

## Assembly Bill No. 754

### CHAPTER 392

An act to add Section 10229 to the Business and Professions Code, and to add Section 25102.5 to the Corporations Code, relating to real estate.

[Approved by Governor August 26, 1997. Filed with Secretary of State August 27, 1997.]

#### LEGISLATIVE COUNSEL'S DIGEST

AB 754, Kuykendall. Real property: sales of series of notes and undivided interests.

The Corporate Securities Law of 1968 provides that it is unlawful for any person to offer or sell any security in an issuer transaction unless the sale has been qualified, with specified exemptions.

This bill would also exempt from the qualification requirement a transaction that is the sale of a series of notes secured directly by an interest in the same property or the sale of undivided interests in a note equivalent to a series transaction, if the notes or interests are sold by or through a licensed real estate broker and if the transaction complies with specified notice, advertising, trust account, reporting, and other related requirements. The bill would require the real estate directly securing the notes or interests to be in this state, and would require the notes or interests to not be sold to more than 10 persons, as specified.

The bill would require the notes or interests of purchasers to be identical in their underlying terms, but would not preclude different selling prices for interests. The bill would require the interest of each purchaser to be recorded.

The bill would also establish limitations on the combined total of the aggregate principal amount of the notes or interests sold and the unpaid principal amount of any senior encumbrances on the real property, and would require that the documentation of the transaction include a contractual obligation that a default on any interest or note is a default on all interests or notes. The bill contains other related provisions. Because a violation of provisions relating to real estate would be a misdemeanor, this bill would impose a state-mandated local program by creating a new crime.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.



*The people of the State of California do enact as follows:*

SECTION 1. Section 10229 is added to the Business and Professions Code, to read:

10229. Any transaction that involves the sale of or offer to sell a series of notes secured directly by an interest in the same real property, or the sale of undivided interests in a note secured directly by real property equivalent to a series transaction, shall comply with all of the following, except as provided in paragraph (4) of subdivision (i), the terms “sale” and “offer to sell,” as used in this section, shall have the same meaning as set forth in Section 25017 of the Corporations Code and include the acts of negotiating and arranging the transaction:

(a) A notice in the following form and containing the following information shall be filed with the commissioner within 30 days after the first transaction and within 30 days of any material change in the information required in the notice:

TO: Real Estate Commissioner  
Mortgage Loan Section  
2201 Broadway  
Sacramento, CA 95818

This notice is filed pursuant to Section 10229 of the Business and Professions Code.

Original Notice                       Amended Notice

1. Name of Broker conducting transaction under Section 10229:

\_\_\_\_\_

2. Firm name (if different from “1”):

\_\_\_\_\_

3. Street address (main location):

\_\_\_\_\_

# and Street                      City                      State                      ZIP Code



4. Mailing address (if different from “3”):

\_\_\_\_\_

5. Servicing Agent: Identify the person or persons who will act as the servicing agent in transactions pursuant to Section 10229 (including the undersigned Broker if such is the case):

\_\_\_\_\_  
\_\_\_\_\_

6. Inspection of trust account (before answering this question, review the provisions of paragraph (3) of subdivision (j) of Section 10229).

CHECK ONLY ONE OF THE FOLLOWING:

( ) The undersigned Broker is (or expects to be) required to file reports of inspection of its trust account(s) with the Real Estate Commissioner pursuant to paragraph (3) of subdivision (j) of Section 10229.

( ) The undersigned Broker is NOT (or does NOT expect to be) required to file reports of inspection of its trust account(s) with the Real Estate Commissioner pursuant to paragraph (3) of subdivision (j) of Section 10229.

7. Signature. The contents of this notice are true and correct.

\_\_\_\_\_

Date

Type Name of Broker

\_\_\_\_\_  
Signature of Broker or of Designated Officer  
of Corporate Broker

\_\_\_\_\_  
Type Name of Persons Signing This Notice

NOTE: AN AMENDED NOTICE MUST BE FILED BY THE BROKER WITHIN 30 DAYS OF ANY MATERIAL CHANGE IN THE INFORMATION REQUIRED TO BE SET FORTH HEREIN.



(b) All advertising employed for transactions under this section shall (1) show the name of the broker and (2) comply with Section 260.302 of Title 10 of the California Code of Regulations, Section 10235 of the Business and Professions Code, and Section 2848 of Title 10 of the California Code of Regulations. Brokers and their agents are cautioned that a reference to a prospective investor that a transaction is conducted under this section may be deemed misleading or deceptive if this representation may reasonably be construed by the investor as an implication of merit or approval of the transaction.

