

# NORTH CAROLINA REAL ESTATE COMMISSION

# Real Estate Bulletin

Volume 16

1986

Number 4

## LOAN FRAUD: FACT AND FANTASY

*By Blackwell M. Brogden, Jr.*  
Deputy Legal Counsel

Most real estate brokers and salesmen, especially those who specialize in the sale of residential property, will inevitably be confronted with a prospective purchaser who, for one reason or another, does not quite qualify for the financing necessary to purchase a home. The temptation at that point is to lapse into the so-called "little white lie syndrome" by presenting to the lender incomplete or incorrect information concerning the property or the terms of the sale. Or by suggesting "gift letters" to convince the lender that the purchaser/borrower has or will have sufficient cash funds to close the transaction. Or perhaps suggesting to the purchasers that they not disclose to the lender certain financial obligations which could adversely affect their expense to income qualifying ratio.

Those agents who yield to this temptation are often otherwise self-respecting, law-abiding citizens who do not equate their actions with violating the law and who attempt to rationalize their actions in an effort to salve their guilty consciences. But the dividing line separating the facts from the fantasies of loan fraud is crystal clear as indicated by the following list:

- FANTASY:** What I'm doing isn't loan fraud.

**FACT:** Violation of federal laws governing lending practices requires only that you knowingly make a false statement or a false report, or that you willfully overvalue any land, property, or security for the purposes of obtaining credit from protected institutions and authorities.
- FANTASY:** No one cares about it.

**FACT:** Federal auditors are required to report any evidence of fraudulent loan transactions to the appropriate law enforcement authorities. Even if the loan has been paid back or the transaction rescinded or discovered before credit was extended, the violation will still be reported.
- FANTASY:** No one is hurt by loan fraud. It's just the bank's money.

**FACT:** Loans predicated upon inadequate security and/or uncreditworthy borrowers endanger the financial soundness of the monetary and banking system. Many of the recent failures of financial institutions in the United States can be attributed directly to fraudulent loan transactions. Although these failures have usually resulted from a substantial pattern of fraud, nevertheless the pattern has been composed of many individual transactions. In the final analysis, the victims of the crime are the financial institutions' depositors and the taxpayers.
- FANTASY:** Everyone does it, so it must be O.K.

**FACT:** Violating United States Code provision, Title 18, Section 1014, is a criminal offense punishable by two years' imprisonment or a \$5,000 fine or both. Furthermore, engaging in a fraudulent real estate transaction or criminal conviction for this type of offense is grounds for the suspension or revocation of your real estate license. □

## LICENSE RENEWAL ALERT

Plans are already being made for the renewal of real estate licenses for the coming year. Renewal applications are scheduled to be mailed to all licensed real estate brokers, salesmen and corporations on May 9 to give you more than adequate time to return your renewal application and fee to the Commission Office by the June 30 deadline.

Although the Real Estate License Law has been changed to authorize the Commission to renew licenses on a "staggered basis" (like drivers' licenses), the Commission will continue to renew all licenses at one time so long as it is physically possible.

Two administrative changes will be implemented in the renewal processing this year in an effort to speed the renewal of licenses. A computer bar code representing your license number will be printed on your renewal application which can be electronically "read" and entered into your license file. And your renewal sticker will be affixed and mailed to you on a post card to save postal costs.

With "renewal season" only two months away, it is important for you to verify that the Real Estate Commission has your correct mailing address on file. Otherwise, your renewal application will be delayed or perhaps never received. Since your license renewal application will be sent to the same address as this *Bulletin*, check the mailing label on this *Bulletin* to verify that your name, business name and address are correct. If any of this information is not correctly stated, you should immediately notify the Records Department of the Real Estate Commission. □

**IS YOUR NAME AND  
ADDRESS ON THIS  
BULLETIN CORRECT?**

# 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 Regulations, and 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

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# ADMINISTRATOR'S NOTES



Frances Johnson has been employed by the Real Estate Commission as Financial/Legal Secretary to assist the Commission's Financial Officer and Legal Staff. Frances previously taught various secretarial courses at a Raleigh business college for ten years.



