

Risk Management for Real Estate Professionals

**CONTINUING EDUCATION COURSE
(BY CORRESPONDENCE)
FOR CALIFORNIA REAL ESTATE LICENSE RENEWAL**

**(3 Hours Credit)
Risk Management Requirement**

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To Comply with this Requirement, YOU MUST COMPLETE the Section Quizzes offered at the end of each Course Section before you can take the Course Final Exam.

There are 3 Quiz Sections to be completed for this course, Risk Management for Real Estate Professionals, as follow:

- **Quiz Section #1 is to be taken after reading pages 1 through 10**
- **Quiz Section #2 is to be taken after reading pages 13 through 28**
- **Quiz Section #3 is to be taken after reading pages 31 through 39**

Risk Management for Real Estate Professionals

TABLE OF CONTENTS

CHAPTER 1	1
INTRODUCTION TO RISK AND RISK MANAGEMENT	1
THE CONCEPT OF RISK.....	1
UNCERTAINTY	1
SOURCES OF RISK	2
SOURCES OF RISK FOR REAL ESTATE PROFESSIONALS	2
RISK MANAGEMENT	4
REASONS FOR MANAGING RISK	4
APPROACHES TO MANAGING RISK	5
RISK AVOIDANCE	5
RISK IDENTIFICATION	6
RISK ASSESSMENT	6
RISK REDUCTION	7
RISK TRANSFERENCE	8
RISK RETENTION	8
RISK MONITORING	9
RISK MANAGEMENT FOR REAL ESTATE PROFESSIONALS	9
ECONOMIC RISKS.....	9
LEGAL RISKS	9
RISK MANAGEMENT AND CONSUMERS	10
INCREASED ACCESS TO INFORMATION.....	10
 CHAPTER 2	 13
COMMON AREAS OF RISK FOR REAL ESTATE PROFESSIONALS	13
INTRODUCTION	13
CONTRACT PREPARATION	13
ESSENTIALS OF A REAL ESTATE CONTRACT.....	13
CONTRACT PROVISIONS	14
COMMON VIOLATIONS.....	14
PROPERTY CONDITIONS	15
TRUST FUND HANDLING	16
SECTION 10145 OF THE BUSINESS AND PROFESSIONS CODE — GENERAL STATUTE GOVERNING THE HANDING OF TRUSTS FUNDS.....	16

COMMISSIONER’S REGULATION 2831 — TRUST FUND RECORDS TO BE MAINTAINED	17
COMMISSIONER’S REGULATION 2831.1 — MAINTAINING SEPARATE RECORDS FOR EACH BENEFICIARY	18
COMMISSIONER’S REGULATION 2831.2 — PERFORMING MONTHLY RECONCILIATION OF TRUST FUND ACCOUNTS	18
COMMISSIONER’S REGULATION 2834 — TRUST ACCOUNT WITHDRAWALS	18
COMMISSIONER’S REGULATION 2835 — COMMINGLING	18
BROKER SUPERVISION	19
DISCLOSURE	19
AGENCY RELATIONSHIP DISCLOSURES	20
TERMINATION RIGHT	20
REAL ESTATE TRANSFER DISCLOSURE STATEMENT (TDS)	20
LOCAL OPTION DISCLOSURE STATEMENT	21
THE NATURAL HAZARD DISCLOSURE STATEMENT (NHDS)	22
MELLO-ROOS BONDS AND TAXES	22
PROPERTY TAXES	22
DISCLOSURE OF ORDNANCE LOCATION	23
METHAMPHETAMINE CONTAMINATION	23
SMOKE DETECTOR STATEMENT OF COMPLIANCE	23
LEAD-BASED PAINT DISCLOSURES	24
ENERGY CONSERVATION RETROFIT AND THERMAL INSULATION DISCLOSURES	24
FOREIGN INVESTMENT IN REAL PROPERTY TAX ACT	24
CERTIFICATION REGARDING WATER HEATER’S SECURITY AGAINST EARTHQUAKE ..	25
DATA BASE – LOCATIONS OF REGISTERED SEX OFFENDERS	25
RESPA VIOLATIONS	25
REFERRALS TO VENDORS AND THIRD PARTIES AND CONFLICTS OF INTEREST	26
NEGLIGENT ADVICE	26
FRAUD	27
ACTUAL FRAUD	27
CONSTRUCTIVE FRAUD	28
MISREPRESENTATION	28

