Consumer Protection Reader, 2012
QUIZ for Part 1 of 2
February 16, 2012

This is an optional pen-and-paper quiz (unlike the final which is online and automatically graded). We recommend you print this PDF document, take the quiz by marking your answers with a pen, and then read the explanations for the answers following the quiz.

The questions on this quiz are not representative of the questions on the final. Most quiz questions are true/false while 90% of the questions on the final are multiple choice. The quiz questions tend to be longer and more difficult than the questions on the final.

The objective of the quiz is educational while the objective of the final is to measure your understanding of the course material.

While the DRE prohibits us from giving you the answers to the final, we give you the answers to the quiz with explanations supported using citations from the course’s textbook.

In all questions which reference Linda, Sam, Betty, or Bob: Linda is a listing broker, Sam is a seller, Betty is a buyer’s broker, and Bob is a buyer.

1. When Linda helps Sam complete his TDS, Sam discloses “my next door neighbor is a pedophile” but Linda hears instead “my next door neighbor is a bit senile.” Consequently, Linda fails to disclose to Bob that Sam’s neighbor is a registered sex offender. Bob buys Sam’s house and moves in with his two young daughters. When Bob learns about his neighbor he moves and then sues Sam (the seller) for misrepresentation. Sam is not liable because Linda failed to make the disclosure to Bob.  
   T     F

2. The “deep pocket” rule states that a plaintiff awarded monetary damages from multiple defendants must collect his entire judgment from the defendant found most responsible for his injuries.  
   T     F

3. In suing for negligence, the client must prove his damages were reasonably foreseeable by his broker.  
   T     F

4. A broker owes third parties the duty of utmost care.  
   T     F

5. George signs a contract with Armando to paint his house for $4,500. Later, Armando realizes he can not make a profit since his contract requires him to pay for the paint. Armando refuses to honor his contract. George can take Armando to Small Claims court to enforce his contract.  
   T     F

6. Arbitration decisions are a matter of public record.  
   T     F

7. The standard of proof in civil cases is “clear and convincing proof to a reasonable certainty.”  
   T     F

8. By signing CAR®’s Residential Listing Agreement, the seller agrees his broker may also represent the buyer.  
   T     F

9. Betty represents Bob. After working with him for two weeks she concludes Bob is wasting her time. But because Betty signed a representation agreement with Bob, she has a professional and ethical duty to continue representing him.  
   T     F

10. Although the DRE requires brokers to keep all signed documents for three years, Barbara Nichols, a risk management expert, maintains they should be kept longer. She believes all documentation should be kept at least _____ years and major contracts _____ years. 
   A. three/six  
   B. five/ten  
   C. ten/twenty

11. When communicating with clients, telephone communication is nearly always preferable to email.  
   T     F
12. E&O covers the cost for the defense for lawsuits and consequent money judgments for all of the following violations resulting from professional negligence except:
   A. failure to disclose.
   B. breach of duty.
   C. excessive compensation.
   D. conflict of interest.
   E. failure to secure adequate pricing.
   F. discrimination based on a protected group.

13. Most E&O policies cover personal injuries occurring in the work place.  

14. Pete and Repete are identical twins. Repete takes care of Pete’s home while Pete tours Europe. In his brother’s absence and without his knowledge, Repete sells his brother’s home to Bob. Bob pays $500K for Pete’s home putting $300K down and taking out a $200K mortgage insured with an ALTA Lender’s Policy. When Pete returns home, he demands Bob move out. Bob’s title insurance will compensate Bob for...
   A. $0K.
   B. $200K.
   C. $500K.
   D. $300K.

15. Flashing is used to direct the flow of ground water away from a structure.  

16. Which picture is efflorescence?
   A. Picture ‘A’
   B. Picture ‘B’
   C. Picture ‘C’

17. The life cycle of dry rot is most similar to …
   A. mistletoe.
   B. moss.
   C. a mushroom.
   D. lichen.
   E. a fern.

18. Termites have wings.  

19. These are termite galleries.  

20. California law prohibits any home inspector from contractually limiting his liability to the value of his inspection fee.  