Commission Member LaNelle Lilley of Wrightsville Beach has been honored by the Wilmington Board of REALTORS as its "REALTOR of the Year." Ms. Lilley also recently received one of six REALTOR Regional Service Awards presented by the North Carolina Association of REALTORS.

## 1986 LICENSE EXAM SCHEDULE

Filing Deadlines	Examination Dates
March 19	April 19
April 17	May 17
May 21	June 21
June 26	July 26
July 23	August 23
August 27	September 27
September 25	October 25
October 22	November 22
November 20	December 20

## TRUST ACCOUNT SHORT COURSE On the Road Again

The Real Estate Commission's trust account auditing staff will again this year be taking its half-day Trust Account Short Course to various cities and towns across the state. Beginning in Greensboro on April 7, they will travel west stopping in Statesville, Asheville and Franklin. Then on April 16, they will head east beginning in Fayetteville and criss-crossing to Wilmington and back to New Bern. These classes will be in addition to their monthly class in Raleigh.

Director of Audits L. Ted Gayle recently reported to the Commission that nearly 2,000 persons had attended the course since it began in 1982. Last year 746 persons participated (a record!) traveling an average of 132 miles to attend. Mr. Gayle and Trust Account Auditors Emmet R. Wood, CPA, and Nancy C. Adams, CPA, conduct the courses.

This free course is designed to bring participants up to date on current laws, rules and procedures governing the handling of client funds and to assist real estate firms in developing good recordkeeping practices. The course takes from three to four hours to complete, and upon completion, a certificate of participation is awarded.

## EXAM RESULTS

EXAMINATION — November, 1985

	Passed	Failed
Brokers	88	56
Salesmen	514	305

EXAMINATION — December, 1985

	Passed	Failed
Brokers	134	84
Salesmen	763	498

EXAMINATION — January, 1986

	Passed	Failed
Brokers	108	83
Salesmen	769	397

## TRUST ACCOUNT SHORT COURSE

Registration Form

(All Classes Begin at 9:30 a.m.)

- Greensboro (April 7)
- Statesville (April 8)
- Asheville (April 9)
- Franklin (April 10)
- Fayetteville (April 16)
- Wilmington (April 17)
- New Bern (April 18)

OR

McKimmon Center, Raleigh, N.C.  
(All Raleigh Classes Begin at 1:00 p.m.)

- April 14
- May 20
- June 17

Name: ..... Phone: .....

Address: ..... City: .....

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

# EASTON V. STRASSBURGER DISCLOSURE RESPONSIBILITY OF REAL ESTATE AGENT

by

W. Jerome Thomas  
Chief Legal Officer

California Department of Real Estate

*NOTE: Although the following article is based upon a decision of a California Appellate Court, nevertheless the finding of the Court in this important case accurately reflects the position of the North Carolina Real Estate Commission with regard to the negligent omission of material facts concerning a property or transaction about which real estate brokers and salesmen should reasonably be aware.*

In February of this year, Division Two of the First District Court of Appeal rendered a decision in a case entitled *Easton v. Strassburger*, 152 C.A. 3d 90. On May 31, 1984, the California Supreme Court denied the requests of appellant, the National Association of Realtors, California Association of Realtors and a host of other organizations and persons for a hearing or decertification of the opinion. The opinion is therefore judicial precedent in future litigation involving the alleged failure of a real estate licensee to disclose information about a residential property to a prospective purchaser.

The *Easton* case stands for the proposition that a real estate broker acting as an agent in the sale of a residential real property has a duty to the prospective buyer, not only to disclose facts about the property known to the broker that may materially affect the value or desirability of the property to the buyer, but also a "duty to conduct a reasonably competent and diligent inspection of property . . . in order to discover defects . . ." to be disclosed to the buyer.

Briefly stated, the facts of the case are that Easton, the plaintiff, purchased a single-family residence from Strassburger for \$170,000 in 1976. Valley Realty (Valley) was the listing broker in the transaction. During the three years immediately preceding the sale to Easton, there had been two landslides on the property. Strassburger had taken corrective action to prevent further subsidence of the soil, but did not inform Valley of the soil problems nor of the corrective action taken. Valley's agents inspected the property several times during the listing period and, according to the appellate court, there was evidence that Valley's agents "were aware of certain 'red flags' which should have

indicated to them that there were soils problems." Earth movements and land slides occurring soon after Easton occupied the property virtually destroyed its value.