CHAPTER 3 31

LICENSEE ACTIVITIES LIKELY TO CONTRIBUTE TO RISK 31

AGENCY DUTIES	31
AGENT ACTING FOR HIS OR HER OWN ACCOUNT	31
DUAL AGENCY	32
DISCLOSURE	32
FAILURE TO DISCLOSE	32
OPTION TO PURCHASE	32
CONTRACT FAMILIARITY	33

LEGAL EFFECTIVENESS	33
ESSENTIAL ELEMENTS	34
TERMINATION	34
ADVERTISING	35
FAIR HOUSING.....	35
DISCRIMINATION UNDER THE BUSINESS AND PROFESSIONS CODE.....	35
DISCRIMINATION UNDER THE CIVIL CODE.....	35
EMPLOYMENT ISSUES.....	36
TRUST FUND HANDLING	37
PRIVACY ISSUES	38
ANTI-TRUST ISSUES.....	38
PREDATORY LENDING.....	39

CHAPTER 1

INTRODUCTION TO RISK AND RISK MANAGEMENT

THE CONCEPT OF RISK

Q-1 #1-R Risk is a combination of the probability of a negative event and its resulting consequences. It is a measure of harm or loss associated with an activity. If an event is expected but insignificant, it does not represent a risk since it has no meaningful effect. On the other hand, an improbable event with significant consequences may be an acceptable risk. A likely event with significant consequences represents a high risk. *#1-a Final*

Critical to our discussion of risk is the term "hazard." A hazard is anything that can cause harm, for example, chemicals, electricity, working on ladders, potholes, etc. Risk is the probability, high or low, that someone will be harmed by the hazard.

If all of the facts about a given situation could be fully recognized, understood, and accepted – including the consequences of all external influences – there would be no risk involved. However, not all of the pertinent facts of any situation can be known, and any predictions about a business or business transaction are based on conjecture and speculation.

For example, suppose a real estate investor purchases a large tract of land because of a county's plan to build a complicated set of highway interchanges nearby. He envisions a significant increase in land value based on increased demand in the area. He may sell the land at a higher price or develop it by building housing and retail business centers. However, no matter how thorough the investor's assessment of the risks involved in the transaction, there are always elements of risk lurking. County officials may postpone the highway, may construct it elsewhere, or may, based on economic factors, dispense with the plan altogether. In this as in many situations, the potential rewards from speculation are great, but so is the risk.

The concept of risk exists in all business activities and transactions. We all continuously manage risk. In fact, both formal and informal approaches to managing risk have evolved to such an extent that they are now regarded as good management practice.

UNCERTAINTY

In any situation, some uncertainty exists. Greater recognition of the relevant facts will create less guesswork in estimating the risks. A complete study of the facts produces reliable predictions. Although the elimination of uncertainty

is impossible, the management of risk is an realistic objective.

Walking alone at night in a high-crime neighborhood is risky. Walking with friends or taking another course lessens the risk. After evaluating a risk, we can choose a path of risk avoidance or some form of risk management. If we understand and accept the risks of a certain enterprise, we can decide which risks are acceptable and take action to lessen or delay them. If our risk assessment establishes that a risk is particularly excessive, we may consider restructuring the enterprise within an acceptable level of risk, or we may choose to avoid the risk altogether.

Risks that do not offer the potential for gain obviously should be avoided. Risks that suggest achieving meaningful objectives should be managed. Gathering information about relevant issues in order to lessen the level of uncertainty is one way to reduce risk. Reducing the probability of failure and employing ways to diminish negative consequences are paths to risk management.

SOURCES OF RISK

Unfamiliarity with a process or inexperienced personnel constitutes risk. External influences cause risk because they can change or because their descriptions or specifications provided by others may be inaccurate or incomplete. Incomplete planning and optimistic cost or schedule goals also create risk. Anything that is not well understood, well documented, or which can bring risk to the table.