21. Builder warranties typically last ten years. In the first year there is coverage for workmanship and materials, in the first ___ years basic systems such as plumbing and electrical work are covered, and for the full ___ years structural items are covered.
   A. three/eight
   B. two/ten
   C. five/20

22. Before an insurer is asked to write a homeowners insurance policy, the insurer checks the home’s claims history on CLUE.  

23. The federal legislation which requires each state to register all residential loan originators in a national database is known as the “SAFE Act.”  

24. The law requires all licensees to print their license numbers on the following materials except:
   A. business cards
   B. email
   C. for-sale signs
   D. advertising flyers
   E. websites

25. Corporations are “persons” under the Real Estate Law and, as such, may obtain real estate licenses.  

Quiz for the Consumer Protection Reader, 2012 – Part 1/2
26. Which of the following responsibilities does the DRE **not** require for a broker who employs a salesperson with a restricted license?

A. To petition the DRE to remove the licensee’s restriction after the licensee’s probationary period ends.
B. To read the Commissioner’s decision outlining the basis for the licensee’s restriction.
C. To notify the DRE that he (the broker) has accepted responsibility to closely supervise the licensee.
D. To work with the licensee to ensure his professional conduct.

27. Is a DRE license required to broker residential mortgage loans in California?

A. Yes
B. No
C. Maybe

28. The DRE may revoke the license of any licensee for any unlawful act committed with the intent of conferring a financial benefit upon the perpetrator.  

**T**  **F**

29. Dan advertises his 480sf. apartment on Craigslist stating it is “perfect for 1 or 2 professionals.” A local fair housing group deems his ad illegal because it implies a preference for tenants without children. The fair housing group may sue Dan for violating the Fair Housing Act.  

**T**  **F**

30. DRE’s Recovery Account covers consumer losses for licensee’s negligent misrepresentations.  

**T**  **F**

31. In short sale transactions, settlement payments outside of escrow are illegal.  

**T**  **F**

32. The DRE’s new Enforcement Advocacy Program …

A. educates brokers on how to avoid common real estate violations.
B. attempts to resolve simple disputes between consumers and licensees.
C. helps licensees with restricted licenses regain their full licenses.

33. The Smiths have two liens on their home: A $300K first financed by a 6% interest-only loan; and a $300K HELOC also at 6%. If the Smiths used the $300K funded from their HELOC to buy a boat, then how much mortgage interest can they deduct on their personal tax return?

A. 6% on $400K
B. 6% on $300K
C. 6% on 600K.

34. The capital gains exclusion for personal residences may include the capital gains rolled into the acquisition of the property through a §1031 exchange.  

**T**  **F**

35. Howard has a vacation home in Palm Springs. For each of the past three years, Howard has rented his home at fair market rates for two weeks and occupied it for two weeks. Howard can sell his vacation home at twice what he paid for it and use the proceeds to purchase another vacation home of equal or greater value without paying capital gains.  

**T**  **F**
1. **1.2.1.1.1: Vicarious Liability**

When Linda helps Sam complete his TDS, Sam discloses "my next door neighbor is a pedophile" but Linda hears instead "my next door neighbor is a bit senile." Consequently, Linda fails to disclose to Bob that Sam's neighbor is a registered sex offender. Bob buys Sam’s house and moves in with his two young daughters. When Bob learns about his neighbor he moves and then sues Sam (the seller) for misrepresentation. Sam is not liable because Linda failed to make the disclosure to Bob.

**False** Sam is “vicariously liable” for Linda’s mistake.

**Citation:** Vicarious liability applies only to those acts performed by subordinates within the scope of the superior’s agency. Since helping Sam fill out his TDS is certainly within Linda’s scope of agency, Sam is vicariously liable for her mistakes.

**Comment:** We don’t know if Bob has an actionable claim against Linda. We guess that he does because she made a mistake; on the other hand, strictly speaking, Linda never knew that Sam’s neighbor was a sex offender.

2. **1.2.1.1.2: Joint and Several Liability**

The “deep pocket” rule states that a plaintiff awarded monetary damages from multiple defendants must collect his entire judgment from the defendant found most responsible for his injuries.

**False** The ‘deep pocket’ rule states that when a plaintiff is awarded damages against multiple defendants, the plaintiff may recover the full amount of his judgment from any single defendant regardless of that defendant’s degree of liability.