Easton filed suit against Strassburger, Valley and others. Valley was charged with fraudulent concealment, intentional misrepresentation and negligent misrepresentation. The jury found against Valley only under a simple negligence theory. It returned a joint and several judgment against several of the defendants and apportioned comparative negligence 5 percent to Valley, 5 percent to the cooperating broker who had not been named as a defendant, 65 percent to the seller and 25 percent to other defendants. While the opinion does not reflect the fact, Valley's monetary exposure far exceeded 5 percent of the \$197,000 awarded to Easton as a result of the seller's having become insolvent following the sale of the property.

Valley appealed the trial court judgment relying principally upon an asserted error by the trial judge in giving the following instruction to the jury:

"A real estate broker is a licensed person or entity who holds himself out to the public as having particular skills and knowledge in the real estate field. He is under a duty to disclose facts materially affecting the value or desirability of the property that are known to him or which through reasonable diligence should be known to him."

Valley contended that a broker's duty to a prospective buyer was only to disclose known facts about the property, not facts which should be known in the exercise of reasonable diligence.

The Court of Appeal rejected Valley's contention. In its opinion, it pointed out that the law of California has long required both the seller of real property and the broker to inform a prospective buyer concerning material defects known to them but unknown and unobservable by the buyer. It pointed out that a broker in a transaction is liable for the intentional tort of fraudulent concealment or negative fraud if he fails to disclose material facts about the property that are not known to, nor within the reach of the diligent obser-

vation of, the prospective buyer. The court acknowledged the fact that no California appellate decision had expressly held that a broker is under a duty to disclose material facts about the property that he **should have known**. It then went on to declare that the purpose of assuring that a prospective buyer was provided with sufficient information to make an informed decision on whether to purchase "would be seriously undermined if the rule were not seen to include a duty to disclose reasonably discoverable defects." The court's reasoning appears to be summed up in the following observations:

"If a broker were required to disclose only known defects, but not also those that are reasonably discoverable, he would be shielded by his ignorance of that which he holds himself out to know. The rule thus narrowly construed would have results inimical to the policy upon which it is based. Such a construction would not only reward the unskilled broker for his incompetence, but might provide the unscrupulous broker the unilateral ability to protect himself at the expense of the inexperienced and unwary who rely upon him."

The opinion in this case leaves a host of unanswered questions, not only for the practitioner who wants to avoid liability, but also for the practitioner who wants to do what the law tells him is the right thing to do. For example, is there a duty of a **cooperating broker** to inspect and discover defects in the property? For reasons that are not apparent from the opinion itself, the selling broker was not named as a defendant in the *Easton* case and the holding of liability was against the listing broker who was undeniably the agent of the seller. The rationale underlying the decision suggests that if a listing broker and selling broker were both named as defendants in a suit by a buyer, both would be jointly and severally liable if the court or jury found a negligent failure-to-detect and failure-to-disclose set of circumstances. That conclusion, however, cannot be stated with certainty since the

(Continued on Page 4)

# EDUCATION REPORT

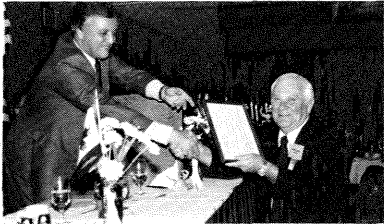
By Larry A. Outlaw  
Education Director

EASTON

(Continued from Page 3)

## COMMISSION RECEIVES NATIONAL RECOGNITION

The National Association of Real Estate License Law Officials has awarded the N.C. Real Estate Commission a Certificate of Recognition for outstanding achievement in the development of the publication *Real Estate Licensing in North Carolina*.



Real Estate Commission Chairman Brantley T. Poole (right) accepts NARELLO Education Recognition Award.

This 47-page booklet is furnished to all applicants for North Carolina real estate licenses and contains ■ General Information on Real Estate Licensing ■ the North Carolina Real Estate License Law ■ the Real Estate Commission's Rules and Regulations ■ Trust Account Guidelines ■ a Study Guide for the License Law and Rules, and ■ an Application for Real Estate License Form and return envelope.