It is important to consider that what may appear to be an unacceptable risk to one person might seem as a very appealing opportunity to another.

SOURCES OF RISK FOR REAL ESTATE PROFESSIONALS

The sources of risk relevant to real estate professionals are generally those associated with economic risk, property market risk, professional liability, and public liability. It is essential that real estate professionals remain current on the types of risk affecting them and the techniques for dealing with such risk.

Economic Risk

The economic risk for real estate professionals applies primarily to brokers and the office space they occupy. Economic risk is both direct and indirect. That is, it potentially affects both the short-term cash flow events and also has a long-term impact on total enterprise value.

It is nearly impossible to predict ongoing workplace costs. The heating and air conditioning system may fail or the plumbing may leak. While lease agreements establish rent amounts, they are written for a fixed period of time. Eventually the term of the agreement is concluded, and a new agreement takes into consideration the advancing costs of

- to provide better results from projects and programs;
- to provide accurate information for decision making;
- to assist with compliance with regulatory requirements;
- to assist in clearly defining insurance needs;
- to present potential defenses and supporting evidence for future legal actions; and
- to reduce exposure to injury or loss.

APPROACHES TO MANAGING RISK

In the broadest terms, risk management is the practice of assessing risk and developing strategies to manage the risk. It is the combination of several steps which help to limit and deal with risk.

In effective risk management, the process of prioritizing the risks with the greatest severity of loss and the greatest probability of occurrence are addressed first. Risks with lower probability of occurrence and lower severity of loss are handled next. Of course, balancing risks with a high probability of occurrence but lower loss against risks with high loss but lower probability of occurrence can be difficult.

Some approaches to risk management include:

- risk avoidance;
- risk identification;
- risk assessment;
- risk reduction;
- risk transference
- risk retention; and
- risk monitoring

RISK AVOIDANCE

A risk may be avoided by not entering into the event which has a hazard or risk. Risk avoidance involves not performing the activity that carries risk.

For example, after much deliberation, a potential buyer of rental units decides not to purchase the property because of the liability issues accompanying it. Risk avoidance may be a viable method of risk management, but avoiding the risk also means surrendering the potential gain that accepting the risk may have produced. Not entering into a business or carrying out a transaction in order to avoid the risk of loss also eliminates the possibility of achieving the profits.

RISK IDENTIFICATION

Once it has been decided to accept the risk, the next step is to identify all potential risks. Remember, risks are events that, when triggered, will cause problems. This step involves identifying areas of risk and criteria used to rank or score them. It is the responsibility of brokers, office managers, supervisors all other employees and associates to recognize areas of risk.

Risk identification may begin with the source of problems or with the problem itself. Identification takes into consideration the nature of the problem, existing controls, likelihood of the event, consequences of the event, prioritizing the risk, and a study of vulnerability to factors beyond control since sources of risk may be external to the system that is the target of risk management.

The key process in risk assessment, our next step, is to evaluate all of the sources of material risks which can affect business operations. In most cases, the gradual evolution of the business presents few new sources of risk. However, in times of rapid change, new sources of risk can emerge with little warning. The primary issue here is to generate enough thought so that all reasonable and significant risks are uncovered

RISK ASSESSMENT

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Risk assessment is the overall process of risk analysis and evaluation. It is a careful examination of the things that could cause harm to people or damage to property so that these can be evaluated to determine if sufficient precautions have been taken in order to prevent harm or damage.

The most important point to consider in the risk assessment phase is whether a hazard is significant and whether it is covered by satisfactory precautions so that the risk is small. For example, electricity is dangerous and can kill, but the risk of doing so in an office environment is remote.

The general measure of risk assessment is the qualitative approach. A qualitative approach measures the likelihood and impact of identified risks. Study the chart below which measures the likelihood of a risk occurring.

Level of Importance	Likelihood	Event
1	Almost certain	Is expected to occur in most circumstances
2	Likely	Will probably occur in most circumstances
3	Possible	Might occur at some time
4	Unlikely	Could occur at some time
5	Rare	May occur only in special circumstances

Now study the following chart which shows the impact of such occurrence.

