



## NORTH CAROLINA REAL ESTATE COMMISSION

# Real Estate Bulletin

Volume 16

1985

Number 1

### LICENSE RENEWAL FORMS MAILED

On May 10, application forms were mailed to North Carolina's nearly 60,000 real estate brokers, salesmen and corporations for the renewal of their licenses for the coming year.

Applications to renew "active" salesman licenses were sent to the address of the Broker-In-Charge of the office at which the salesman is associated (i.e., the salesman's Supervising Broker). Applications to renew salesman licenses which are on Inactive Status were sent to the salesmen's address of record. And corporation renewal applications were mailed to the Principal Broker of the corporation. Licensees who do not receive their renewal forms should contact the Commission Office for instructions.

To renew your real estate license, simply (1) Verify that the information on your application form is accurate (Change any inaccurate information); (2) Remit your \$15 renewal fee (Do not include fees for license transfers, duplicate licenses, etc. in your renewal fee check); and (3) Return your renewal application and fee to the Commission Office. In addition, Brokers-In-Charge must sign the applications of their licensed salesmen and Principal Brokers must sign the applications of their corporations.

*All real estate licenses expire on June 30. So don't delay! Renew early! And contact the Commission Office if you have any questions concerning the renewal of your license.* □

### Commission Honors Millard Rich

Deputy Attorney General Millard R. Rich, Jr. was recently honored by the members of the Real Estate Commission for his 15 years of service as Legal Counsel and later Supervisor of the Commission's Legal Counsel. Mr. Rich was presented an award in recognition of his faithful and dedicated service at the Commission's April 11 meeting in Raleigh. □



(Pictured left to right) Commission Members Brantley T. Poole, Bart T. Bryson, A. P. Carlton, Deputy Attorney General Rich, Commission Chairman Thomas Council, and Commission Members B. Hunt Baxter, Jr., Lee R. Barnes, and LaNelle K. Lilley.

### REAL ESTATE INSTRUCTOR WORKSHOP

The Real Estate Commission recently sponsored its 6th Annual Real Estate Instructor Workshop in conjunction with the annual meeting of the North Carolina Real Estate Educators Association (NCREEA). With more than 140 real estate instructors and administrators in attendance, this year's Workshop was the most successful to date. The Workshop program included presentations on:

- \* The Status of Prelicensing Education
- \* How "Value Programming" as a Child Affects Adult Attitudes and Behavior
- \* Teaching Various Real Estate Subject Areas
- \* Course Examinations
- \* Licensing Examination Performance and Problem Topics
- \* Seminar for New Instructors

The NCREEA elected as its officers for 1985-86 the following real estate educators:

- President - Bob Kugelmann, Instructor, Fayetteville Technical Institute, Fayetteville.

- President-Elect - Bob Ervin, Owner/Director, Fayetteville Real Estate Academy, Fayetteville.
- Secretary-Treasurer - Judy Wright, Director, Fonville-Morisey Center for Real Estate Studies, Raleigh.
- Asst. Secretary-Treasurer - Linda Dalrymple, Instructor, Central Carolina Technical College, Sanford.

Workshop participants were also the first to have the opportunity to acquire the new *Real Estate Prelicensing Question Bank*, which is a compilation of approximately 1300 questions and answers on real estate topics for use by prelicensing course instructors in preparing course examinations. The Question Bank was developed by the NCREEA and the Appalachian State University Real Estate Research Center (directed by Dr. Linda Johnson) under a development grant from the Real Estate Commission for the purpose of improving the quality of testing in prelicensing courses. □

### SURVEY INDICATES N. C. LAWYERS WANT INCREASED ROLE IN RESIDENTIAL SALES TRANSACTIONS

By Blackwell M. Brogden, Jr.  
Deputy Legal Counsel

Research by three law students at Campbell University has produced some interesting comments from attorneys who practice in the real estate field. Kristi E. Cave, Sarah S. Stevens and Phillip Wilson surveyed the attorneys by means of a questionnaire published in the *Campbell Law Observer*. With their permission, we have reprinted below some of the questions and answers from their survey which the Commission felt would be of interest to real estate licensees.

