

AUDITS AND NEW RULES EARLY RESOLUTIONS

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If you are reading this and you are involved in managing rental properties, you understand that your role is to help people solve problems on a daily basis. Those problems are not always clear at the beginning of the day, and the only thing you can guarantee is being prepared to deal with the unexpected challenges. Part of the Firm's mission is to help prepare those in the industry for the different challenges that they are likely to face and to provide guidance for navigating the changing environment of property management.

Licensed parties and companies can be audited at any time, pursuant to the Real Estate Broker rules. The Department of Regulatory Agencies ("DORA") conducts audits of licensed parties on behalf of the Real Estate Commission. These audits can occur to brokers and companies engaged in third party management and who are licensed by the state. If you are only managing your own properties and are unlicensed, DORA will not be auditing you. DORA has increased their focus on audits in general, and has increased their focus on auditing property management companies. These audits can be triggered as a result of anyone making a complaint against a company or broker directly. Complaints can be a result of a disgruntled owner, tenant, or former employee. Additionally, audits may be performed randomly. Financial audits by DORA can also be requested by brokers, if you really want to make sure that your books are in order.

Audits are conducted by investigators who are employed by DORA and their goal is to review what you are doing and whether or not that it complies with their interpretation of the rules and laws that apply to licensed parties. One of the most common ways that brokers commit a violation of the law is by not including a disclosure on their forms that indicates that an attorney had prepared the forms. This requirement is part of C.R.S. § 12-10-403(4) adopted in 2017, and is further explained in our newsletter from August 2017. It is important to remember, simply saying that the form was downloaded from an attorney's website DOES NOT comply with the rules. There needs to be a specific statement on the form being used that the form is not a Real Estate Commission approved form and that it was prepared by a law firm for the broker's use.

Another common concern, when it comes to audits, is making sure that fees are appropriately disclosed. Brokers are required to disclose markups to their clients, and they are required to disclose if there is an affiliated business that they are using that may also receive a financial benefit from the client.

As if audits alone were not enough to be concerned about, going into effect January 2020 are the new real estate broker rules. The new rules can be found at: tinyurl.com/CRECRules2019

In many cases, the changes are meant to clean up the language of the existing rules in order to improve readability and make the rules easier to understand, including the modification from a lettering format to a number format. However, there are some places in the Commission's Rules where rules have been repealed and/ or combined which could result in a change in the

interpretation of the rules. DORA has provided a convenient summary of these rule changes, which can be found here: tinyurl.com/CRECRuleSummary

Brokers engaged in property management should pay particular attention to the following rules that directly impact operations.

There is now a new rule regarding 5.1, which requires checks and balances to be in place to protect “other people’s money”

Rule 5.5, provides a new change for Brokers that only manage a few properties. Under the old rules, Brokers that only managed six or fewer properties were exempt from having a separate trust account. Now, if you manage even one property, you must have a separate trust or escrow account.

Rule 5.8, now adds the new requirement of a 30-day notification from when a management agreement is executed that the new broker holding the deposit must notify the tenant that they are holding the deposit. Previously, it was just a requirement of the broker transferring the deposit to provide notice.

Rule 6.3, addresses employing brokers’ responsibility for reasonable supervision. It modifies part of the Employing Broker’s responsibility for reasonable supervision standard from a requirement to “review all executed contracts and transaction files” to now “ensuring all executed contracts and transaction files are reviewed.” This modification appears to be a more reasonable requirement and should be easier for brokers to comply with the rule.

As a reminder there is still a specific rule for supervising unlicensed on-site managers. The restated rule can be found under 6.3.

Rule 6.3 - Supervision of Unlicensed On-Site Manager Employing Brokers must:

1. Actively and diligently supervise all activities of any Unlicensed On-Site Manager or delegate supervisory authority as set forth in subsection F. of this Rule;
2. Require the Unlicensed On-Site Manager to report directly to either the Employing Broker or a Supervisory Broker;
3. Require the Unlicensed On-Site Manager to account for and remit all monies, including rents and security deposits, collected on behalf of the Employing Broker or owner to the Employing Broker or Supervisory Broker;
4. Ensure that property maintenance scheduled by the Unlicensed On-Site Manager is performed in accordance with the Property Management Agreement; and
5. Instruct the Unlicensed On-Site Manager not to negotiate any of the material terms of a lease or rental agreement with a Consumer.

Most clients have multiple layers of procedures and reporting requirements to supervise on-site managers, and for good reasons. The law requires that oversight, and managers are on the front line of protecting the owner's asset and interacting with tenants.

With new rules and audits out there, the best thing for property managers to do is to review the new rules, and do a self-audit of your own documents. If things have been changed without attorney approval, set up a time with your attorney to review those documents. Take a look at the changes to the existing rules, and see if there are any surprises. While we all operate in a busy industry, it is important to take a moment and self-assess to ensure that you are taking the appropriate precautions to maintain compliance with the law and the rules, so that you can continue to safely navigate the challenging environment of property management.