Level of Importance	Measure	Impact
1	Insignificant	A low level of economic loss, no disruption to business, no impact on community standing
2	Minor	A small economic loss, minor disruption to business, minor impact on community standing
3	Moderate	A significant economic loss, some ongoing disruption to business, moderate impact on community standing
4	Major	A major economic loss, ongoing disruption to business, major impact on community standing
5	Catastrophic	A mission critical economic loss, permanent disruption to business, devastating impact on community standing

Risk assessment is a technique to evaluate factors that may jeopardize achieving a goal. It serves to define measures to reduce the probability of occurrence. It provides the foundation for the next step, risk reduction, which identifies countermeasures to successfully treat the potential risks.

Risk assessment is the most difficult phase of the risk management process because it is prone to error. The difficulty stems from measurement of the risk itself. No two risks are exactly alike. There is no single standard of measure for quantifying impact. It may also be difficult to assign priorities to risk. This task asks the question, "Which evil is favored?" A risk with a considerable potential for loss and a low probability of occurrence must be treated differently from one with a minor potential for loss but with a high likelihood of occurrence. In theory both are of nearly equal priority. The scarcity of resources, especially time, also plays an important part in this process.

RISK REDUCTION

Risk reduction involves methods that reduce the severity or the likelihood of loss and its consequences. Risks can be reduced through strategies such as proper planning, education and training, implementation of certain operating procedures, establishing security methods, and preventive maintenance. Risk reduction measures generally include physical modification, procedural changes, or other measures that will reduce the risk to an acceptable level. Applications of appropriate techniques and management principles reduce either the likelihood of an occurrence, its severity, or both. Risk reduction is accomplished through a combination of prevention and/or mitigation and preparedness efforts, and all companies should adopt an official risk management strategy that addresses company policy and objectives.

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Examples of risk reduction are early warning systems to monitor river flooding, the construction of buildings capable of withstanding high-force hurricane winds, labeling which states the conditions under which hazardous chemicals should be disposed of, sprinklers designed to put out a fire, emergency shut down systems, the required removal of asbestos, smoke detectors, caution signs, fire escapes, automobile air bags, and seat belts.

Note that these efforts do not guarantee that a loss will not take place. They merely support mitigation once a triggering event has occurred.

Methods for reducing the likelihood or the extent of a risk may include:

- preventive maintenance;
- review of compliance programs;
- contract review;
- suitable training, education, and testing programs;
- fraud control;
- strategic and operational planning processes;
- business continuity and disaster recovery plans;
- satisfactory supervision; and
- quality management and standards.

RISK TRANSFERENCE

Through risk transference, individuals and businesses transfer their risk of loss to an insurer. All insurance contracts involve risk transference. By means of an insurance policy, risks can be transferred to another party contractually.

RISK RETENTION

Risk retention, or self-insurance, takes place when an individual or business manages risk without using insurance. If an entity engages in sufficient volume, its risk can be spread by acting on its own. For example, a large trucking firm with thousands of trucks may manage the risk of bodily injury claims by setting aside sufficient assets in a special fund. This fund will be used to pay claims, rather than to purchase insurance.

The analysis performed to determine whether risk retention is viable considers overall exposure to loss, available cash flow, predictability of loss, and relative cost. When appropriate, risk retention can save on insurance premiums, reduce exposure to insurance market volatility, and reduce moral hazard. Moral hazard refers to the tendency to change behavior because insurance is in place, for example, the temptation of an insured to pad an insurance claim once he has met his deductible.

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CHAPTER 2

COMMON AREAS OF RISK FOR REAL ESTATE PROFESSIONALS

INTRODUCTION

Real estate agents and brokers face risk daily in their business operations and in their business transactions. Some of these risks are economic, and some are legal. This chapter focuses primarily on the legal risks faced by real estate professionals and how to mitigate them. Of course, avoiding lawsuits completely is not possible. However, there are steps which can be taken to reduce these risks.

CONTRACT PREPARATION

Contract preparation is the foundation for all legal and valid real estate transactions. The Statute of Frauds requires that real estate contracts and leases of one year or more must be in writing. In order to avoid liability associated with a poorly or incorrectly prepared contract, the contract should reflect as accurately and honestly as possible the actual agreement between the parties. In some cases, errors occur in the translation from spoken agreement to written contract. Contracts for real estate transactions must be written properly if they are to be enforceable.

