby began her report with an overview of the fiscal condition of the Department, summarizing revenue, net expenditures and reserves for the first three quarters of Fiscal Year (FY) 2008/09, which is the period of July 2008 through March 2009. Revenue averaged \$1.8 million, while expenditures averaged \$2.8 million, continuing a monthly drain on the reserve balance. Accordingly, the reserve balance is down from \$36 million to \$27 million. Comparing July through March 2008/09 to the same period in FY

2007/08, revenue received was down 27 percent from \$22.6 million in FY 2007/08 to \$16.6 million in FY 2008/09. Net expenditures declined 5 percent from \$27 million in FY 2007/08 to \$25 million in FY 08/09, which includes an increase in recovery fund claims from 17 in FY 07/08 to 120 in 08/09. Reserves have declined by 35 percent, from \$42 million in FY 06/07 to \$27 million as of March 31, 2009.

As to Licensing workload, comparing July 1 – March 31 of FY 08/09 with the same time period in FY 07/08, Salesperson examination applications have declined by 70 percent or roughly 45,000 applications. Broker examinees have slipped by 36 percent or 6,154 applications. Original licenses issued are also in decline, with a 61 percent decline in salesperson licenses issued, and a 30 percent decline in broker licenses issued, from the prior year. As to license renewals, salesperson renewals are down 10 percent from 2007, at 64 percent renewing. Broker renewals also dropped, from 91 percent to 80 percent, representing a decline of 11 percent. Despite the decline in the percentage of licensees renewing, actual renewal applications increased by a little over 2,300. The actual renewal percentages are consistent with those reported at the January DRE Forum, and appear to reflect an apparent stabilization in the renewal rate.

As to the total licensee population, as of March 31, 2007, there were 546,247 licensees. One year later, on March 31, 2008, there were 525,824 licensees, which represents a 4 percent decrease. As of June 1, 2009, there were 521,247 licensees, a slight decline but still a significant number in terms of the workload necessary to support this size licensee population.

As to Enforcement activity, again comparing July 1 – March 31 of the 2008/09 fiscal year with the same time period in the 2007/08 fiscal year, the number of license denials is down 29 percent, reflecting a change in the focus of the enforcement program from background checks on new license applicants to a focus on subsequent arrest and convictions as well as transactional investigations. Disciplinary actions taken are up 24 percent over the same time in the prior fiscal year. The issuance of Desist and Refrain Orders has skyrocketed by 92 percent, most of which are being issued against loan modification companies and individuals. Investigative audits are up by 17 percent over last year.

As to Subdivision activity, there was a 47 percent decline in final applications for subdivision public reports, and an 18 percent decline in applications for amended public reports. Due to this decline in workload, Subdivision Deputies continue to support the Enforcement Program by working on enforcement cases.

As to the Electronic Exam project currently underway, the first exam facility in Oakland is ready for occupancy, and examinations are expected to commence this summer. The Fresno exam site is nearing completion. The 'combo' applicants who successfully pass the new electronic exam, and have no criminal background, will be issued a license number at the completion of the exam.

Ms. Bigby announced the call for participation in the Exam Study Survey. The Department of Real Estate is in the process of conducting an examination study to ensure the real estate examinations are up to date and test on the current knowledge needed for a licensee to perform effectively in today's market. Exam improvements cannot be realized without the input of current licensees. Broker participation is encouraged and appreciated.

In conclusion, and in response to ongoing requests, Ms. Bigby announced the following: 1) Beginning Monday, June 8th, licensing and examinations questions can be posed to department staff via the Internet. Licensing technicians will research your questions and reply within 2-3 business days. The form is available on the website at www.dre.ca.gov/lic_ask_drelicensing.html. 2) Beginning next fiscal year, a project to add the actual date first licensed to the public license record will commence. As dates are validated, they will be published on the Internet.

ADVANCE FEES AND LOAN MODIFICATION UPDATE:

Tom Pool, Assistant Commissioner for Legislation, Public Information and Mortgage Lending presented a report focused on DRE's consumer protection efforts with respect to loan modification transactions as well as the legal requirements for the collection of advance fees.

By definition, an advance fee is the collection of an upfront fee for the purpose of promoting the sale or lease of real property. In addition, it can also be defined as the collection of an upfront fee for the purpose of performing services for borrowers or lenders in connection with loan secured by real property. A real estate broker license is required to do a real estate loan modification or to collect an advance fee. Attorneys who provide legal services and act within the scope of his or her license can also collect an advance fee for a loan modification. Brokers must have a contract vetted and approved by the DRE before a fee can be collected, and no advance fee can be collected if a Notice of Default against a property has been filed. The agreement must: a) specify how much is being collected and what services are being rendered b) must require the money to be placed in a trust account, c) the money can only be expended on the promised services, and d) the broker must provide a verified accounting of how the money was held and disbursed. If there is any money left over, that money must be returned to the principal.