(c) The real property directly securing the notes or interests is located in this state, the note or notes are not by their terms subject to subordination to any subsequently created deed of trust upon the real property, and the note or notes are not promotional notes secured by liens on separate parcels of real property in one subdivision or in contiguous subdivisions. For purposes of this subdivision, a promotional note means a promissory note secured by a trust deed executed on unimproved real property or executed after construction of an improvement of the property but before the first purchase of the property as so improved, or executed as a means of financing the first purchase of the property as so improved, and which is subordinate or which by its terms may become subordinate to any other trust deed on the property. However, the term “promotional note” does not include either of the following:

(1) A note that was executed in excess of three years prior to being offered for sale.

(2) A note secured by a first trust deed on real property in a subdivision, which evidences a bona fide loan made in connection with the financing of the usual cost of the development in a residential, commercial, or industrial building or buildings on the property under a written agreement providing for the disbursement of the loan funds as costs are incurred or in relation to the progress of the work and providing for title insurance ensuring the priority of the security as against mechanic’s and materialmen’s liens or for the final disbursement of at least 10 percent of the loan funds after the expiration of the period of the filing of mechanic’s and materialmen’s liens.

(d) (1) The notes or interests are sold by or through a real estate broker, as principal or agent. At the time the interests are originally sold or assigned, neither the broker nor an affiliate of the broker shall have an interest as owner, lessor, or developer of the property securing the loan, or any contractual right to acquire, lease, or develop the property securing the loan. This provision shall not prohibit a broker from conducting the following transactions if, in either case, the disclosure statement furnished by the broker pursuant to subdivision (k) discloses the interest of the broker or



affiliate in the transaction and the circumstances under which the broker or affiliate acquired the interest:

(A) A transaction in which the broker or an affiliate of the broker is acquiring the property pursuant to a foreclosure under, or sale pursuant to, a deed of trust securing a note for which the broker is the servicing agent or which the broker sold to the holder or holders.

(B) A transaction in which the broker or an affiliate of the broker is reselling from inventory property acquired by the broker pursuant to a foreclosure under, or sale pursuant to, a deed of trust securing a note for which the broker is the servicing agent or which the broker sold to the holder or holders.

(2) For the purposes of this subdivision, the following definitions apply:

(A) "Broker" means a person licensed as a broker under any of the provisions of this part.

(B) "Affiliate" means a person controlled by, controlling, or under common control with, the broker.

(e) (1) The notes or interests shall not be sold to more than 10 persons, each of whom meets one or both of the qualifications of income or net worth set forth below and who signs a statement, which shall be retained by the broker for four years conforming to the following:

Transaction Identifier: \_\_\_\_\_

Name of Purchaser: \_\_\_\_\_ Date: \_\_\_\_\_

Check either one of the following, if true.

( ) My investment in the transaction does not exceed 10% of my net worth, exclusive of home, furnishings, and automobiles.

( ) My investment in the transaction does not exceed 10% of my adjusted gross income for federal income tax purposes for my last tax year, or in the alternative, as estimated for the current year.

\_\_\_\_\_  
Signature

(2) The number of offerees shall not be considered for the purposes of this section.

(3) A husband and wife and their dependents, and an individual and his or her dependents, shall be counted as one person.

(4) A retirement plan, trust, business trust, corporation, or other entity that is wholly owned by an individual, and the individual's



spouse, or the individual’s dependents, or any combination thereof, shall not be counted separately from the individual but the investments of these entities shall be aggregated with those of the individual for the purposes of the statement required by paragraph (1). If the investments of any entities are required to be aggregated under this subdivision, the adjusted gross income or net worth of these entities may also be aggregated with the net worth, or both, income of the individual.

(5) The “institutional investors” enumerated in subdivision (i) of Section 25102 or subdivision (c) of Section 25104 of the Corporations Code, or in a rule adopted pursuant thereto shall not be counted.

(f) The notes or interests of the purchasers shall be identical in their underlying terms including the right to direct or require foreclosure, rights to and rate of interest, and other incidents of being a lender, and the sale to each purchaser pursuant to this section shall be upon the same terms, subject to adjustment for the face or principal amount or percentage interest purchased and for interest earned or accrued. This subdivision shall not preclude different selling prices for interests to the extent that these differences are reasonably related to changes in the market value of the loan occurring between the sales of these interests. The interest of each purchaser shall be recorded.