Agents and brokers must be careful to comply with the numerous regulatory measures incorporated within the Real Estate Law. Violations may prevent enforcement of a listing or sales contract. It should be noted that violations of law not only affect the enforceability of the contract but may also subject one who violates Real Estate Law in this manner to criminal punishment.

ESSENTIALS OF A REAL ESTATE CONTRACT

Real estate contracts are essentially like any other contract. Real estate contracts and leases of one year or more must be in writing and must be signed by the parties to the agreement in order to render them valid under the Statute of Frauds. The most common types of real contracts include:

- contracts for the sale of real property or of an interest therein;
- agreements for leasing of realty for a period longer than one year; and
- listing agreements authorizing or employing an agent or broker to buy or sell real estate for compensation or a commission.

As with contracts in general, real estate contracts must involve parties capable of contracting, mutual consent, a lawful object, and sufficient

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consideration. Rental contracts of one year or more and purchase contracts must be in writing.

In the usual real estate sales transaction, the prospective buyer states the terms and conditions under which the buyer is willing to purchase the property. These terms and conditions constitute the offer. If the owner of the property agrees to all of the terms and conditions of the offer, this constitutes acceptance which results in the creation of a contract. It makes no difference whether the offer comes from the seller or the buyer; if the negotiation finally leads to an offer from one party and unconditional acceptance from the other, a contract of sale has been effected.

CONTRACT PROVISIONS

Forms such as listing agreements, deposit receipts, exchange agreements, and other real estate contracts for the sale or exchange of real estate should contain the following provisions:

- the date of the agreement;
- the names and addresses of the parties to the contract;
- a clear and accurate description of the property;
- the consideration;
- reference to creation of new mortgages or trust deeds, if any, and the terms thereof; also the terms and conditions of existing mortgages, if any;
- any other provisions which may be required or requested by either of the parties; and
- the date and place of closing the contract.

COMMON VIOLATIONS

Some of the more frequent types of situations in real estate involving statutory contract violations are discussed below.

Contracts of Unlicensed Agents and Brokers

Under California law, agents and brokers are not permitted to enforce their contracts unless they can prove they are properly licensed by the state to act in their respective capacities.

Liquidated Damages Provisions

A contract clause which specifies a fixed amount of damages in the event of a breach is known as a "liquidated damages clause." A liquidated damages clause is presumed valid unless the party seeking to invalidate the provision proves that the provision was unreasonable

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under the circumstances at the time the contract was made.

Avoiding Responsibility

Parties to a contract may not generally avoid responsibility for their own fraud or negligence merely by so providing in a contract.

Usury

A contract calling for the payment of interest in excess of the California Constitution's limits may be usurious depending on the lending entity and the purpose of the loan. If a contract is usurious, that portion of the contract relating to the payment of interest is void.

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PROPERTY CONDITIONS

Our discussion of property conditions and potential liability applies to real estate agents and brokers as property owners and those who manage property for others.

Legal liability is the responsibility or obligation of one party to another. In the case of property ownership, this legal obligation includes the duty to compensate, in whole or in part, anyone harmed by the owner's acts or omissions. Property owners are most often held liable on simple negligence grounds for injuries resulting from potentially hazardous conditions or defects in the premises. The liability is quite obvious if the owner is aware of such conditions, but liability also applies if the owner is unaware but the conditions or defects could have been discovered by a reasonable inspection of the premises. Property owners have a duty to warn users of the property of any unsafe conditions not obvious to reasonable persons.

Property owners and property managers must take steps to reduce their risk of liability. Examples of such liability include an injured woman who claims that her sprained ankle was due to failure to maintain the premises in a reasonable and safe condition, a delivery person who slips and suffers a head injury when making a delivery on wet steps after a hard rain, and a child who falls from playground equipment and breaks his arm.

