

CHANGES TO REAL ESTATE LAW (ENFORCEMENT) MAY AFFECT YOU

The public does not expect to deal with a real estate broker (“broker”) when leasing an apartment. Who is a broker? A broker is anyone who offers to rent, rents, shows units, or negotiates leases for compensation. Who offers to rent, rents, shows units, or negotiates leases at your property? Managers, assistant managers, and leasing agents have traditionally performed some or all of these functions. Does that mean that all onsite personnel have to be licensed real estate brokers? Technically, the answer is yes. However, as discussed below, there are some exceptions to this requirement. You either have to meet one of the exceptions, or you have to have a valid Colorado real estate broker’s license if you offer to rent, show, or negotiate leases.

How can this be? Is this a new law? No, this is not a new law. The Colorado law requiring a broker’s license for the sale of real estate dates back to near the turn of the 20th century. A 1929 Colorado case refers to a 1925 law defining real estate brokers. The modern definition or a substantial equivalent has been on the books since at least 1963. The 1963 law specifically included rental or leasing activities. In short, the law has required a real estate license for leasing activities for decades. However, until recently, Colorado never enforced the law. To the surprise of everyone, the Colorado Real Estate Commission (“Commission”) declared in 2005 its intention to start enforcing the law. The Commission now takes the position that most, if not all, onsite personnel are engaging in real estate broker activity.

The law has always allowed for certain exceptions to this rule. The owner exemption is one exception. You are always allowed to sell or lease your own property without a broker’s license. This exception is much narrower than you would expect. You meet this exception if you manage your own property. If you meet the owner’s exemption, your onsite personnel are also covered by the exemption as long as further requirements are met. The onsite personnel have to be regularly salaried employees, and act as on-site managers. The owner must pay them directly. Onsite personnel cannot be paid by a management company. Further, the exemption only applies to any

onsite personnel when they perform customary duties of an onsite manager performed for his employer.

Until the recent adoption of certain rules by the Commission this year, you did not meet this exception if you owned the property, but had a separate management company manage the property, even if you owned both the ownership entity and the management company. This business model is very common in the property management industry. Owner's want to separate management functions from ownership, and limit liability. This meant that if ABC Owners owned ABC Apartments, but had ABC Management Company (also owned by owners) manage ABC Apartments, ABC Management Co. needed a broker's license.

The Commission realized that this was an absurd result and passed rules that allowed for owners to manage their own properties through separate management company entities. However, to meet the requirements of the rule, the owners of the property must also own and control the management company. This may work for some owners. However, the vast majority of property management relationships do not meet the ownership exemption for one reason or another.

A partnership is a very common relationship that frequently does not meet the owner's exemption. Financial interests partner with management interests to own and manage rental property. The management interest then manages the property for the ownership (the partnership). This typical deal structure does not meet the ownership exemption because the financial partner in ownership has no interest in the management company managing the property. To meet the ownership exemption, the ownership entity and the management entity must be under the same control as the ownership entity.

Along these same lines, even a single large company with a large national or regional portfolio may not fall within the owner's exemption. A national or regional company may not be able to claim the ownership exemption because of the way their legal entities are structured. These companies frequently have multiple legal operational entities. For example, the company's Colorado properties may be owned by X Residential of Colorado, Inc. The company may manage its Colorado properties

through X Residential of Colorado Management, Inc. If the ownership entity and the management entity are not comprised of the same persons, and more importantly controlled by the same persons, this company would not qualify under the owner's exemption, and thus would need a broker's license. Further, even if this company did meet the owner's exemption for its own portfolio, the company's ownership exemption would be lost if it fee managed a single property that it did not own.

This brings us to fee management. If you engage in broker activities, you need a real estate broker's license. This means without exception, all property management companies that fee manage for third parties must have a valid Colorado real estate broker's license. This requirement has been well known, and followed for years by most fee management companies. Fee management companies have typically complied by having one person of the management firm be a licensed broker for that property management company. Thus, for fee management companies, the broker's license requirement is nothing new. What is new is the Commission's position that onsite personnel are engaging in broker activities, and thus must meet certain requirements or be licensed. For obvious reasons which are beyond the scope of this article, the property management industry would either not function at all, or would be dramatically changed if all onsite personnel were required to be licensed brokers.