(g) (1) Except as provided in paragraph (2), the aggregate principal amount of the notes or interests sold, together with the unpaid principal amount of any encumbrances upon the real property senior thereto, shall not exceed the following percentages of the current market value of the real property as determined in writing by the broker or appraiser pursuant to Section 10232.6 plus the amount for which the payment of principal and interest in excess of the percentage of current market value is insured for the benefit of the holders of the notes or interests by an insurer admitted to do business in this state by the Insurance Commissioner:

- (A) Single-family residence, owner-occupied . . . . . 80%
- (B) Single-family residence, not owner-occupied . . . . . 75%
- (C) Commercial and income-producing properties . . . . . 65%
- (D) Land which has been zoned for (and if required,  
approved for subdivision as) commercial or  
residential development . . . . . 50%
- (E) Other real property . . . . . 35%

(2) The percentage amounts specified in paragraph (1) may be exceeded when and to the extent that the broker determines that the encumbrance of the property in excess of these percentages is reasonable and prudent considering all relevant factors pertaining to the real property. However, in no event shall the aggregate principal



amount of the notes or interests sold, together with the unpaid principal amount of any encumbrances upon the property senior thereto, exceed 80 percent of the current fair market value of improved real property or 50 percent of the current fair market value of unimproved real property, plus the amount insured as specified in paragraph (1). A written statement shall be prepared by the broker that sets forth the material considerations and facts that the broker relies upon for his or her determination which shall be retained as a part of the broker's record of the transaction. Either a copy of the statement or the information contained therein shall be included in the disclosures required pursuant to subdivision (k).

(3) A copy of the appraisal or the broker's evaluation shall be delivered to each purchaser upon request. The broker shall advise purchasers of their right to receive a copy. For purposes of this paragraph, "appraisal" means a written estimate of value based upon the assembling, analyzing, and reconciling of facts and value indicators for the real property in question. A broker shall not purport to make an appraisal unless the person so employed is qualified on the basis of special training, preparation, or experience.

(h) The documentation of the transaction shall require that (1) a default upon any interest or note is a default upon all interests or notes, and (2) the holders of more than fifty percent of the record beneficial interests of the notes or interests may be governed by the actions to be taken on behalf of all holders in accordance with Section 2941.9 of the Civil Code in the event of default or foreclosure for matters that require direction or approval of the holders, including designation of the broker, servicing agent, or other person acting on their behalf, and the sale, encumbrance, or lease of real property owned by the holders resulting from foreclosure or receipt of a deed in lieu of foreclosure. The terms called for by this subdivision may be included in the deed of trust, in the assignment of interests, or in any other documentation as is necessary or appropriate to make them binding on the parties.

(i) (1) The broker shall not accept any purchase or loan funds or other consideration from a prospective lender or purchaser, or directly or indirectly cause the funds or other consideration to be deposited in an escrow or trust account, except as to a specific loan or note secured by deed of trust that the broker owns, is authorized to negotiate, or is unconditionally obligated to buy.

(2) All funds received by the broker from the purchasers or lenders shall be handled in accordance with Section 10145 for disbursement to the persons thereto entitled upon recordation of the interests of the purchasers or lenders in the note and deed of trust. No provision of this section shall be construed as modifying or superseding applicable law regulating the escrow holder in any transaction or the handling of the escrow account.



(3) The books and records of the broker or servicing agent, or both, shall be maintained in a manner that readily identifies transactions under this section and the receipt and disbursement of funds in connection with these transactions.

(4) If required by paragraph (3) of subdivision (j), the review by the independent certified public accountant shall include a sample of transactions as reflected in the records of the trust account required pursuant to paragraph (1) of subdivision (j), and the bank statements and supporting documents. These documents shall be reviewed for compliance with this section with respect to the handling and distribution of funds. The sample shall be selected at random by the accountant from all these transactions and shall consist of the following: (A) three sales made or 5 percent of the sales made pursuant to this section during the period for which the examination is conducted, whichever is greater, and (B) 10 payments processed or 2 percent of payments processed under this exemption during the period for which the examination is conducted, whichever is greater. The transaction that constitutes a “sale,” for purposes of this subdivision, is the series of transactions by which a series of notes of a maker, or the interests in the note of a maker, are sold or issued to their various purchasers under this section, including all receipts and disbursements in that process of funds received from the purchasers or lenders. The transaction that constitutes a “payment,” for the purposes of this subdivision, is the receipt of a payment from the person obligated on the note, or from some other person on behalf of the person so obligated, including the broker or servicing agent, and the distribution of that payment to the persons entitled thereto. If such a payment involves an advance paid by the broker or servicing agent as the result of a dishonored check, the inspection shall identify the source of funds from which the payment was made or, in the alternative, the steps that are reasonably necessary to determine that there was not a disbursement of trust funds. The specific provisions of this section, compliance with which is to be inspected by the accountant, are the following: paragraphs (1), (2), and (3) of subdivision (i) and paragraphs (1) and (2) of subdivision (j).