The question of liability rests on the degree of care owed by the property owner to the injured party. The degree of care required varies depending on whether the injured person is a trespasser or is an invitee. Those entering onto property for no benefit to the owner and without permission are trespassers and are owed little duty of care by the owner. A greater degree care is owed to those who enter the premises with the owner's knowledge or permission. Special care is owed to children and others who cannot easily recognize dangerous situations. An effective risk assessment program will include a careful consideration of these issues along with appropriate loss control measures to avoid harm.

Of course, this type of liability can be protected against with sufficient insurance to cover claims of bodily injury, personal injury, and property damage which might arise

in connection with the property. In order to adequately protect themselves against potentially large financial losses, many insureds increase their limits of liability for an additional premium or purchase personal umbrella liability insurance. Umbrella coverage protects above the basic liability coverage afforded by the underlying policy. Personal umbrella policies are typically written with limits of liability ranging from \$1 to \$5 million with self-insured retentions that range from \$500 to \$10,000.

TRUST FUND HANDLING

An earnest money deposit by a prospective purchaser of real property is termed "trust funds." The deposit must be handled by the broker as prescribed by the Real Estate Law and the Regulations of the Real Estate Commissioner. The Commissioner's Regulations spell out the procedures to be followed by the broker who elects to place the earnest money deposit into a trust fund account.

The regulations provide that the earnest money deposit must be maintained in the trust fund account for the benefit of the offeror until there has been an acceptance of the offer. During the time between receipt of the check by the broker and acceptance of the purchase offer by the seller, the broker must record receipt of the check on broker's trust fund records and hold the check in a safe place. Following these procedures will help to reduce the risks associated with handling others' funds.

Q-2
#4-b Brokers who handle trust monies on behalf of others may not convert the monies to their own use, and they must have or develop the expertise to maintain proper accounting records. To avoid liability problems in this area, all real estate brokers should be familiar with the following laws and regulations that govern the handling of trust funds:

- Section 10145 of the Business and Professions Code — General statute governing the handing of trusts funds
- Commissioner's Regulation 2831 — Trust fund records to be maintained
- Commissioner's Regulation 2831.1 — Maintaining separate records for each beneficiary
- Commissioner's Regulation 2831.2 — Performing monthly reconciliation of trust fund accounts
- Commissioner's Regulation 2834 — Trust Account Withdrawals
- Commissioner's Regulation 2835 — Commingling

SECTION 10145 OF THE BUSINESS AND PROFESSIONS CODE — GENERAL STATUTE GOVERNING THE HANDING OF TRUSTS FUNDS

Section 10145 of California's Business and Professions Code provides that the broker who receives trust funds must place the funds into a trust fund account in a bank or other recognized depository if the broker does not place the funds into a neutral escrow or into the hands of the broker's principal.

A trust fund bank account normally may not be interest bearing. A broker may, however, at the request of the owner of trust funds or the principal deposit the funds into an interest bearing account if all of the following requirements are met:

- the account is in the name of the broker as trustee for a specified beneficiary or specified principal of a transaction or series of transactions;
- all of the funds in the account are covered by insurance provided by an agency of the federal government;
- the funds in the account are kept separate, distinct, and apart from funds belonging to the broker or to any other person for whom the broker holds funds in trust;
- the broker discloses the following information to the person from whom the trust funds are received and to any beneficiary whose identity is known to the broker at the time of establishing the account:
 1. the nature of the account;
 2. how the interest will be calculated and paid under various circumstances;
 3. whether service charges will be paid to the depository and by whom; and
 4. possible notice requirements or penalties for withdrawal of funds from the account.
- No interest earned on funds in the account may directly or indirectly benefit the broker or any person licensed to the broker, even if the funds' owners would permit such an arrangement; and
- In an executory sale, lease, or loan transaction in which the broker accepts funds in trust to be applied to the purchase, lease, or loan, the parties to the contract must have specified in the contract or by collateral written agreement the person to whom interest earned on the funds is to be paid or credited.

The only other situation where a real estate broker is allowed to deposit trust funds into an interest bearing account occurs when the broker is acting as an agent for a financial institution which is the beneficiary of a loan.