Mr. Pool reported that in June 2008, five advance fee contracts had been submitted for review. As of April 2009, 1784 contacts have been submitted, and 690 contracts had been deemed compliant.

In a consumer protection effort, the Department has improved its website to include an Advance Fee Agreement Listing link so licensees and consumers can see first hand who has an approved advance fee agreement on file for loan modification services (www.dre.ca.gov/mlb_adv_fee.html). A list of licensees who have been issued a Desist and Refrain Order and/or Accusation for illegal loan modification activities has also been added (www.dre.ca.gov/cons_DandR.html). By clicking on the link, consumers can view a copy of the actual complaint that was filed and of what the licensee or individual is being accused. Other additions to the website include consumer alerts, public service announcements, information for consumers on how to avoid becoming victims of a loan modification scam, and information on how consumers can contact HUD approved housing counselors, who can provide loan modification services free of charge.

In conclusion, Mr. Pool suggested that anyone considering the use of a fee for service company for a loan modification should visit the DRE website, verify the company's license status and make sure they've had their advance fee contact approved by the DRE. In addition, be aware that there are free services available and there is no need to pay anyone for this service.

ENFORCEMENT CASES:

Bill Moran, Assistant Commissioner for Enforcement, discussed loan modification scams and the various abuses that have occurred. He reported that the mortgage meltdown and foreclosure crisis has created an environment ripe for abuse and as a result, over the past 8 months loan modification firms have sprung up throughout California and the nation. These companies collect an advance fee with the promise that they will negotiate with the lender on behalf of the borrower to obtain a modification of their loans. Most promise success, but in actuality, perform no service at all. Over the last 8 months, DRE has set up over 800 cases against loan modification companies, most of which turn out to be unlicensed. To date, 158 Desist and Refrain Orders have been issued, and about 29 Accusations against licensed real estate agents have been filed. What the Department is seeing in terms of who is actually doing these loan modifications: 1) Real Estate Brokers. To date, DRE has issued approximately 680 "no objection" letters to brokers who collect advance fees. Twenty-nine Accusations have been filed against licensees. Based upon these numbers, the majority of complaints are not coming from real estate brokers. 2) Law Firms – This is legal if conducted in the normal course of their business. 3) Attorney Affiliated Organizations –this is a big problem area. These firms set up networks of oftentimes unlicensed companies to solicit loan modifications, collect the advance fees, and in most cases, the

borrower never sees the attorney. 4) Unlicensed firms – these firms are popping up every day in California, and nationwide. Mr. Moran played news clips on two loan modification companies, The Firm, and Pope Mortgage and Associates, to demonstrate the types of activity the department is seeing.

As the DRE is limited to revoking or disciplining a license, cases are being referred to criminal prosecutors at the State and local level to encourage the pursuit of criminal charges against these violators. The Attorney General's Office has already filed two criminal actions, one in Orange County and one in Fresno.

In conclusion, Moran stated that the Department would like to maximize its consumer protection efforts, and the best fraud is the fraud that never occurs. The Department is enlisting the support of local associations by asking them to spread the word in your communities, encourage anyone who is thinking about a loan modification to be certain of whom they are dealing with, refer them to the DRE website for information on loan modifications, and follow the Commissioner's advise to "log on, look 'em up, and check em out."

AUDIT CASES:

Fa-Chi Lin, Chief Auditor, gave a report on loan modification audits. These audits are different from a normal audit in that the auditor would focus specifically on the handling of the advance fee. The collection of an advance fee for loan modification services is prohibited without having first vetted the contract to the DRE for approval, so initially, the Auditor would confirm that a no objection letter was obtained from the DRE. If one is on file, the auditor would then confirm that the same contract is being used and that all consumer protections are intact. The auditors will also confirm that broker is actually following all the terms of the contract, such as if the money collected is being held in trust until the services with the borrower have been rendered. Auditors will exam transaction files and confirm that the handling of the advance fees is done according to the terms of the contract. Auditors will confirm that basic trust fund record keeping requirements are being met. In addition to normal requirements, since the funds are advance fees, there is an added requirement of periodic accountings by the broker to the borrower from whom they collected the money. The law also requires that borrowers be provided with a detailed accounting of how their funds were used at the end of each calendar quarter and also when the contract has been completed. Auditors will exam the broker's records to make sure that these accountings were provided timely and that they contained the required content, including date performed, amount of fee allocated, date disbursed, and balance of advance fee collected. If the required services are not rendered or if some of the advance fees are not expended, the auditor will look to see that the remaining advance fees have been refunded to the borrower.