**Note:** When multiple defendants are found liable, the plaintiff usually collects from the defendant with the greatest ability to pay and who is expected to put up the least resistance. Often this is the defendant with the best insurance.

3. **1.2.1.1.2: Joint and Several Liability**

In suing for negligence, the client must prove his damages were reasonably foreseeable by his broker.

**True** The elements which your client must prove to win a judgment of negligence are: ● **Duty:** You owed him a duty of care. ● **Breach of Duty:** You breached that duty. ● **Causation:** As a result of your breach, he suffered damage. ● **Expectation:** You could have reasonably foreseen the damage.

4. **1.2.1.2.3: Negligence**

A broker owes third parties the duty of utmost care.
False  A broker owes his principal the duties of “utmost care” and “loyalty” but does not owe these same
duties to a third party.

Citation:  The duties you, as a fiduciary, owe your client are loyalty, honesty, integrity, and utmost care (CC
§2079.16). The duties you owe third parties are: competence, fairness, and disclosure.

Note: The Agency Disclosure form mandated by CC §2079.16 lists the fiduciary’s duties as “utmost care,”
“integrity,” “honesty,” and “loyalty”; and the duties owed to third parties as “honesty,” “fair dealing,” and
“good faith.”

5.  1.2.2.2.3: Small Claims Court

George signs a contract with Armando to paint his house for $4,500. Later, Armando realizes he can not
make a profit since his contract requires him to pay for the paint. Armando refuses to honor his contract.
George can take Armando to Small Claims court to enforce his contract.

False  Small Claims court can only be used by plaintiffs seeking monetary damages of less than $7,500.00 and
Small Claims court can not be used to obtain equitable relief; that is to obtain any form of restitution other than a
money award. For example, you can not use the Small Claims court to enforce a contract or to obtain an injunction.

6.  1.2.2.3.1: Arbitration

Arbitration decisions are a matter of public record.

False  …unlike public justice where all documents and proceedings are open to the public; arbitration is 100%
private.

Note: Arbitration findings, unlike the findings of a civil court, are not made public and are therefore
unknown to the DRE.

7.  1.2.2.3.2: Litigation

The standard of proof in civil cases is “clear and convincing proof to a reasonable certainty.”

False  In civil cases the standard of proof is “a preponderance of the evidence.”

Administrative courts use the standard of “clear and convincing proof to a reasonable certainty” and criminal
courts use the standard of “beyond a reasonable doubt.”

8.  1.3.1.1: Avoid Dual Agency

By signing CAR®’s Residential Listing Agreement, the seller agrees his broker may also represent the
buyer.

True  CAR®’s Residential Listing Agreement permits the listing broker to elect dual agency.

Note: The clause in CAR®’s 2010 Residential Listing Agreement in which the seller pre-authorizes dual
agency is 10© and is entitled “Possible Dual Agency with Buyer.” It states that in the event the broker
procures a buyer the “… Seller hereby consents to Broker acting as a dual agent for Seller and such
Buyer…” and this clause requires the seller’s initials.

9.  1.3.1.2: Avoid Vexatious Clients

Betty represents Bob. After working with him for two weeks she concludes Bob is wasting her time. But
because Betty signed a representation agreement with Bob, she has a professional and ethical duty to
continue representing him.

False  Neither NAR®’s Code, the Real Estate Law, or CAR®’s Buyers Representation Agreement in anyway
prohibits an agent from firing his client. As quoted from Robert Bass in the text, “the last time I looked,
disagreeable SOB’s are not a constitutionally protected class!”

Quiz for the Consumer Protection Reader, 2012 – Part 1/2
10. 1.3.2.2: Document Review

Although the DRE requires brokers to keep all signed documents for three years, Barbara Nichols, a risk management expert, maintains they should be kept longer. She believes all documentation should be kept at least ____ years and major contracts ____ years.

A. three/six  
B. five/ten  
C. ten/twenty

According to her website, “since 1994, Barbara [Nichols] has served as an expert witness in hundreds of real-estate-related lawsuits, most of which involved lawsuits against agents and their brokerages.” It is her opinion that … the best advice is to keep all transaction files for at least five years and major contracts, such as the listing agreement, purchase contract, and disclosure forms for 10 years.