## DALRYMPLE AWARDED SCHWEIDLER SCHOLARSHIP

The Real Estate Commission is pleased to announce that Mrs. Linda B. Dalrymple of Sanford has been awarded the 1985 Joe Schweidler Memorial Scholarship. The scholarship is presented by the Commission to the student who achieves the highest scholastic average in Course B of the REALTORS Institute during the academic year. It is given in honor and memory of Joseph F. Schweidler who served as Secretary-Treasurer of the Real Estate Licensing Board from 1960 to 1975.

The Commission congratulates Mrs. Dalrymple on having achieved this special honor.

## 1986 REAL ESTATE INSTRUCTOR WORKSHOP

The Real Estate Commission, in conjunction with the North Carolina Real Estate Educators Association (NCREEA), will hold its annual Real Estate Instructor Workshop at the Jane S. McKimmon

Extension Education Center in Raleigh on April 29 and 30.

This year's program will include presentations on classroom communications, new developments in pre-licensing education and the real estate license examinations, the application of agency and related law to co-brokered sales transactions, and new developments in real estate finance. There will also be a special seminar for new instructors.

The Workshop is intended primarily for Commission-certified real estate instructors and members of NCREEA, but is also open to others interested in real estate education on a space-available basis.

## LICENSE EXAM UPDATE

January 1986 marked the 2nd anniversary of the Real Estate Commission's "in-house" license examination program. By "in-house" we mean that the development and administration (scheduling, scoring, etc.) of the state examinations for real estate broker and salesman licenses is controlled, and in most cases performed, by the Real Estate Commission staff, rather than contracted to a private testing company for these services.

Since January 1984, more than 35,000 license applicants have been scheduled (or re-scheduled) for examination under this new system; more than 30,000 persons have been tested; and nearly 16,700 licenses have been issued.

Over the past two years, efforts have been made to refine the examination and the administrative procedures. We have been especially successful in reducing the "waiting period" for candidates between the time they sit for their examination and the issuance of their score reports and license certificates. Under the previous examination system, candidates were generally sent their examination score reports two weeks after taking the examination. Then, if they passed their examination, an additional two to three weeks were needed in order for the Commission to issue the license certificates. But under our current "in-house" system, score reports and licenses are usually sent to examinees within 5 to 7 business days after their examination. Consequently, as a result of recent changes in the salesman license transfer procedure, persons can often begin working as real estate brokers and salesmen within ten days after passing their license examinations. □

opinion does include an observation that "seller's broker" (listing broker) is the agent "most frequently . . . best situated to obtain and provide the most reliable information on the property . . ." to the prospective buyer. While that statement by the court is undoubtedly true in the abstract, defects in the property that have not been disclosed by the seller but are discoverable through an inspection of the property are equally discernible to listing broker and selling broker in most cases.

If a defect is not one that is readily discernible through a careful walk-through inspection of the property, this decision could portend future decisions holding that either a listing broker or selling broker has a duty to hire professional persons to inspect the property and its component systems to discover defects that are not readily discernible. If the law does develop along those lines, then the duty that the listing broker owes to a prospective buyer could transcend that owed by the seller.

As the law now stands, it is not possible to specify how far a broker must go in any particular set of circumstances to discover existing defects to be pointed out to a prospective buyer or to give reasonable assurance that no significant defects exist. For the present, however, both listing brokers and selling brokers will be well advised to spot "red flags" that signal possible defects and to follow up as necessary to minimize the possibility that a buyer will enter into a contract to purchase the property without having at least as much information about the apparent defect as the broker has or can readily obtain. □

## RECIPROCITY UPDATE

The following states exempt resident N. C. real estate brokers and salesmen from their license exam requirements:

Arkansas	Oklahoma
Delaware	South
District of Columbia	Carolina
Georgia	Tennessee
Pennsylvania	Virginia
New Jersey	West Virginia

Interested persons should contact the Real Estate Commission in these states for additional licensing information.

# 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.*

**NORMAN R. BRUNETTE** (Shallotte) - The Commission revoked Mr. Brunette's broker's license effective January 3, 1986. The Commission found that Mr. Brunette, upon terminating his association as broker-in-charge of a real estate firm, had withdrawn all funds on deposit in the firm's trust account and had taken said funds and the firm's trust account records with him to South Carolina. The Commission also found that Mr. Brunette subsequently converted these funds to his own use and refused several requests from the Commission's trust account auditor to produce the firm's records.