The respondents included attorneys from firms who had within the past year closed as few as 12 and as many as 1200 residential real estate transactions. Although only 52

*(Continued on page 2)*

## REAL ESTATE BULLETIN

Published quarterly as a service to real estate licensees to promote a better understanding of the Real Estate License Law, Rules and Regulation, proficiency in ethical real estate practice. The articles published herein shall not be reprinted or reproduced in any other publication without specific reference being made to their original publication in the **North Carolina Real Estate Commission Real Estate Bulletin**.

### NORTH CAROLINA REAL ESTATE COMMISSION

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James G. Martin, Governor

### COMMISSION MEMBERS

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..... Dep. Leg. Counsel  
Larry A. Outlaw ..... Education Dir.  
F. Michael Hughes ..... Asst. Ed. Dir.  
Mary Frances Whitley ..... Fin. Off.

### EXAM RESULTS

EXAMINATION — March, 1985

#### PASSED FAILED

Brokers	94	108
Salesmen	686	370

EXAMINATION — April, 1985

#### PASSED FAILED

Brokers	135	57
Salesmen	836	369

**RENEW EARLY!**

## LAWYERS (continued from page 1)

attorneys (from 35 of the more populated counties) responded to the questionnaire, nevertheless this group was considered to be representative of practitioners as a whole; however, no determination of statistical significance has been made.

It should be noted that since some persons did not answer every question and others gave multiple answers to the same question, the responses (shown in **bold type**) represent the percentage of total responses given for that question.

### Responses

- What percent of your work is residential real estate closings?  
**33%** 25% **2%** 1%  
**27%** 10% **20%** Other  
**18%** 50%
- For residential real estate closings, how do people usually find your firm?  
**27%** Referral by real estate agent.  
**24%** Direct contact by the prospective client.  
**24%** Referral by previous clients.  
**22%** Referral by financial institution.  
1% Referral by seller of property.  
1% Builder referral.
- In a typical residential real estate transaction, who do you represent?  
**49%** Buyer  
**29%** Lender  
**14%** Seller  
**7%** Realty Company  
**1%** Other
- What percent of your time are you involved in a residential transaction where both seller and buyer are represented by separate attorneys?  
**29%** 1% **4%** 25%  
**27%** 5% **2%** 0%  
**27%** 10% **10%** Other
- What is your usual fee for a residential real estate closing?  
**46%** 1% of sales price  
**36%** Flat fee  
**18%** Hourly

- Do clients come to you before the signing of the purchase agreement?  
**0%** Always **57%** Rarely  
**2%** Usually **8%** Never  
**33%** Sometimes
- Do you discuss the purchase agreement with the client for clarification (i.e., personal property that is to be included in transaction, ambiguous clauses, etc.)?  
**28%** Always **28%** Sometimes  
**40%** Usually **4%** Rarely
- When a client comes to you for a title search, do you examine the purchase agreement?  
**55%** Always **15%** Sometimes  
**26%** Usually **4%** Rarely
- What title defects do you disclose to your client upon completion of your title search?  
**84%** All  
**14%** All, excluding minor  
**2%** Only major
- When the lender does not require a policy of title insurance, do you recommend an owner's policy of title insurance to the buyer?  
**3%** Always **13%** Rarely  
**18%** Usually **3%** Never  
**63%** Sometimes
- When you disclose information to your client regarding the real estate transaction, what is the disclosure based on?  
**41%** Client's ability to understand.  
**11%** Time available to spend with client.  
**6%** Cost of real estate involved.  
**4%** Client's educational level.  
**39%** Other.
- Do you think real estate brokers and agents play too large a part in the real estate transaction?  
**63%** Yes **37%** No
- Would you like to see attorneys play a larger part in the real estate transaction?  
**61%** Yes **19%** No  
**20%** Leave as is ☐

### TRUST ACCOUNT SHORT COURSE

#### Registration Form

Commission Office, Raleigh, N.C.