Mr. Lin then discussed the recent audit of 2nd Chance Negotiations, Inc. This company collected \$1 million+ a month in advance fees, had no approved advance fee contract on file, did not place funds into a trust account and had a success rate of only 10%. After an investigation, the DRE and the Department of Corporations both issued separate Desist and Refrain Orders against the company, ordering them to stop performing loan modification services.

HYBRID ATTORNEY-REAL ESTATE LICENSEE ARRANGEMENTS: ISSUES AND OUTREACH:

Wayne Bell, Chief Legal Counsel, discussed the proliferation of hybrid attorney/real estate licensee arrangements, i.e., real estate licensees and lawyers who join together and perform loan modification and foreclosure rescue services, and why these types of arrangements pose both serious legal and ethical challenges.

The attorney/real estate licensee arrangement may appear to be advantageous to both parties for a number of reasons. Under current law, lawyers, unlike real estate brokers, are able to collect fees in advance from clients even after the recordation of a Notice of Default. Lawyers do not have the same restrictions as real estate brokers with respect to the acceptance of advance fees. In addition, the association with a lawyer may seem to add an air of legitimacy to the company. An attorney-backed scenario includes lawyers collecting advance fees

(or retainer fees) and sharing those fees with the referring real estate brokers and/or salesperson; lawyers hiring real estate licensees and supervising licensees as legal assistants, paralegals or some other sort of legal office personnel; and lawyers who act as “in-house” counsel in real estate companies.

Mr. Bell stated that the association between brokers and lawyers raises serious ethical and legal questions which should be considered. Some of those questions include: Is the business model an unlawful scheme to circumvent the prohibition against the collection of advance fees by a real estate licensee after the recordation of a Notice of Defense? Is the lawyer actually performing legal services and providing a valuable service to individual clients? Is the lawyer just a “front” and/or a non-participating magnet for business from desperate homeowners? Is the real estate licensee who is working with the lawyer a real estate “salesperson” engaged in real estate licensed activity? If a non-lawyer real estate licensee is working on loan modifications in a law firm or “law” business, is the licensee a law firm employee working under the supervision of a licensed lawyer or is the licensee “practicing law” without a license?

Because of the potential problems arising in these types of relationships, DRE has reached out to the California State Bar to educate them on these issues. The State Bar is now actively working with the DRE in investigating hundreds of cases where lawyers are involved in the loan modification and foreclosure rescue business. Many of these cases also involve real estate licensees. The State Bar has also issued an Ethics Alert to California Lawyers titled “Legal Services to Distressed Homeowners and Foreclosure Consultants on Loan Modifications” and is actively examining the accuracy and propriety of attorney print, radio, television and internet ads for loan mod and foreclosure prevention services. The California Bar Journal, an official publication of the State Bar of California, has published an article entitled “Bar Issues Foreclosure Ethics Alert,” which contains cautionary notes. In addition to the State Bar, the DRE continues to cooperate with other federal, state and local public service and law enforcement partners including FBI, US Attorneys, State Attorney Generals, District Attorneys, City Attorneys, Federal Trade Commission and HUD, on these issues.

Mr. Bell concluded his report by suggesting that if you’re a real estate licensee who is contemplating a relationship with a lawyer to perform loan modification or foreclosure prevention work, do your homework. Carefully review the State Bar’s Ethics Alert, check the accuracy of the statements of the lawyer’s ads, determine the legitimacy of the lawyer by reviewing his/her disciplinary history, bar membership records and experience in the area of loan modifications and foreclosure consulting, before entering into such a relationship.

OPEN FORUM:

Q) 1) Regarding the PSAs, have you thought of putting them on YouTube? 2) Please justify the license fee increase.

A) 1) The PSAs have already been posted to YouTube. 2) The Department has for the past five years maintained fees at the same levels as those charged in 1982. Despite having taken steps to achieve functional efficiencies and reduce expenditures, the Department must now increase fees to the statutory maximum to fund its operational needs.

Q) What body oversees non-licensees who set up loan modification services? And what do those people need to do to set up legitimate loan modification services?

A) DRE enforces the Real Estate Law, which requires an individual to hold a real estate broker license in order to engage in advance fee collection and loan modification activity, unless specifically exempted. We would enforce the law by issuing a Desist and Refrain Order to any unlicensed individual/company. Until such time as that individual/company becomes licensed and in compliance with the law, or they are attorneys conducting the activity in the normal course of their legal practices, they are operating illegally.

