

Date of Hearing: June 22, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Matthew Dababneh, Chair
SB 647 (Morrell) – As Amended April 7, 2015

SENATE VOTE: 36-0

SUBJECT: Real estate investments: securities: qualification exemption.

SUMMARY: Modifies the provisions of the Real Estate Law that governs the activities of threshold brokers, and deletes a requirement that certain persons engaged in the offer or sale of real-estate securities submit information regarding their activities to the Department of Business Oversight (DBO). Specifically, **this bill:**

- 1) Adds a category of property (land that produces income from crops, timber, or minerals) and a maximum loan-to-value (LTV) ratio (60%) to the list of property types and maximum LTV ratios for which real estate licensees are authorized to solicit investors.
- 2) Clarifies the requirement for threshold brokers to obtain a completed investor questionnaire from persons to whom they offer or sell notes and deeds of trust by specifying that the investor questionnaire must be obtained at least two business days and not more than one year prior to completing each sale. Further clarifies that, after obtaining an initial questionnaire, any subsequent questionnaire from the same person need only reflect any material changes from the immediately preceding questionnaire.
- 3) Deletes the requirement that threshold brokers obtain updated annual questionnaires from persons to whom notes and deeds of trust are offered or on whose behalf they are serviced.
- 4) Deletes the requirement that persons who are engaged in the business of purchasing, selling, financing, or brokering real estate, who rely upon a securities law exemption authorized by Corporations Code Section 25100(p), submit information about their offering to the DBO.

EXISTING LAW:

- 1) Establishes a category of real estate broker known as a threshold broker. Generally speaking, threshold brokers are real estate brokers who make, broker, and/or service mortgage loans on behalf of private individuals and small pension plans. More specifically, threshold brokers are brokers who intend or reasonably expect to do any of the following in any consecutive 12-month period:
 - a) Negotiate a combination of 10 or more real property loans or business opportunities, or sales contracts or promissory notes secured by real property loans or business opportunities, in an aggregate amount of \$1 million or more. The real estate licensee can either act on behalf of another party (i.e., act as a broker), or can be the owner of the property or the sales contracts or notes (i.e., act as a lender).
 - b) Collect payments of at least \$250,000, in the aggregate, on behalf of themselves, or on behalf of lenders, or owners of promissory notes secured by real property (i.e., act as a servicer).

If the lender or purchaser is an institutional lender, loans or sales negotiated by a broker, or for which a broker collects payments or provides other servicing for the owner of the note or contract, are not counted toward the threshold broker criteria. Institutional lenders include federal housing entities and government-sponsored enterprises (e.g., Fannie Mae, Freddie Mac, the Federal Housing Administration, and the Veterans Administration), depository institutions regulated by either the state or federal government, pensions and other profit-sharing funds with a net worth of at least \$15 million, corporations registered with the Securities and Exchange Commission (SEC), the California Housing Finance Agency, a person licensed by the DBO as a residential mortgage lender or servicer, or an institutional investor that issues mortgage-backed securities in accordance with a specified section of the California Financial Code. (Business and Professions Code, Section 10232)

- 2) Prescribes six different types of property, and maximum LTVs that correspond to each type of property, for which threshold brokers are authorized to solicit the backing of investors. These property types and maximum LTVs include owner-occupied single-family residences (80%); non-owner occupied single family residences (75%), commercial and income-producing properties (65%); single-family residentially zoned lot or parcel with specified improvements (65%); land that has been zoned for, and, if required, approved for subdivision as commercial or residential development (50%); and other real property (35%). (Business and Professions Code, Sections 10232.3 and 10238)
- 3) Requires threshold brokers to obtain a completed investor questionnaire from each person to whom notes and deeds of trust or interests therein are offered or sold, and, on an annual basis, obtain an updated investor questionnaire from each person to whom notes and deeds of trust or interests therein are offered or sold, or on whose behalf they are serviced. (Business and Professions Code, Section 10232.45)
- 4) Requires persons who are engaged in the business of purchasing, selling, financing, or brokering real estate, who rely upon a securities law exemption authorized by Corporations Code Section 25102(e), 25102(f), 25102(h), 25102(n), or 25100(p) for offerings that involve the offer or sale of securities to non-accredited investors, in transactions that are not registered by the SEC, submit information to DBO about those offerings. This information includes the names of the issuer's principals, the offering disclosure documents provided to prospective purchasers, a list of all state and federal licenses required to further the purposes of the investment, and the names of all licensed persons that will undertake the activities. (Corporations Code, Section 25102.2)

FISCAL EFFECT: Unknown.