11. 1.3.2.4: Communication

When communicating with clients, telephone communication is nearly always preferable to email.

False. Of all the forms of communication you may use, email offers the most advantages. It can be sent and replied to at any convenient time, it is time stamped, it can be easily copied to many recipients, it can be searched and retrieved, and it provides a permanent record. But … email has disadvantages too. Many people do not like email or have trouble expressing themselves in writing. It is all too easy to be misunderstood and give accidental offense using email. Email too often fails to convey emotions, concerns, and other levels of non-verbal meaning that are best conveyed through direct communication.

12. 1.3.3.4.1.1: E&O

E&O covers the cost for the defense for lawsuits and consequent money judgments for all of the following violations resulting from professional negligence except:

A. failure to disclose.  
B. breach of duty.  
C. excessive compensation.  
D. conflict of interest.  
E. failure to secure adequate pricing.  
F. discrimination based on a protected group.

Most [E&O] policies exclude: intentional acts (except for innocent participants), acts performed outside the scope of agency, personal injury, suits alleging environmental damage (especially toxic mold), fair housing violations (except, possibly, for defense), commission disputes, transactions for properties owned by the broker, and issues pertaining to trademarks.

Typical claims covered are those alleging misrepresentation, failure to disclose, breach of duty, excessive compensation, conflict of interest, and failure to secure adequate pricing.

E&O insurance (aka, “professional liability insurance”) is designed to cover the legal expenses and damage awards for “goofs”; that is, negligent acts where the broker (or an associate) has inadvertently neglected to do something he should have done pursuant to rule or custom.

Note: All fair housing violations involve discriminatory actions based on a protect group; for example, steering Vietnamese immigrants to Vietnamese neighborhoods (assuming the Vietnamese immigrants didn’t ask to see only homes in Vietnamese neighborhoods).

13. 1.3.3.4.1.1: E&O

Most E&O policies cover personal injuries occurring in the work place.
Most E&O policies do not cover personal injuries occurring in the workplace; general liability insurance does. It [general liability insurance] covers the cost of defending personal injury lawsuits including investigations and settlements, and for any bonds or judgments required during an appeal procedure.

14. 1.3.3.4.2.1: Title Insurance

Pete and Repete are identical twins. Repete takes care of Pete's home while Pete tours Europe. In his brother's absence and without his knowledge, Repete sells his brother's home to Bob. Bob pays $500K for Pete's home putting $300K down and taking out a $200K mortgage insured with an ALTA Lender's Policy. When Pete returns home, he demands Bob move out. Bob's title insurance will compensate Bob for...

A. $0K.
B. $200K.
C. $500K.
D. $300K.

[ ] Bob will receive nothing. Repete stole his brother's $300K down payment.

Citation: You should advise buyers paying cash or making large down payments to purchase a homeowner's title insurance policy and not a lender's policy since the liability limit of a lender's policy is only the amount of the loan while the limit on a homeowner's policy is its purchase price.

CAR®'s purchase agreement requires that buyers be provided a current preliminary title report and a CLTA/ALTA Homeowners Policy of title insurance.

15. 1.4.1.1: Ten Most Common Defects

Flashing is used to direct the flow of ground water away from a structure.

False Flashing is used to prevent water from entering the home through the roof. French drains are used to divert water from a home's foundation.

Citation: Look for curling, damaged, or missing shingles or flashing. If you find such defects check for water damage underneath.

16. 1.4.1.2.1: Visual

Which picture is efflorescence?

A. Picture 'A'
B. Picture 'B'
C. Picture 'C'

[ ] Efflorescence is a white chalky substance consisting of minerals left from the evaporation of water. Choice 'A' depicts dry rot and choice 'C' depicts shelter tubes.

Comment: We are aware that this question is a repeat of a quiz question from our Risk Management course.
The life cycle of dry rot is most similar to …
A. mistletoe.
B. moss.
C. a mushroom.
D. lichen.
E. a fern.
(C) Dry rots and mushrooms are both fungi; both feed on organic material in the presence of moisture.