Q) What is the status of the requirement to include our license number on our business cards? And is it accurate to say that my broker's number must also be on my business card?

A) The requirement to have license number on all first point of contact solicitation material is still going through the regulation process. If we succeed in getting it passed, it will become effective July, 2009. The only number that must be on your card is your license number. Sales licensees are not required to have their broker's license number on their business cards.

Q) What is the current timeframe from the Department's receipt of a complaint to the hearing date?

A) The timeframe varies. Typically, it takes about 6 months from the time the complaint is received to the time an Accusation is filed. Once the Accusation is filed, it could be several more months to get a hearing date as we are impacted by the workload facing the Office of Administrative Hearings. It could take upwards to a year to have a decision on the final formal disciplinary action.

Q) What is the process to inform the complainant of the outcome?

A) The complainant would typically be called as a witness in the case. The action becomes a public record and notice would normally be sent out to the person who made the complaint.

Q) Between the time that the complaint is filed and the hearing, is there any conversation with the accuser?

A) Yes, especially if the Accuser is going to be called as a witness. Attorneys actually send out subpoenas to the individual ordering them to appear as a witness during the hearing. This usually occurs one month to six weeks prior to the hearing date.

Q) Is there a minimum font size requirement for the display of our license number on our business cards?

A) The regulation states that the type size shall be no smaller than the smallest font used in the solicitation.

Q) Does DRE have a policy for outside websites wishing to link to your website?

A) No. We encourage the posting of our link to other websites.

Q) Is it true that if a licensee has been in business for over 30 years that they don't have to pay for their license renewals?

A) That is incorrect. You're thinking of the 70/30 exemption, which states that if you're 70 years or older, and have been licensed in good standing for 30 consecutive years, you are exempt from the continuing education requirements. However, payment of the renewal fee is still required.

Q) Today we heard two cases, one involving the collection of over \$3 million in advance fees, and one with over \$1 million in advance fees. When these guys are caught, what happens to that money – are their assets frozen?

A) Most of the time that money is long gone. The Attorney General or local prosecutor may possibly file civil litigation under 17200 B&P and upon the filing of the lawsuit, freeze and seize any assets. Law enforcement agencies will look at these cases and will take a look at going after any available assets as part of the settlement.

Q) Regarding unlicensed assistants. They seem to be handling most of the transactions these days, and are even communicating offers and counter offers.

A) If an unlicensed assistant is sending offers and counteroffers in their own name, it probably does cross over into the area of activities that require a license. We have a Real Estate Bulletin article that we've published a couple times called Guidelines for Unlicensed Assistants which sets out the perimeters of activities that are allowed of unlicensed assistants.

Q) What is the status of the proposed elimination of DRE?

A) You're referring to Assembly Bill 33. The bill originally was going to combine DRE, Office of Real Estate Appraisers, Department of Corporations and Department of Financial Institutions into one called the Department of Financial Services, under the Business, Transportation & Housing Agency. We've been successful in convincing the legislature that DRE does not conduct financial activity and does not belong under this umbrella. As it stands, we expect that the Office of Real Estate Appraisers will probably merge with the DRE, and that the Departments of Corporations and Financial Institutions, along with the mortgage brokers from DRE, will go under the new Department of Financial Services.

Q) Regarding gaining approval of advance fee agreements for loan modification services, in the interest of disclosure for the consumer, couldn't the DRE require that as part of that agreement they report how many modifications they've done successfully and how much in advance fees they've collected?

A) The problem with that is if they're able to disclose that information, they've already violated the law by accepting advance fees without prior approval. When we file a D&R on a licensee who has collected advance fees before submitting an agreement, we include in the order that before the D&R can be lifted, they have to give a full accounting of all the trust funds they've received as advance fees, what was done with them, and make sure any monies for modifications that they haven't done are still in the trust fund. Much of what is in the advance fee agreement is a statutory requirement, so any changes to the language would require a statutory change.

Q) Cable television stations are required to have a public service channel and posting on those channels is free of charge. Have you considered running your PSAs on these channels?

A) Yes, that's one of the options we're looking currently looking into. If any of you have a special connection at your local cable stations, please let us know.

Q) I recently saw a commercial for a loan modification program that appears to have the support of President Obama. I called the 800# provided in the commercial, and they asked for \$4,000 to do the modification. I've seen several such commercials on the air. Are these people being investigated?

A) Yes, we're investigating as well as the Federal Trade Commission. Our goal is to get these ads off the air. We would appreciate you calling to our attention anything that you see on the air that is suspect because there are several companies using variations on that same commercial.

Closing Remarks:

Next meeting is scheduled for October 7, 2009 in San Jose.

Meeting concluded at 2:50 pm.