**RICHARD J. COOK** (Greensboro) - The Commission suspended Mr. Cook's broker's license for one year, of which six months of the suspension are to be active and the remaining six months suspended on condition that he complete courses in real estate law and brokerage operations. The Commission found that Mr. Cook had willfully misrepresented to his seller that it was not necessary for her husband to sign deeds to convey property owned by them by the entireties and that she could, without authorization, sign her husband's name on

such deeds. The Commission also found that he had acted for more than one party in a real estate transaction without the knowledge or informed consent of all parties.

**PHYLLIS M. COOPER** (Gastonia) - The Commission revoked Ms. Cooper's salesman's license effective January 6, 1986. The Commission found that Ms. Cooper had encouraged and assisted a purchaser to furnish false information to a lender regarding the purchaser's child support obligation. The Commission also found that she had assured the purchaser that his purchase deposit would be returned in full in the event the purchase was not consummated, but in fact, only a portion of his deposit was returned when the lender withdrew its approval of the purchaser's loan application.

**FIRST STAR, INC.; SNOWCLOUD I CONDOMINIUM; SNOWCLOUD II CONDOMINIUM** (Seven Devils) - The Commission revoked the corporate real estate broker's license of First Star, Inc. and the registration certificates of the time share projects Snowcloud I Condominium and Snowcloud II Condominium effective December 31, 1985. The Commission found that First Star, Inc., as the registered developer of the Snowcloud I and Snowcloud II time share projects, employed numerous unlicensed persons to sell time shares at these projects. The Commission also found that these unlicensed salesmen made false promises to prospective purchasers to induce them to purchase time shares; and that the salesmen failed to give purchasers certain required information, such as the purchasers' right to a refund of their purchase

money should they elect to cancel their sales contract within five days after signing it.

**GOLD COAST MARKETING, INC.** (Holly Ridge) - The Commission revoked the corporate real estate broker's license of Gold Coast Marketing, Inc. effective January 7, 1986 for issuing a purchase deposit refund check which was dishonored by the bank and then falsely representing to the Attorney General's Office that such deposit had been refunded. The Commission also found that the corporation's real estate broker's license contained false and fraudulent representations to the effect that no officer, director or employee of the corporation had been convicted of a criminal offense when in fact two of the initial directors of the corporation had been convicted of serious criminal offenses.

**EDWARD L. HALE** (Greensboro) - The Commission denied the reinstatement of Mr. Hale's expired broker's license on the grounds that he did not possess the requisite character for licensure. The Commission's determination was based upon a finding that Mr. Hale, while licensed as a real estate broker, failed to account for and remit to a property owner rental monies and security deposits collected on properties managed for the owner, and that he failed to produce any trust account records for inspection by the Commission's trust account auditor.

**JEANETTE M. JOHNSON ROWELL** (Spring Lake) - The Commission suspended Mrs. Rowell's salesman's license for one year effective January 1, 1986. Six months of the suspension are to be active and the remain-

*(Continued on Page 6)*

## FORMER BROKER CONVICTED OF EMBEZZLEMENT

Former Jacksonville real estate broker WILLIAM A. CANADY has been sentenced in Onslow County Superior Court to two separate ten-year terms of imprisonment for embezzling funds received in real estate transactions. The first ten-year term is to be active, but the second term was suspended on condition that Canady repay the approximately \$24,000 which he embezzled.

The legal and investigative staff of the Real Estate Commission assisted law enforcement officials in the investigation and prosecution of the case against Canady, whose broker's license was revoked by the Commission in April, 1985.

## NO INTANGIBLES TAX ON TRUST ACCOUNTS

On July 12, 1985 the North Carolina General Assembly repealed the state intangibles tax on money on deposit and money on hand (including checking and savings accounts). This repeal was retroactive to January 1, 1985. This means that escrow or trust accounts will no longer be subject to this tax; however, these accounts will still be subject to the same bank service charges and fees which you have experienced in the past. The intangibles tax will still be levied on stocks and bonds.