Citation: The life cycle of dry rot is similar to that of the best known fungi – the mushroom.

Note: Molds are also fungi but differ from both dry rots and mushrooms in one important respect: Molds grow on the surface of the substances on which they feed while dry rots and mushrooms grow within the substance. The visible portion of the mushroom, for example, is the mushroom’s bloom but the more massive body of the fungi lies below the surface. The same is true for a dry rot. This means when the dry rot’s bloom appears, it is too late to save the underlying wood.

18. 1.4.1.5: Termites

Termites have wings.

True Termites fly in swarms to start new colonies – and so do ants. It is for this reason they are often confused with one another.

Citation: Termites swarm once a year usually in late summer. After swarming, winged termites may alight on a home and if the termite is lucky, find an unprotected section of damp wood on which to start feeding.

Note: Termites and ants loose their wings after their swarm. Only the small reproductive caste swarms; all other termites are incapable of reproduction and often blind.

Comment: Why is this Important to know?
One or two participants have complained that learning termite biology is a waste of their time. We disagree.
We think the adage “know your enemy!” applies to the termite. The termite is your enemy because the damage he creates results in lost or renegotiated sales.
Certainly the pest inspector is the expert and the professional most responsible for identifying termite damage, but typically he is involved after the purchase agreement has been signed and his findings are a contingency to the sale. Buyer’s agents should use their knowledge of wood pests to advise their buyer’s on how thorough of an inspection they should request. For example, if structural damage is suspected but not found in a non-invasive inspection, the buyer’s agent should urge his buyer to pay (with the seller’s permission) for an invasive inspection (e.g., pulling up carpets, drilling holes in plasterboard to inspect framing, moving heavy furniture to inspect behind walls).
Knowing the termite’s life cycle helps you predict and identify damage. If you see termite wings, you know termites have recently attempted entry. If you see winged termites in the home, you know the home has been colonized by termites. If you see shelter tubes rising up from the home’s foundation, you should suspect the home has been colonized by subterranean termites.
19.  1.4.1.5: Termites

These are termite galleries.

**True** Galleries: These are the most telling and distressing sign of termite damage since they reduce the strength of the lumber in which they are found.

20.  1.4.4.3.1: Legal Issues

California law prohibits any home inspector from contractually limiting his liability to the value of his inspection fee.

**True** For example, suppose a home inspector fails to find a leak in a master shower pan which subsequently costs the new owner $5,000 to repair. In this situation, the home inspector may not limit his liability to his inspection fee.

**Citation**: [BPC] §7198 states that contracts used by home inspectors which purport to waive the inspector’s duty to conduct a professional home inspection (per BPC §7196) or limit the home inspector’s liability to the inspection fee are invalid since these limitations are contrary to public policy.

21.  1.4.5.4: Builder Warranties

Builder warranties typically last ten years. In the first year there is coverage for workmanship and materials, in the first ____ years basic systems such as plumbing and electrical work are covered, and for the full ____ years structural items are covered.

A. three/eight
B. two/ten
C. five/20

**B** Builders provide warranties to individuals who purchase their homes. Although not stated in the book, builder warranties are transferable over the warranty period (normally ten years).

**Citation**: Third-party plans typically last ten years. In the first year there is coverage for workmanship and materials, in the first two years basic systems such as plumbing and electrical work are covered, and for the full ten years structural items are covered.

22.  1.4.5.7: CLUE Reports

Before an insurer is asked to write a homeowners insurance policy, the insurer checks the home’s claims history on CLUE.

**True** When homeowners file a claim on their homeowners insurance policy for a wind-damaged roof, for injuries from a dog bite, for damage from a tree falling onto the roof; most insurers post a record of the claim to a cooperative database called CLUE (Comprehensive Loss Underwriting Exchange).

23.  2.1.1.1.2.6: 6/6 SAFE Act of 2008

The federal legislation which requires each state to register all residential loan originators in a national database is known as the “SAFE Act.”

**True** Only residential loan originators must register in the National Mortgage Licensing System (NMLS) – a requirement of the SAFE Act.

