

Date of Hearing: April 19, 2010

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Mike Eng, Chair

AB 2288 (Blakeslee) – As Amended: April 6, 2010

SUBJECT: Issuers of securities: real estate brokers: hard money lending.

SUMMARY: Implements specific criteria for issuers involved in hard money lending. Specifically, this bill:

- 1) Requires an issuer engaging in hard money lending to satisfy the following:
 - a) Maintain records for three years of copies of all listings, deposit receipts, canceled checks, trust records, and other documents executed by him or her or obtained by him or her in connection with any transactions as required.
 - b) Establish a contractual agreement with person whom the issuer sells a limited or general partnership, limited liability company, limited liability partnership trust, joint venture, unincorporated association, or similar organization formed and operated for the primary purpose of investing in mortgage loans.
 - i) Contract must be signed by both parties and include a plan for the use of the invested moneys.
 - c) Maintain a surety bond with specific criteria including:
 - i) Bond shall be in an amount no less than 10 percent of the amount of the total pooled investment.
 - ii) An issuer shall not make new investments unless the total value of the pooled investment is covered by a bond meeting the requirements.
 - iii) The issuer shall provide the Department of Corporations (DOC) with evidence on an annual basis indicating that requirements have been met.
 - iv) The original surety bond shall be filed with the DOC within 10 days of its execution.
- 2) Defines "hard money lending" as the offering or selling of a limited or general partnership, limited liability company, limited liability partnership trust, joint venture, unincorporated association, or similar organization formed and operated for the primary purpose of investing in mortgage loan, commercial property loans, and construction loans.
- 3) Requires a real estate broker to provide information to the person whom the real estate broker arranges a transaction with.

EXISTING LAW

- 1) Defines "issuer" as any person who issues or proposes to issue any security, except when specified. [Corporations Code 25010]
- 2) Requires every issuer qualifying securities for sale in this state to keep and maintain a complete set of books, records, and accounts of such sales and the disposition of the proceeds thereof, and shall thereafter, at such times as are required by the commissioner, make and file in the office of the commissioner a report, setting forth the securities sold by it under such qualification, the proceeds derived there from and the disposition thereof. [Corporations Code 25145]
- 3) Requires California Real Estate Law, Finance Lenders Law, and Residential Mortgage Lending Act into compliance with the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the SAFE Act) by requiring those engaging in mortgage loan origination activities to obtain a license from Department of Corporations after meeting specified requirements, or if a real estate licensee, obtain a license endorsement from the Department of Real Estate after meeting specified requirements. [Business & Professions Code Section]

FISCAL EFFECT: Unknown

COMMENTS:

What is hard money lending?

Most hard money comes from private individuals with a great deal of money on hand. The money used for investment purposes comes from people, not a typical lending institution.

Most hard money lenders lend solely based upon the deal or property at hand. They only lend up to a certain percentage of the fair market value of the property, that way in the event of default, the hard money lender would profit if they had to foreclose or sell. Hard money lending is common in real estate and construction characterized by short-term, high-interest loans and relaxed underwriting standards. Hard money lending is typically used by investors intending to buy a blighted property and rehabilitate it to increase its market value. Most hard money lending happens in lower-middle class neighborhoods where property values are relatively stable and blighted properties are available to purchase at significant discounts.

Typically hard money lenders will only loan you up to 70% ARV (after repaired value). This means that a hard money lender can loan you up to 70% of what the home is worth in repaired condition. So if a home is worth \$45,000 in the condition it's in and needs \$20,000 in repair work and after it is repaired the current fair market value is worth \$100,000, then typically a hard money lender can lend you up to \$70,000, which would cover the cost of the house and the repairs. Hard money lenders will often loan the investor the funds necessary to both purchase the property and to complete its rehabilitation.

Downsides to hard money lending include high interest rates. Interest rates vary from 12% - 20% annually and terms can last for 6 months to a few years. Many times these rates vary depending

on a credit score. Typically hard money lenders will charge anywhere from 2-10 points just to use their money. One point equals one percent of the mortgage amount. So charging 1 point on a \$100,000 loan would be \$1000.

Investors also use hard money when they need to purchase quickly. Typical soft money or conventional loans take 30 days or more.

NEED FOR BILL: According to the author, "The hard money lending industry has minimal regulations, lending itself to possible fraudulent behavior. In San Luis Obispo County there were a series of losses due to lack of oversight in these types of investments. People lost significant savings into the real estate market with hard money lenders who were subsequently convicted of fraud. The issuers of the investments, also called "pooled money investments," are not required to be transparent with investors about where the money goes and are not required provide progress of their investment making it difficult for investors to take precautionary steps to protect their investments. Victims have lost their life savings, have had to sell their homes, given up retirement. While there is no way to prevent fraud, AB 2288 provides sufficient protection to those who invest in pooled investments to guard against undue losses."

CONCERNS: Currently, it is unclear as to why this bill is necessary and what problems this measure is trying to address. In all known cases where investors have sued hard money lenders for fraudulent behavior, the court has found in favor of the investors and the hard money lenders have been prosecuted. It seems the law is working correctly by prosecuting those who abuse the practice of hard money lending. Hard money lenders walk away with felony convictions and 20 years if not more in jail. In addition, most commonly, real estate brokers are those involved in hard money lending. As written this bill does not specifically address or bring attention to licensed real estate brokers. Who would consider themselves as an issuer and fall under the requirements of this bill? If in fact an issuer is a real estate broker, a real estate broker already has to comply with a number of the provisions required in this bill.

In 2009, the Governor enacted legislation conforming state law to federal law under the Secure and Fair Enforcement for mortgage licensing act (SAFE Act). This bill required licensing of all mortgage loan originators, as well as, registration with the Nationwide Mortgage Licensing System and Registry (NMLSR). This bill established standards, requirements, prohibitions for mortgage loan originators operating under the real estate law, the California finance lenders law (CFL) and the Residential Mortgage Lending Act (RMLA) in order to comply with the SAFE Act (Public Law 110-289). It also prohibits any individual from engaging in the business as a mortgage loan originator without first obtaining and maintaining a loan originator's license or license endorsement and registering with the NMLSR. Due to these recent enactments, the provisions this bill changes may be unnecessary since the regulators will have more transparency and access regarding their licensees involved in lending activities. The SAFE Act requires every loan originator on residential real property to register in the national database. Considering the requirements real estate licensees will be subject to more strict guidelines making portions of bill potentially obsolete.

The surety bond required under this measure goes above and beyond typical surety bond requirements under existing law. Currently, DOC requires financial services licensees to have surety bonds - the mortgage bankers, finance lenders, payday lenders, and escrow agents but DOC does not require surety bonds for licensed broker-dealers or investment advisers. This bill

would require an issuer to have a surety bond but not a licensed broker-dealer or investment adviser? Surety bonds usually come in specified requirements ranging from \$10,000-\$100,000. As drafted an issuer would have to have a surety bond in an amount no less than 10 percent of the amount of the total pool investment.

AB 2288 amends B&P code section 10239.4 which would require real estate brokers to provide a copy of information to the person whom the real estate broker arranges the transaction. The background provided to committee did not touch upon this addition; therefore, it is unclear as to why this change is necessary and what this change would accomplish. It is also unclear as to what "information" should be included.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

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