COMMENTS:

Background:

According to the Bureau of Real Estate (BRE), there were 317 threshold brokers operating in California during 2013 (the most recent year for which data are available). These brokers made, arranged, and serviced over \$12.4 billion in loans.

Because they handle large amounts of money on a regular basis, threshold brokers are subject to special reporting and disclosure requirements not imposed on other real estate licensees. Furthermore, because the people who invest in loans brokered by threshold brokers are generally less sophisticated than large institutional investors, the law imposes certain restrictions on loans that may be funded with private money. It is these disclosure requirements and these loan restrictions that this bill proposes to modify.

AB 647 applies to a special category of real estate brokers known as threshold brokers. As discussed above, threshold brokers can generally be thought of as those who make, broker, and/or service mortgage loans on behalf of private individuals and small pension plans.

The following are a few examples of activities in which threshold brokers can engage:

- The broker can receive money from an individual investor or a small pension plan, and can lend that money on behalf of the small investor or pension plan to an individual or a business owner seeking to purchase or refinance real property. In this instance, the threshold broker is acting as a broker.
- The broker can arrange a loan made by an individual investor or a small pension plan directly to an individual or business owner seeking to purchase or refinance real property. In this instance, the threshold broker is acting as a broker.
- The broker can fund a loan from a line of credit obtained from a depository institution, mortgage bank, or insurance company, or from personal funds, and then sell all or part interest in that loan to a private investor or investors. In this instance, the threshold broker is acting as a lender.
- The broker can service any of the types of loans described immediately above (i.e., collect monthly mortgage payments from the borrower, and transmit them to the investor/pension plan). In this instance, the broker is acting as a servicer.

Need for the bill:

AB 647 makes three substantive changes:

- 1) Creates a new category of property and maximum LTV to the list of property types and LTVs for which threshold brokers are authorized to solicit investors: The six property types and LTVs in existing law have not been updated in decades. The author is seeking to add an additional category (land that produces income from crops, timber, or minerals) and corresponding LTV (60%) to better distinguish this type of property. Under existing law, it is unclear whether this type of property should be treated as “commercial and income-producing property” with a maximum LTV of 65% or as “other real property” with a maximum LTV of 35%.
- 2) Revises the rules for obtaining investor questionnaires from private money investors: SB 978 (Vargas & Price, Statutes of 2012) required threshold brokers to obtain initial investor questionnaires from persons to whom they offered or sold investments, and to obtain updated questionnaires on an annual basis from those to whom they offered or sold investments, or on whose behalf they serviced investments. SB 647 deletes the requirement that updated annual

questionnaires be obtained from those who are solicited to purchase investments, but do not purchase them, and from those on whose behalf investments are serviced. These changes are intended to focus the requirement to obtain updated annual questionnaires on only those investors who purchase new investments. SB 647 also clarifies the timing with which the initial and annual updated questionnaires must be obtained by requiring them to be obtained at least two business days and not more than one year prior to completing each sale.

- 3) Deletes the requirement that persons who are engaged in the business of purchasing, selling, financing, or brokering real estate, who rely upon a securities law exemption authorized by Corporations Code Section 25100(p), submit information about their offering to DBO: Section 25100(p) provides a securities exemption to real estate licensees who sell whole (i.e., unfractionalized) notes, where a single investor is backing the loan. Because these transactions are already heavily regulated under Article 5 of the Real Estate Law, the author is seeking to delete the requirement that real estate licensees utilizing this exemption additionally report to DBO regarding their activities.

Previous Legislation:

SB 978 (Vargas & Price, Chapter 669, Statutes of 2012) enacted several changes to the Real Estate Law and Corporations Code, by increasing real estate investor protections, and requiring the Department of Corporations (DOC) to focus greater regulatory scrutiny on, and provide greater transparency regarding, the activities of those who solicit investors in connection with real estate investments.

Recommended Amendments:

- 1) On page 7, line 22, delete "95818" and insert "95815"
- 2) On page 12, line 17 after income-producing properties, insert, "not described in (B) or (E)"
- 3) On page 12, line 18 & 19, delete "not described in (B) or (E)"

REGISTERED SUPPORT / OPPOSITION:

Support

California Mortgage Association

Opposition

None on file.

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