**Citation**: It [the SAFE Act] requires all residential loan originators to pass an exam to obtain an “endorsement” (i.e., a license) to legally originate home loans and to meet annual continuing education requirements to maintain the endorsement.
24. **2.1.2.2: Clarifying the License ID Number Disclosure Requirement**

The law requires all licensees to print their license numbers on all of the following materials **except**:

A. business cards  
B. email  
C. for-sale signs  
D. advertising flyers  
E. websites

(C) **The new law (2009) requires** licensees who are acting as agents in transactions to disclose their license numbers on all solicitation materials intended to be the first point of contact with consumers, and on real property purchase agreements when acting as agents in those transactions. Although for-sale signs might be the **first point of contact with consumers**, for some reason, these are exempted: The new law also excludes certain materials from the license number requirement; namely: advertisements in print or electronic media, “For Sale” signs, and classified rental advertisements that provide the telephone number at the premises of properties offered for rent or the address of the property offered for rent.

25. **2.1.2.3: Broker Supervision: The Buck Stops Here**

Corporations are “persons” under the Real Estate Law and, as such, may obtain real estate licenses. **True** Because corporations are “persons” under the Real Estate Law, corporations may obtain real estate broker licenses. **Note**: A corporation may be licensed as a real estate broker through one or more of its officers who must be active brokers or have qualified for a broker license by examination within the twelve months preceding receipt of application.

26. **2.1.3.1: Supervising restricted real estate salespersons**

Which of the following responsibilities does the DRE **not** require for a broker who employs a salesperson with a restricted license?

A. To petition the DRE to remove the licensee’s restriction after the licensee’s probationary period ends.  
B. To read the Commissioner’s decision outlining the basis for the licensee’s restriction.  
C. To notify the DRE that he (the broker) has accepted responsibility to closely supervise the licensee.  
D. To work with the licensee to ensure his professional conduct.

(A) is not a responsibility of the employing broker. There is no fixed “probationary period” (see below note). The duration of the restriction is indefinite; that is, it remains in effect until such time the licensee (not the employing broker) petitions the DRE to remove it. In his petition, the licensee must convince the DRE that he no longer deserves the restriction(s) the Commission had placed on his license. **Citations**: … the broker is also extending the opportunity for the restricted licensee to exhibit evidence of rehabilitation which will be required at a later date should the individual [i.e., “licensee”] seek to petition for a plenary license. **Re the employing broker’s responsibilities**: As a condition of employment, you, as the prospective employing broker, are required to complete the RE 552 form, in which you certify that you have read the Decision of the Real Estate Commissioner outlining the basis under which this licensee was disciplined. In addition, you promise to ensure that all transactional documents which the RRES licensee prepares will be reviewed and you will otherwise exercise “close supervision” over the licensed activity of that applicant. Before the broker can consider the parameters leading to “close supervision” of the RRES, the broker should first of all become thoroughly familiar with the reasons for the licensee’s discipline.
Note: The article entitled “Rehabilitation and Petitioning for Reinstatement of a Real Estate License or Removal of License Restrictions” in DRE’s Bulletin for Spring 2007 goes into considerable detail how a licensee may successfully petition the Commissioner for removal of his restrictions. The article says that the petition may not be made any earlier than one year following the first day of the salesperson’s restricted license and the “burden of proof” is on the licensee to convince the Commissioner that the restrictions should be removed. The Commissioner investigates the petitioner’s claims on a case-by-case basis and, if convinced that the licensee no longer requires close supervision may issue the licensee a full (“plenary”) and unrestricted license.

27. 2.1.3.3: Mortgage Brokering in California

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<th>Is a DRE license required to broker residential mortgage loans in California?</th>
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<tbody>
<tr>
<td>A. Yes</td>
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<tr>
<td>B. No</td>
</tr>
<tr>
<td>C. Maybe</td>
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(C) Is a DRE license required in order to broker residential mortgage loans in California? The answer is maybe. There are two common licensing options available to those wishing to operate as a mortgage broker: 1) a real estate broker license under the jurisdiction of DRE, or 2) a California Finance Lender (CFL) license under the jurisdiction of the Department of Corporations (DOC), with limitations.

28. 2.1.3.6: Real Estate License Can Be Easily Lost

The DRE may revoke the license of any licensee for any unlawful act committed with the intent of conferring a financial benefit upon the perpetrator.