If you have further questions, please contact your local Department of Revenue office or the Intangibles Tax Division of the N.C. Department of Revenue in Raleigh.

# DISCIPLINARY ACTION

(Continued from Page 5)

ing six months on probation. The Commission found that Mrs. Rowell had allowed Mr. Robert L. Maxey, an unlicensed individual, to control her acts as a licensee and that she assisted Mr. Maxey in obtaining Veterans Administration financing for purchasers when she knew that Mr. Maxey was barred from participating in VA financing programs on property owned or controlled by him.

GLADYS T. SPEARS (Fayetteville) - The Commission suspended Mrs. Spears' broker's license for one year effective February 1, 1986, of which thirty days are to be active and the remaining eleven months on probation. The Commission found that Mrs. Spears had commingled an earnest money deposit with her business or personal funds, and had failed to promptly remit the deposit to the proper party.

SWISS MOUNTAIN CORPORATION (Blowing Rock), HOWARD C. McDERMID, II; MARK A. MOORE; ERVIN S. BATCHELOR, JR.; ROBERT S. CHAREST; LARRY D. CROWELL; PAMELA R. GABLE; DAVID F. HINSHAW; NOEL C. JOHNSON; DONALD K. LANE; CHARLES L. MUNN - By Consent, the Commission reprimanded Swiss Mountain Corporation, which is the registered developer of the time share project Swiss Mountain Village, for failing to notify the Commission of a change in its sales contract form.

By Consent, the Commission revoked the broker's license of Howard C. McDermid, II effective December 1, 1985, but subsequently issued a salesman's license to him on January 9, 1986. The Commission found that Mr. McDermid, while acting as a

"takeover salesman" at the Swiss Mountain Village time share project, failed to provide public offering statement summary sheets to numerous purchasers, and failed to provide purchasers complete copies of their sales documents containing information relating to the purchasers' right to rescind their sales contracts.

By Consent, the Commission suspended the broker's license of Mark A. Moore for two years effective October 2, 1985, of which one year is to be active and the remaining one year on probation. The Commission found that Mr. Moore, while acting as broker-in-charge of the Swiss Mountain Village time share project, allowed nine persons to work as salesmen prior to receiving their real estate licenses. The Commission also found that he failed to properly supervise the activities of two salesmen by permitting them to close time share sales transactions without delivering to the purchasers all required documentation, and that he allowed the marketing of time shares at Swiss Mountain Village that did not belong to the registered developer of the project.

The Commission reprimanded salesman Bruce D. Godwin for failing to provide time share purchasers at Swiss Mountain Village public offering statement summaries conspicuously disclosing the purchasers' right to cancel their time share purchase agreements.

By Consent, the Commission reprimanded salesmen Ervin S. Batchelor, Jr., Robert S. Charest, Larry D. Crowell, Pamela R. Gable, David F. Hinshaw, Noel C. Johnson, Donald K. Lane, and Charles L. Munn

for working as time share salesmen at Swiss Mountain Village prior to the issuance of their license certificates to the broker-in-charge of the project.

PIER P. TUNSTALL (Goldsboro) - The Commission revoked Mrs. Tunstall's broker's license effective January 3, 1986. The Commission found that Mrs. Tunstall admitted to having converted to her own use more than \$9,000 of client funds from the trust account of the firm with which she was associated. Mrs. Tunstall subsequently repaid all funds. The Commission also found that Mrs. Tunstall, in a single real estate transaction, had forged the names of the purchasers to a note and deed of trust, but that she did so without any intent to convert any of the purchasers' funds to her own use or to deprive the purchasers or her employer of any funds or properties that belonged to them.

JERRY LEE WELLS (Jacksonville) - The Commission revoked Mr. Wells' broker's license effective January 1, 1986, which license may be considered for reinstatement after January 1, 1989. Mr. Wells was subsequently issued a salesman's license effective March 1, 1986. The Commission found that Mr. Wells had obtained his real estate broker's license by making a false representation on his application for license in that he stated that he had never been convicted of a criminal offense when, in fact, he had previously pled guilty and was adjudged guilty of making a materially false statement in a loan application.

## ON THE INSIDE . . .

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. . . AND MORE

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