- |   |   |   |
|---|---|---|
| <input type="checkbox"/> June 18, 8:30 a.m. | <input type="checkbox"/> July 16, 8:30 a.m. | <input type="checkbox"/> August 20, 8:30 a.m. |
| <input type="checkbox"/> June 18, 1:30 p.m. | <input type="checkbox"/> July 16, 1:30 p.m. | <input type="checkbox"/> August 20, 1:30 p.m. |

Name: \_\_\_\_\_ Address: \_\_\_\_\_

Phone: \_\_\_\_\_

Mail to: N.C. Real Estate Commission, P.O. Box 17100, Raleigh, N.C.,  
27619-7100, Attn: Mrs. Hamm

# STUDY GUIDE

## FOR NORTH CAROLINA REAL ESTATE LICENSE LAW

The following is the second and final installment of a "Study Guide" written by Education Director Larry A. Outlaw to assist license applicants in understanding the Real Estate License Law and Commission Rules. Excerpts from the Study Guide are being reprinted in the *Bulletin* because the Commission believes that the information will also be of interest and assistance to practicing real estate agents. In the last issue of the *Bulletin*, the subject of "misrepresentations" was discussed. This issue addresses the subjects of "Conflict of Interest", "Improper Brokerage Commission", "Unworthiness and Incompetence", "Improper Dealing", "Practice of Law", and important provisions of the Time Share Act. The appropriate references to the License Law and Rules are provided in brackets beside each listed topic.

### **Conflict of Interest** [G.S. 93A6(a)(4) and (6)]

A real estate agent is prohibited from "acting for more than one party in a transaction without the knowledge of all parties for whom he acts". A typical violation of this provision occurs when the agent has only one principal in a transaction (which is nearly always the case), but he acts in a manner which benefits another party without the principal's knowledge. In such a situation, the agent violates the duty of loyalty owed to his principal.

**Example:** A house is listed with Firm X. When showing the house to a prospective buyer, an agent of Firm X advises the buyer to offer substantially less than the listing price because the seller must move soon and is very anxious to sell the property fast. (If the seller will be paying the brokerage commission, which is almost always the case, then the agent represents the seller. By advising the prospective buyer as indicated above, the agent is acting to benefit the buyer without the seller's knowledge. This act violates both the License Law and the Law of Agency.)

**Example:** Same facts as above except that the agent is with Firm Y, which is a cooperating brokerage firm in the transaction. (Result is the same. Assuming that the seller will be paying the brokerage commission, then the agent of Firm Y is a **subagent** of the seller and therefore must represent the best interests of the seller. Remember that in the typical real estate sales transaction, no real estate agent represents the buyer and all agents involved work for the seller under the Law of Agency.)

**Example:** An agent with Firm Y assists her sister in purchasing a house listed with Firm X without advising Firm X or the seller of her relationship with the buyer. (In this situation, there is an inherent conflict of interest on the part of the agent. Although she is legally a subagent of the seller if the seller is paying the brokerage commission, it will, nevertheless, be presumed that the agent is working for the buyer because of her special relationship with the buyer. If the agent does not disclose her relationship to the buyer, then the agent violates both the License Law and Law of Agency. The result would also be the same if the buyer were a close friend or business associate of the agent, or in any way enjoyed a special relationship to the agent which would clearly influence the agent to act in behalf of the buyer rather than the seller.)

This provision also prohibits any "self-dealing" on the part of an agent. For example, if an agent attempts to make a secret profit in a transaction where he is supposed to be representing a principal, then the agent violates this "conflict of interest" provision.

**Example:** An agent lists a parcel of undeveloped property which is zoned for single-family residential use. The agent knows that this property is about to be rezoned for multi-family residential use, which would greatly increase the property's value. Rather than informing the seller of this fact, the agent offers to buy the property at the listed price, telling the seller that he wants to acquire the property as a long-term investment. The transaction is closed. Several months later, after the rezoning has been accomplished, the agent sells the property at a substantial profit.

G.S. 93A-6(a)(6) prohibits a broker or salesman from "representing or attempting to represent a real estate broker other than the broker by whom he is engaged or associated without the express knowledge and consent of the broker with whom he is associated". This provision is self-explanatory.