True Bob Hunt argues that this standard is “distressingly broad.”

Citation: According to California law, if a crime is so related to a licensee’s qualifications, functions, or duties, the license may be revoked. But, “licensing authorities do not have unfettered discretion to determine whether a given conviction is substantially related to the relevant professional qualifications.” The authorities are required to develop criteria to aid them in making that determination.

The DRE has developed such criteria in a manner that many think is distressingly broad. Namely, a crime shall be considered substantially related “...if it involves...doing of any unlawful act with the intent of conferring a financial or economic benefit upon the perpetrator...”. Presumably, then, for example, an attempt to fix a horse race or a high school basketball game might be considered “a crime substantially related to the qualifications, functions, or duties of a real estate licensee.”

29. 2.1.4.1: Realty Viewpoint: Fair Housing Groups Need To Be Regulated

Dan advertises his 480sf. apartment on Craigslist stating it is “perfect for 1 or 2 professionals.” A local fair housing group deems his ad illegal because it implies a preference for tenants without children. The fair housing group may sue Dan for violating the Fair Housing Act.

True The question is not a hypothetical but an actual event experienced by Dan Bader and is detailed in the book. In fighting the fair housing group’s demand for a monetary settlement, Mr. Bader lost hundreds of thousands of dollars in legal expenses and, as a consequence, lost his business and livelihood.

Citation: … fair housing groups have unique powers to enforce fair housing laws. They can act as prosecutor, court, and collection agency but because they are funded by settlements, they have no incentive to issue warnings and accept apologies.

Note: To sue, a plaintiff must have “standing”; that is, the legal right to sue. Fair housing groups are private organizations funded by HUD grants. However, federal courts have ruled that these groups have standing on their own behalf to enforce the Fair Housing Act (e.g., The Fair Housing Council of Suburban Philadelphia v. The Mercury, Peerless Publications, Inc. and also Baltimore Neighborhoods, Inc. v. Continental Landmark, Inc.).
30. **2.1.7.1: The Recovery Account**

**DRE’s Recovery Account covers consumer losses for licensee’s negligent misrepresentations.**

**False** As of July 1, 1987, the Recovery Account only compensates consumers for their uncollectible monetary judgments owed by licensees convicted of intentional fraud and conversion (aka, “theft”).

**Citation:** When the Recovery Account was first established, it was intended that only those consumer losses caused by a licensee’s intentional fraud be compensated, assuming all other requirements were met. In 1984, a California Court of Appeal held that the Recovery Account was liable for not only intentional fraud but also for a licensee’s negligent misrepresentation. (*Andrepont v. Meeker, 1984*). Following that decision, an audit of the Recovery Account was ordered to determine whether it could meet the potential liability which would be caused by the lesser standard rather than intentional fraud. It was determined that, without somehow limiting the liability of the Recovery Account, it would become insolvent under the new rule. Effective July 1, 1987, the Legislature amended the Recovery Account law to provide for liability only for intentional fraud or conversion of trust funds and to clarify its intent that the Recovery Account is not an insurance policy but a fund of last resort created to provide limited benefits.

**Note:** Negligent misrepresentation occurs when the defendant carelessly makes a representation while having no reasonable basis to believe it to be true. Fraudulent misrepresentation occurs when one makes a representation with intent to deceive and with the knowledge that it is false.

31. **2.1.7.5: Undisclosed Short Sale Payments May Lead to Trouble**

In short sale transactions, settlement payments outside of escrow are illegal.

**False** Payments made outside of escrow are illegal only if they are not disclosed to the senior lien holder and not marked as “P.O.C.” for Paid Outside of Closing on the lender's HUD-1.

**Citation:** Appendix A to RESPA (24 C.F.R. Part 3500) says that “The settlement agent shall complete the HUD-1 to itemize all charges ... whether to be paid at settlement or outside of settlement ... .” Charges paid outside of settlement “shall be included on the HUD-1 but marked P.O.C. for Paid Outside of Closing... .”

**Note:** Mr. Hunt makes the point that a buyer may be tempted to make an undisclosed payment outside of escrow to encourage a junior lien holder to agree to extinguish his loan without, at the same time, rousing the cupidity of the senior lien holder, who, in coveting the extra cash, might then deny the short sale.