(5) Within 30 days of the close of the period for which the report is made, or within any additional time as the commissioner may in writing allow in a particular case, the accountant shall forward to the broker or servicing agent, as the case may be, and to the commissioner, the report of the accountant, stating that the inspection was performed in accordance with this section, listing the sales and the payments examined, specifying the nature of the deficiencies, if any, noted by the accountant with respect to each sale or payment, together with any further information as the accountant may wish to include, such as corrective steps taken with respect to any deficiency so noted, or stating that no deficiencies were



observed. If the broker meets the threshold criteria of Section 10232, the report of the accountant shall be submitted as part of the quarterly reports required under Section 10232.25.

(j) The notes or interests shall be sold subject to a written agreement that obligates a licensed real estate broker, or a person exempted from the licensing requirement for real estate brokers under Chapter 3 (commencing with Section 10130) of Part 1 of Division 4, to act as agent for the purchasers or lenders to service the note or notes and deed of trust, including the receipt and transmission of payments and the institution of foreclosure proceedings in the event of a default. A copy of this servicing agreement shall be delivered to each purchaser. The broker shall offer to the lenders or purchasers the services of the broker or one or more affiliates of the broker, or both, as servicing agent for each transaction conducted pursuant to this section. The agreement shall require all of the following:

(1) (A) That payments received on the note or notes be immediately deposited to a trust account maintained in accordance with the provisions of law and rules for trust accounts of licensed real estate brokers contained in Section 10145 of this code and Article 15 (commencing with Section 2830) of Chapter 6 of Title 10 of the California Code of Regulations and in accordance with this section.

(B) That these payments shall not be commingled with the assets of the servicing agent or used for any transaction other than the transaction for which the funds are received.

(2) That payments received on the note or notes shall be transmitted to the purchasers or lenders pro rata according to their respective interests within 25 days after receipt thereof by the agent. If the source for the payment is not the maker of the note, the agent shall inform the purchasers or lenders of the source for payment. A broker or servicing agent who transmits to the purchaser or lenders the broker's or servicing agent's own funds to cover payments due from the borrower but unpaid as a result of a dishonored check may recover the amount of the advances from the trust fund when the past due payment is received. However, nothing contained in this section shall authorize the broker, servicing agent, or any other person to issue, or to engage in any practice constituting, any guarantee, or to engage in the practice of advancing payments on behalf of the borrower.

(3) If the broker, directly or through an affiliate, is the servicing agent for notes or interests sold pursuant to this section upon which the payments due during any period of three consecutive months in the aggregate exceed one hundred twenty-five thousand dollars (\$125,000) or the number of persons entitled to the payments exceeds 120, the trust account or accounts of that broker or affiliate shall be inspected at no less than three-month intervals during which the volume is maintained, by an independent certified public



accountant. Within 30 days after the close of the period for which the review is made, the report of the accountant shall be forwarded as provided in paragraph (5) of subdivision (i). If the broker is required to file an annual report pursuant to subdivision (n) or Section 10232.2, the quarterly report pursuant to this subdivision need not be filed for the last quarter of the year for which the annual report is made. For the purposes of this subdivision, an affiliate of a broker is any person controlled by, controlling, or under common control with the broker.

(4) Unless the servicing agent will receive notice pursuant to Section 2924b of the Civil Code, the servicing agent shall file a request for notice of default upon any prior encumbrances and promptly notify the purchasers or lenders of any default on the prior encumbrances or on the note or notes subject to the servicing agreement.

(5) The servicing agent shall promptly forward copies of the following to each purchaser or lender:

(A) Any notice of trustee sale filed on behalf of the purchasers or lenders.

(B) Any request for reconveyance of the deed of trust received on behalf of the purchasers or lenders.

(k) The broker shall disclose in writing to each purchaser or lender the material facts concerning the transaction on a disclosure form adopted or approved by the commissioner pursuant to Section 10232.5, subject to the following:

(1) The disclosure form shall include a description of the terms upon which the note and deed of trust are being sold, including the terms of the undivided interests being offered therein, including the following:

(A) In the case of the sale of an existing note:

(i) The aggregate sale price of the note.