### **Improper Brokerage Commission** [G.S. 93A-6(a)(5) and (9)]

A broker or salesman may NOT pay a commission or valuable consideration to any person for acts or services performed in violation of the License Law. [G.S. 93A-6(a)(9)] This provision flatly prohibits a broker or salesman from paying an unlicensed person for acts which require a real estate license. Listed below are examples of prohibited payments.

**Example:** The payment by brokers of commissions to previously licensed sales associates who failed to properly renew their licenses (for acts performed after their licenses had expired).

**Example:** The payment of a commission, salary or fee by brokers to unlicensed employees or independent contractors (e.g. secretaries, "trainees" who haven't passed the license examination, etc.) for performing acts or services requiring a real estate license.

**Example:** The payment by brokers or salesmen of a "finder's fee", "referral fee", "bird dog fee", or any other valuable consideration to unlicensed persons who find, introduce, or bring together parties to a real estate transaction. This is true even if the ultimate consummation of the transaction is accomplished by a licensed broker or salesman and even if the act is performed without expectation of compensation. Thus, a broker or salesman may NOT compensate a friend, relative, former client or any other unlicensed person for "referring" a prospective buyer, seller, landlord or tenant to such broker or salesman. This prohibition extends to "owner referral" programs at condominium or time share complexes and "tenant referral" programs at apartment complexes.

In addition, a licensed **salesman** may NOT accept any compensation for brokerage services from anyone other than  
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## STUDY GUIDE

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his employing broker or brokerage firm. Consequently, a broker may not pay a commission or fee directly to a salesman of another broker or firm. Any such payment must be made through the salesman's employing broker or firm. [G.S. 93A-6(a)(5)]

### Unworthiness and Incompetence [G.S. 93A-6(a)(8)]

This broad provision authorizes the Real Estate Commission to discipline any broker or salesman who is found by the Commission, based on the agent's conduct and consideration of the public interest, to be unworthy or incompetent to work in the real estate business. A wide range of conduct may serve as the basis for a finding of unworthiness or incompetence, **including** conduct which violates other specific provisions of the License Law or Commission Rules. Listed below are a few examples of improper conduct which does not specifically violate another License Law provision but which might support a finding of unworthiness or incompetence.

1. Failure to properly complete (fill in) real estate contracts or to use contract forms which are legally adequate.
2. Failure to diligently perform the services required under listing contracts or property management contracts.
3. Failure to provide accurate closing statements to sellers and buyers or accurate income/expense reports to property owners.

### Improper Dealing [G.S. 93A-6(a)(10)]

This broad provision prohibits a real estate agent from engaging in "any other conduct (not specifically prohibited elsewhere in the License Law) which constitutes **improper, fraudulent or dishonest dealing**." The determination as to whether particular conduct constitutes "improper, fraudulent or dishonest dealing" is made by the Real Estate Commission on a case-by-case basis. Therefore, a broad range of conduct might be found objectionable under this provision, depending on the facts in a case.

One category of conduct which violates this provision is any breach of the duty to exercise skill, care and diligence in behalf of a client under the Law of Agency. (Note that other breaches of Agency Law duties constituting either a "misrepresentation or omission", a "conflict of interest" or a "failure to properly account for trust funds" are covered by other specific statutory provisions.)

Presented below are a few examples of conduct which the Commission has found objectionable under this provision.

**Example:** A broker is personally conducting the closing of a real estate sale he has negotiated. The seller does not show up for the closing. In order to avoid a delay in closing the transaction, the broker forges the seller's signature on a deed to the property and proceeds with the closing in the seller's absence.

**Example:** An agent assists a prospective buyer in perpetrating a fraud in connection with a mortgage loan application by preparing two contracts — one with false information for submission to the lending institution, and another which represents the actual agreement between seller and buyer. (This practice is commonly referred to as "dual contracting" or "contract kiting".)

**Example:** A broker is preparing, in behalf of a prospective buyer, an offer to purchase a property listed with another

broker. Neither the selling broker nor the listing broker are members of an MLS, nor do they have any standing agreement on splitting brokerage commissions. The selling broker inserts a provision in the offer to purchase requiring the listing broker to split the commission with him if the offer is accepted and the sale is consummated. (This is improper because the brokers are not parties to the sales contract. Therefore, the inclusion of a "commission split" provision is entirely inappropriate and has no legal effect. The commission split matter should be handled by separate agreement between the brokers. Attempting to address this matter in the sales contract could cause problems which might interfere with the proper performance of the agents' duties to their principal, the seller.)