32. **2.1.8.1: New Enforcement Program**

The DRE’s new Enforcement Advocacy Program …

* A. educates brokers on how to avoid common real estate violations.
* B. attempts to resolve simple disputes between consumers and licensees.
* C. helps licensees with restricted licenses regain their full licenses.

**B** The DRE has initiated the Enforcement Advocacy Program which attempts to resolve simple disputes or minor issues between consumers and licensees or subdividers as a potential alternative to setting up formal investigations into such matters.

33. **2.2.1.1: Are You Leaving a Tax Deduction on the Table?**

The Smiths have two liens on their home: A $300K first financed by a 6% interest-only loan; and a $300K HELOC also at 6%. If the Smiths used the $300K funded from their HELOC to buy a boat, then how much mortgage interest can they deduct on their personal tax return?

* A. 6% on $400K
* B. 6% on $300K
* C. 6% on 600K.

**A** The Smiths may deduct from their personal tax return all the interest paid on their first but only $100K of the interest on their $300K HELOC since the IRS limits the interest deduction for loans not used to...
improve the home or buy new property. (Of course, in the case of a fully amortized loan, only that portion of the payments made to the lender which represent the interest portion and not principal may be deducted.)

**Citation:** You are allowed to take a deduction on your personal tax return for mortgage interest you pay on a loan that is secured by either your principal residence or a second home, up to one million dollars in acquisition indebtedness. That means mortgages, lines of credit, and home equity loans all qualify as long as they are secured by your home and you are the primary borrower and legally obligated to repay that loan. …and then later … The amount you can deduct depends on your mortgage. If your mortgage is more than $1 million, you can deduct all interest you pay on the first million but you can’t deduct any more interest after that. Same goes for home equity loans of more than $100,000. You can deduct all the interest you pay on the first $100,000 of debt but you can’t deduct any remaining interest.

**Note:** If Fred and Susy filed separately, their debt and home equity caps would have been half as much as if they had filed jointly: that is, $500K and $50K respectively. The rules work on a per mortgage basis; that is, if Fred and Susy were both on their home’s title but were not married, then they would still be able to claim the deduction however the IRS only allows opposite sex couples who are legally married to file jointly.

**34. 2.2.1.2: Congress Limits Gain Exclusion on the Sale of Some Primary Residences**

The capital gains exclusion for personal residences may include the capital gains rolled into the acquisition of the property through a §1031 exchange.

**True** IRS law excludes $250,000 of the gain from taxation if you’re single and $500,000 if you’re married when you sell a primary residence you’ve lived in for at least two years of the last five years. This is so even if a portion of the gain was rolled over into the property in a §1031 exchange transaction.

**Note:** You might be thinking, “if the tax-free exclusion applies only to personal residences and a §1031 exchange only to investment properties” then how could any part of a §1031 gain be included in the tax-free exclusion? ¶ **Answer:** If the personal residence was originally bought as a rental property through a §1031 exchange. ¶ For example, suppose the Smiths have a rental home in San Diego which has appreciated $500,000 (for simplicity, let’s assume the Smith’s didn’t depreciate it). Now suppose they wish to retire in Boise Idaho. They could make a §1031 exchange for their San Diego home, rent out the Boise home for a couple of years (an IRS requirement), and then retire to their Boise home. After living in the home for two years they could then sell it and pay no tax on their $500K gain (source).

**Disclaimer:** We are not tax experts. Any one considering this strategy should verify it with a tax expert.

**35. 2.2.2.1: IRS Issues Vacation Home Ruling**

Howard has a vacation home in Palm Springs. For each of the past three years, Howard has rented his home at fair market rates for two weeks and occupied it for two weeks. Howard can sell his vacation home at twice what he paid for it and use the proceeds to purchase another vacation home of equal or greater value without paying capital gains.

**True** To qualify for a §1031 exchange between vacation homes, for each 12 month block of this holding period you must have rented the vacation home for at least 14 days at a fair market rent. Also during each 12 month block, the owner is only allowed to use the property for the greater of 14 days or 10% of the days rented.