(ii) The percent of the premium over or discount from the principal balance plus accrued but unpaid interest.

(iii) The effective rate of return to the purchasers if the note is paid according to its terms.

(iv) The name and address of the escrowholder for the transaction.

(v) A description of, and the estimated amount of, each cost payable by the seller in connection with the sale and a description of, and the estimated amount of, each cost payable by the purchasers in connection with the sale.

(B) In the case of the origination of a note:

(i) The name and address of the escrowholder for the transaction.

(ii) The anticipated closing date.

(iii) A description of, and the estimated amount of, each cost payable by the borrower in connection with the loan and a description of, and the estimated amount of, each cost payable by the lenders in connection with the loan.



(2) A copy of the written statement or information contained therein, as required under paragraph (2) of subdivision (g) shall be included in the disclosure form.

(3) Any interest of the broker or affiliate in the transaction as described in subdivision (d) shall be included with the disclosure form.

(4) When the particular circumstances of a transaction make information not specified in the disclosure form material, or essential to make the information provided in the form not misleading, and the other information is known to the broker, the other information shall also be provided by the broker.

(l) The broker or servicing agent shall furnish any purchaser of a note or interest, upon request, with the names and addresses of the purchasers of the other notes or interests in the loan.

(m) No agreement in connection with a transaction covered by this section shall grant to the real estate broker, the servicing agent, or any affiliate of the broker or agent the option or election to acquire the interests of the purchasers or lenders or to acquire the real property securing the interests. This subdivision shall not prohibit the broker or affiliate from acquiring the interests with the consent of the purchasers or lenders whose interests are being purchased, or the property with the consent of the purchasers or lenders, if the consent is given at the time of the acquisition.

(n) Each broker who conducts transactions under this section and meets the criteria of paragraph (3) of subdivision (j) shall file with the commissioner an annual report of a review of its trust account. The report shall be prepared and filed in accordance with subdivision (a) of Section 10232.2 and the rules and procedures thereunder of the commissioner. That report shall cover the broker's transactions under this section and if the broker also meets the threshold criteria set forth in Section 10232, the broker's transactions subject to that section shall be included as well.

(o) Each broker conducting transactions pursuant to this section and who meets the criteria of paragraph (3) of subdivision (j) shall file with the commissioner a report of the transactions which is prepared in accordance with subdivision (c) of Section 10232.2. If the broker also meets the threshold criteria of Section 10232, the report shall include the transactions subject to that section as well. This report shall be confidential pursuant to subdivision (f) of Section 10232.2.

(p) The jurisdiction of the Commissioner of Corporations under the Corporate Securities Law of 1968 shall be neither limited nor expanded by the provisions of the section. Nothing in this section shall be construed to supersede or restrict the application of the Corporate Securities Law of 1968. A transaction under this section shall not be construed to be a transaction involving the issuance of



securities subject to authorization by the Real Estate Commissioner under subdivision (e) of Section 25100 of the Corporations Code.

(q) Nothing in this section shall be construed to change the agency relationships between the parties where they exist or to limit in any manner the fiduciary duty of brokers to borrowers, lenders, and purchasers of notes or interests, in transactions subject to this section.

SEC. 2. Section 25102.5 is added to the Corporations Code, to read:

25102.5. There shall be exempted from Section 25110 a transaction that is the sale of a series of notes secured directly by an interest in the same real property, or the sale of undivided interests in a note secured directly by real property equivalent to a series transaction, that complies with all of the provisions of Section 10229 of the Business and Professions Code. For purposes of this section, a real estate broker licensed by the Real Estate Commissioner of this state who engages in the offer and sale of notes secured directly by real property of various makers, which are a series of notes or notes in which undivided interests are offered and sold, shall be deemed to be the issuer of these notes and undivided interests if the notes of the various makers are offered and sold pursuant to a plan or arrangement that is common to the various makers with respect to documentation and loan standards and that include provisions for servicing these notes on behalf of purchasers.

SEC. 3. It is the intent of the Legislature to maintain or enhance the standards of consumer protection contained in Section 10229 of the Business and Professions Code as added by this act. In addition, it is the intent of the Legislature to streamline administrative functions by vesting in the Department of Real Estate the responsibility under the Real Estate Law for reporting by, and auditing of, real estate brokers acting pursuant to Section 10229 of the Business and Professions Code as added by this act.

SEC. 4. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.

Notwithstanding Section 17580 of the Government Code, unless otherwise specified, the provisions of this act shall become operative on the same date that the act takes effect pursuant to the California Constitution.