### Practice of Law [G.S. 93A-4(e); G.S. 93A-6(a)(11)]

Brokers and salesmen may not perform for others any legal service described in G.S. 84-2.1 or any other legal service. Presented below are several examples of real estate-related legal services which brokers and salesmen may NOT provide.

1. Drafting legal documents such as deeds, deeds of trust, leases and real estate sales contracts for others. Although brokers and salesmen may "fill in" or "complete" preprinted real estate contract **forms** which have been drafted by an attorney, they may NOT under any circumstances complete or fill in deed or deed of trust forms.
2. Abstracting or rendering an opinion on legal title to real property.
3. Providing "legal advice" of any nature to clients and customers, including advice concerning the nature of any interest in real estate or the means of holding title to real estate. (Note: Although providing advice concerning the legal ramifications of a real estate sales contract is prohibited, merely "explaining" the provisions of such a contract is not only acceptable, but highly recommended).

### Other Prohibited Acts [G.S. 93A-6(b)]

In addition to those prohibited acts previously discussed, G.S. 93A-6(b) prescribes several other specific grounds for disciplinary action by the Commission, including:

1. Where a licensee has obtained a license by false or fraudulent representation (e.g. falsifying documentation of prelicensing education, failing to disclose prior criminal convictions, etc.)
2. Where a licensee has been convicted of, or pled guilty or no contest to, certain types of criminal offenses.
3. Where a broker's unlicensed employee, who is exempt from licensing under G.S. 93A-2(c)(6), has committed an act which, if committed by the broker, would have constituted a violation of the Licensing Law.

### TIME SHARE ACT

Article 4 of the License Law is referred to as the "North Carolina Time Share Act" and applies only to time share developers and salesmen. It should be noted that most of the provisions of Article 1 of the License Law and the Commission Rules which have been previously covered in this "Study Guide" also apply to time share salesmen. However, the provisions of Article 4 and the Commission Rules which are covered in this section of the "Study Guide" apply only to time share developers and salesmen. Where the laws and rules governing time share sales (Article 4 of the License Law and Subchapter 58 B of the Commission Rules) conflict with the

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## STUDY GUIDE

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laws and rules governing traditional real estate brokerage activities (Article 1 of the License Law and Subchapter 58 A of the Commission Rules), the time share laws and rules will govern as they relate to time share sales.

### **Project Registration** [G.S. 93A-40]

All time share projects located in North Carolina must be registered with the Real Estate Commission before the developer may sell (or offer to sell) a time share at the project. Time share projects which are located outside North Carolina do not have to be registered with the Commission.

### **License Required** [G.S. 93A-40]

All persons who sell or offer to sell time shares in North Carolina (whether or not the time share project is located in North Carolina) must have a North Carolina real estate broker or salesman license. There is no special license or license examination for time share salesmen. The license process is the same as that for salesmen and brokers who will be engaging in general real estate brokerage. Time share developers do not have to be licensed; however, time share projects must have a broker-in-charge as required by Rule A.0110.

### **Definitions** [G.S. 93A-41]

Applicants for real estate licenses should be familiar with all the definitions included in G.S. 93A-41. Most definitions are self-explanatory; however, particular attention should be paid to the following definition of a "time share".

A "time share" is any right to occupy a unit or units of real property (apartment, condominium, etc.) during **five** or more separated time periods (usually consisting of one or two weeks) over a period of at least **five years**, including renewal options. A time share may take the form of or include a freehold estate, an estate for years, a vacation license, a prepaid hotel reservation, a club membership, a limited partnership, a vacation bond, or any other form. The "form" of time share interest is, therefore, unimportant. Rather, it is the number of separated time periods and the total time period over which use is authorized which determines whether or not a right to occupy or use a unit(s) is a time share.