Fortunately, for the property management industry, the Commission has adopted Rule C-23, and has proposed adopting a Commission Position Statement (CP-17) to address unlicensed onsite personnel that are employed by management companies required to have a broker's license. If the Commission's requirements are met, onsite personnel are not required to have a broker's license.

The Commission's requirements for onsite personnel to be exempted are numerous. The Broker must closely supervise all onsite personnel. This requirement includes having a written office policy explaining the duties, responsibilities and limitations on the use of unlicensed leasing and management persons. This policy should be reviewed by and explained to all on-site leasing and management persons, and those persons must attest that they have read and understood the property management companies office policy by signing an affidavit after their review.

Although not discussed in this article, owner's that meet the owner's exemption still must meet some of or similar requirements that brokers are required to meet to preserve the exemption. For example, rather than following the Broker's instructions, the owner's instructions must be followed.

One of the most significant changes affecting the industry is the requirement that all onsite personnel have to be either a regularly salaried employee or independent contractor. This means you may not pay leasing commissions to leasing agents or others who lease units. Discounted rent is acceptable, as well as bonuses, as long as any bonuses are not tied to the number or amount of leases executed. Bonuses can be based on the property's overall performance. This is an issue of enormous impact and significance to the property management industry because lease commissions are the nearly universally accepted compensation method. Under the rule, new compensation structures and methods will have to be adopted to replace the old commission structure in order to be in compliance with the rule

The Broker has to instruct onsite personnel not to negotiate leases. The Broker may issue written authority to onsite personnel to fill in blank lease forms (non – material terms), under the terms of a written, binding delegation of authority from either the owner or the company. Onsite personnel may collect security deposits and rents in conformance with the company's written office policy. Onsite personnel may not distribute information on units available for lease other than information that has been prepared or approved by the Broker. You may distribute preprinted, objective information previously approved by the Broker at an on-site leasing office, so long as no negotiating, offering or contracting is involved.

Onsite personnel may perform clerical duties for the Broker including the gathering of information about competing communities. Onsite personnel may obtain personal and employment information, including credit information, from a prospective tenant for the purpose of qualifying the tenant for a lease or rental agreement. Onsite personnel may deliver paperwork to the Broker and deliver paperwork to landlords or tenants, if such paperwork has already been reviewed by the Broker or has been prepared in accordance with the Broker's instructions.

Mandatory disclosures are a significant change to the leasing process required by the Commission. If you fee manage and thus are required to have a broker at your company, you must disclose in writing to all prospective tenants your brokerage relationships. Generally, this means disclosing to the prospective tenant that you are a broker for the owner (you work for the owner), and that the tenant is a customer. You don't have to disclose to all prospects, rather only to any prospects when small talk turns into serious discussion of terms. Any prospective resident that is serious enough to complete a guest card should receive disclosures. You should definitely provide disclosures to any prospect that completes an application if disclosures have not been made prior to that time. The Commission has not approved a standard disclosure form, but likely will in the near future. When approved, the approved disclosure form will be available on the Commission's website. The Commission's rules and positions statements already adopted can be found at <http://www.dora.state.co.us/real-estate/manual/manual.htm>.

This article is meant to make you aware of this legal issue and provide general information. Due to the complex nature of this topic and space limitations, this article does not address all legal requirements for any given client to be in compliance with the Colorado real estate law in general, or the Colorado Real Estate Commission's rules in particular. The article should not be relied upon in determining if your company either needs a license or is in compliance with current law. Compliance can only be determined by specific legal advice based on particular factual circumstances. If you need such advice, please do not hesitate to contact us. The firm will be adding this subject to its roster of educational class offerings in the near future. Look for an announcement either in future newsletters, or on our website.