COMMISSIONER'S REGULATION 2831 — TRUST FUND RECORDS TO BE MAINTAINED

Every broker must keep a record of all trust funds received, including uncashed checks held pursuant to instructions of his or her principal. This record must set forth in chronological sequence the following information in columnar form:

- date of deposit;

- amount of deposit;
- date of each related disbursement;
- check number of each related disbursement;
- amount of each related disbursement;
- if applicable, dates and amounts of interest earned and credited to the account; and
- balance after posting transactions on any date.

COMMISSIONER'S REGULATION 2831.1 — MAINTAINING SEPARATE RECORDS FOR EACH BENEFICIARY

Brokers must keep a separate record for each beneficiary or transaction, accounting for all funds which have been deposited to the broker's trust bank account and interest, if any, earned on the funds on deposit. This record must include information sufficient to identify the transaction and the parties to the transaction.

COMMISSIONER'S REGULATION 2831.2 — PERFORMING MONTHLY RECONCILIATION OF TRUST FUND ACCOUNTS

Trust fund accounts must be reconciled at least once a month, except in those months when the bank account has no activity.

COMMISSIONER'S REGULATION 2834 — TRUST ACCOUNT WITHDRAWALS

Withdrawals may be made from a trust fund account only upon the signature of the broker or one or more of the following persons if specifically authorized in writing by the broker:

- a salesperson licensed to the broker;
- anyone under a written broker-salesperson agreement; or
- an unlicensed employee of the broker with fidelity bond coverage;

Withdrawals may be made from the trust fund account of a corporate broker only upon the signature of a corporate officer or one of the persons enumerated above.

COMMISSIONER'S REGULATION 2835 — COMMINGLING

An agent who places a client's money in his or her personal bank account is guilty of commingling and risks attachment of the funds for personal claims. Except for a check to be held until acceptance, a real estate broker must, within three business days of receipt, place all funds received on behalf of principals in a trust account, neutral escrow depository, or into the hands of the principal who is entitled to them. If the broker fails to do so, the broker's license may be subject

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account, the supplemental tax bills will not be paid by your lender. It is your responsibility to pay these supplemental bills directly to the Tax Collector.

If you have any question concerning this matter, please call your local Tax Collector's Office."

(2) A title must be included in at least 14-point type or a contrasting color that reads as follows:

"Notice of Your 'Supplemental Property Tax Bill."

The disclosure notice requirements of this section may be satisfied by including the required information in the Mello-Roos disclosure.

DISCLOSURE OF ORDNANCE LOCATION

Federal and state agencies have identified certain areas once used for military training which may contain live ammunition. A seller of residential property located within one mile of such a hazard must give the buyer written notice of this. Of course, this obligation depends upon the seller having actual knowledge of the hazard.

METHAMPHETAMINE CONTAMINATION

Also effective January 1, 2006, the California Health and Safety Code requires local health officers to make an assessment of a property after receiving notification from a law enforcement agency of potential contamination or of known or suspected contamination by methamphetamine laboratory activity. If the property is determined to be contaminated, an order prohibiting its use or habitation will be issued.

Until the property owner receives a notice from a local health officer that the property identified in an order requires no further action, the property owner must notify the prospective buyer in writing of the order and provide the prospective buyer with a copy of the order. The prospective buyer must acknowledge in writing the receipt of a copy of the order.

SMOKE DETECTOR STATEMENT OF COMPLIANCE

Whenever a sale or exchange of a single family dwelling occurs, the seller must provide the buyer with a written statement representing that the property is in compliance with California law regarding smoke detectors. Some local ordinances impose more stringent smoke detector requirements than state law. Therefore, local city or county building or public safety departments should be consulted regarding smoke detector requirements.

The State Building Code mandates that all existing dwelling units have a smoke detector installed in a central location outside each sleeping area. In a two-story home with bedrooms on both floors, at least two smoke detectors would be required.

New construction, or any additions, alterations or repairs exceeding \$1,000 and for which a permit is required, must include a smoke detector installed in each bedroom and also at a point centrally located in a corridor or area outside of the bedroom(s). This standard applies for the addition of one or more bedrooms, no matter what the cost.

In new home construction, the smoke detector must be hard wired with a battery backup. In existing dwellings, the detector may be battery operated.