### **Time Shares Deemed Real Estate** [G.S. 93A-42]

Regardless of the form of interest or right, any time share is deemed to be an interest in real estate, and the instrument conveying the time share may be recorded with the County Register of Deeds the same as any other real property instrument.

### **Public Offering Statement** [G.S. 93A-44 and G.S. 93A-45(a) and (d)]

Time share developers must furnish to prospective time share purchasers a public offering statement containing various information about the time share project and other matters relating to a time share purchase. (Note: The specific information which must be included in the public offering statement is listed in G.S. 93A-44 and is considered to be self-explanatory.) A copy of the public offering statement must be provided to prospective purchasers before transfer of a time share and no later than the date of any contract of sale. [G.S. 93A-45(a)] If a developer fails to properly provide a purchaser with a copy of the public offering statement, then the purchaser, in addition to any other rights to damages or other relief, is entitled to receive from the developer a civil penalty in an amount equal to 10% of the sales price of the time share, not to exceed \$3,000. [G.S. 93A-45(d)]

### **Purchaser's Right to Cancel** [G.S. 93A-45(a) and (b); Rule B.0301]

A time share purchaser may elect to cancel his purchase within five days of contract execution (signing) by either hand delivering or mailing his notice of cancellation to the developer or time share salesmen. Cancellation is without penalty to the purchaser, and the purchaser is entitled to a full refund of all monies paid prior to cancellation.

Should a time share purchaser cancel his purchase by mail, the postmark date on the envelope containing the notice of cancellation shall be presumed by the Real Estate Commission to be the date the notice was mailed to the developer. Developers (and their agents) must retain the cancellation notice and any enclosure, envelope or other cover in their files at the time share project.

### **Escrow Requirements** [G.S. 93A-45(c); Rule B.0501]

Provisions are self-explanatory.

### **Rule-Making Authority** [G.S. 93A-51]

Provision is self-explanatory.

### **Disciplinary Actions** [G.S. 93A-54(a)-(c)]

Upon finding a time share salesman guilty of violating the North Carolina Time Share Act or Commission Rules, the Real Estate Commission may suspend or revoke the salesman's real estate license, or may reprimand or censure the salesman. In the case of a time share developer, the Commission may suspend or revoke the certificate of registration of the project, or reprimand or censure the developer, or **fine the developer** in the amount of \$500 for each violation. (**Note: Only developers may be fined** — not time share salesmen.)

Most of the provisions contained in G.S. 93A-54(a)-(c) regarding disciplinary action and prohibited acts are similar to the provisions contained in G.S. 93A-6(a)-(c) and previously discussed in the "Prohibited Acts" section of this "Study Guide." Consequently, discussion of these provisions is not repeated here. The disciplinary provisions in the Time Share Act which are completely unique to time share sales are paragraphs (10), (11), (12), and (13) of G.S. 93A-54(a), which are considered to be self-explanatory. □

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## ADMINISTRATOR'S NOTES

Director of Audits **L. Ted Gayle** was recently recognized by the Commission on having completed five years service and for his work in developing the Trust Account Short Course and audio/visual presentation . . . . A meeting of the Board of Directors of the North Carolina Real Estate Educator's Association was held in the Commission Office on April 4 to discuss with Commission Education Director **Larry A. Outlaw** and Assistant Education Director **Mike Hughes** the Association's Examination Question Bank project (See page 1 of this **Bulletin**) . . . Trust Account Auditor **Emmet Wood** presented a five-hour program on the auditing of time share projects at an Advanced Investigators' Seminar sponsored by the National Association of Real Estate License Law Officials . . . . The Virginia Real Estate Commission has announced that applicants for nonresident Virginia *salesman* licenses are no longer required to have any experience as a licensed real estate salesman in order to qualify for licensure *by reciprocity*. Brokers are still required to have been actively engaged as a broker and/or salesman for at least 36 of the 40 months immediately prior to making application.



# DISCIPLINARY ACTION

*Penalties for violations of the Real Estate License Law and Commission Rules and Regulations vary depending upon the particular facts and circumstances present in each case. Due to space limitations in the Bulletin, a complete description of such facts cannot be reported in the following Disciplinary Action summaries.*

DON W. AUSTIN (Emerald Isle) - Broker's license revoked effective June 30, 1985 for failing to disclose an offer to purchase to his principal; misrepresenting to a purchaser that he held title to and would convey certain real estate to such purchaser; failing to properly disclose the nature and extent of his personal financial interest in a real estate transaction; and attempting to conceal a real estate transaction from the firm which he purported to represent.

WILLIAM A. CANNADY (Jacksonville)- By consent, broker's license revoked effective April 4, 1985 for failing to deposit earnest money deposits in a trust account; failing to remit moneys belonging to others; falsifying records and making false statements to the Commission's auditor; compensating an unlicensed person for performing acts which require a real estate license; converting earnest money deposits to his own use; failing to maintain proper trust account and transaction records; and making false statements on his application for licensure.

LYNDA A. COWAN (Sylva) - Broker's license revoked effective April 1, 1985 based upon criminal conviction of obtaining money under false pretense, an offense involving moral turpitude which would reasonably affect her performance as a real estate broker.

JOHN H. LEA (Morehead City) - Broker's license revoked effective April 1, 1985 based upon a no contest plea of felonious possession of marijuana, an offense involving moral turpitude which would reasonably affect his performance as a real estate broker.

JOHN P. MAHONE (Raleigh) - Broker's license revoked effective April 1, 1985 for converting earnest money deposits to his own use; failing to account for, remit, and maintain adequate records regarding the funds of others; failing to deposit earnest money deposits in a trust account, and making false statements and failing to make records available to the Commission's auditor. □

# DEFICIT SPENDING AND PROPERTY MANAGEMENT

By Blackwell M. Brogden, Jr.  
Deputy Legal Counsel

Nearly every day we hear or read news reports regarding the federal government, or state or local governments which are spending more money than they are taking in. This practice has been appropriately termed "deficit spending". All too frequently, however, the Real Estate Commission also encounters a similar practice employed by property managers who spend more money on a given client's property(ies) than they have collected from such property.

For example, some properties will at times simply not generate sufficient income to cover mortgage payments and operating expenses. Or a property might suffer periodic shortfalls in revenue due to extended vacancy, tenant financial hardship, or other factors. When this occurs, and there is not enough money in the property manager's account for the owner of that particular property to make repairs, pay mortgage payments and utilities, and otherwise maintain the property, what is the property manager to do?

If there are funds in the trust account which have been collected on properties owned by other clients, the broker is sometimes tempted to pay bills which are immediately due from these other funds, and to float the "deficit" until future income is received from the deficit properties to repay the "loan". Or the property manager may opt to cover the "deficit" by deferring his commission or property management fee until additional funds have been collected on a client's property(ies). However, **neither of these methods is legal!** In the first case, the broker would be guilty of making an improper disbursement of trust funds because he would be disbursing one client's funds for the benefit of another client's property. And in the second case, the broker would be guilty of

commingling if he were to allow his earned commissions (i.e., his funds) to remain in the trust account with the funds of his clients and customers.

The solution to the "deficit spending" dilemma lies in smart planning on the part of the property manager, beginning with an adequate property management agreement with the owner which anticipates such negative cash flow situations as emergency repairs and nonpayment of rent. There are a number of ways in which property managers and owners can arrange to cover these shortages. For instance, the owner could defer a certain portion of his proceeds each month and allow the property manager to retain these funds in his trust account in reserve. Or the owner could retain direct financial responsibility for payment of bills and authorize the property manager to contract in the owner's name with repairmen and suppliers with bills going directly to the owner.

Or, if the property manager determines that the owner is credit-worthy, he may wish to advance funds to the owner to cover expenses on the property. Any money loaned by the broker to the owner should be handled through the broker's operating account or personal account with the funds being disbursed directly from the operating or personal account to the vendor. While the Commission does not recommend the practice of advancing funds to owners, the practice would be valid if it is specifically provided for in the written property management agreement between the broker and the owners. But remember: The broker is an agent, and the agent's authority is derivative. If the owner does not authorize the advance or the work performed, the owner may not be liable to reimburse the agent. □

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