LEAD-BASED PAINT DISCLOSURES

Many homes in California still contain lead-based paint, which was banned for residential use in 1978. Lead-based paint can peel, chip, and deteriorate into contaminated dust and become a serious health hazard if ingested. A child's ingestion of the lead-laced chips or dust may result in learning disabilities, delayed development, and behavior disorders.

The federal Real Estate Disclosure and Notification Rule requires that owners of "residential dwellings" built before 1978 disclose to their agents and to prospective buyers or lessees/renters the presence of lead-based paint and/or lead-based paint hazards and any known information and reports about lead-based paint and lead-based paint hazards.

ENERGY CONSERVATION RETROFIT AND THERMAL INSULATION DISCLOSURES

State law prescribes minimum energy conservation standards for all new construction. Some local governments also have ordinances that impose additional energy conservation measures on new and/or existing homes. These local ordinances may impose energy retrofitting as a condition of the sale of an existing home. The seller must disclose to a prospective buyer the requirements of the various ordinances, as well as who is responsible for compliance.

FOREIGN INVESTMENT IN REAL PROPERTY TAX ACT

Federal law requires that a buyer of real property must withhold and send to the Internal Revenue Service (IRS) ten percent of the gross sales price if the seller of the real property is a "foreign person." The primary grounds for exemption from this requirement are: the seller's non-foreign affidavit and U.S. taxpayer ID number; a qualifying statement obtained through the IRS attesting to other arrangements resulting in collection of or exemption from the tax; or the sales price does not exceed \$300,000 and the buyer intends to reside on the property.

Because of the number of exemptions and other requirements relating to this law, a qualified tax advisor should be consulted for more information.

Q-2
#7-b
#11-a
Final

CERTIFICATION REGARDING WATER HEATER'S SECURITY AGAINST EARTHQUAKE

The seller of any real property containing a water heater must certify in writing to a prospective buyer that the water heater has been braced, anchored, or strapped to resist falling or horizontal movement due to earthquake motion. The minimum standard for this security is set forth in the California Plumbing Code, although standards may be more restrictively amended by local or municipal code or ordinance.

This certification can be included with the Homeowner's Guide to Earthquake Safety, in the Real Estate Purchase Contract or Receipt for Deposit, or with the Real Estate Transfer Disclosure Statement.

DATA BASE – LOCATIONS OF REGISTERED SEX OFFENDERS

California Civil Code Section 2079 requires that written leases or rental agreements entered into on or after April 1, 2006, for residential real property and contracts for the sale of residential real property of one to four dwelling units must contain, in not less than eight-point type, the following notice:

“Notice: Pursuant to Section 290.46 of the Penal Code, information about specified registered sex offenders is made available to the public via an Internet Web site maintained by the Department of Justice at www.meganslaw.ca.gov. Depending on an offender's criminal history, this information will include either the address at which the offender resides or the community of residence and ZIP Code in which he or she resides.”

RESPA VIOLATIONS

The Real Estate Settlement Procedures Act of 1974 (RESPA) is a federal law requiring the disclosure to borrowers of settlement procedures and costs by the lender's delivery to the borrower of a Special Information Booklet prescribed by the United States Department of Housing and Urban Development, along with a good faith estimate of the amount or range of closing costs. RESPA requires advance disclosure of financial information and charges in connection with real estate transactions.

RESPA is applicable to all federally related mortgage loans, including loans from financial institutions with federally insured deposits and loans which are financed by federal or federally related programs such as the VA and the FHA. Also covered are loans which are to be sold to Fannie Mae, Ginnie Mae, and Freddie Mac.

One of the stated purposes of RESPA is to eliminate kickbacks and referral fees that unnecessarily increase the costs of certain settlement services. Section 8 of RESPA prohibits anyone from giving or accepting a fee, kickback, or anything of value in exchange for referrals of settlement service business involving a federally related mortgage loan. In addition, RESPA prohibits fee splitting and receiving unearned fees for services not actually performed.

Violations of Section 8's anti-kickback, referral fees, and unearned fees provisions of RESPA are subject to criminal and civil penalties. In a criminal case, a person who violates Section 8 may be fined up to \$10,000 and imprisoned for up to one year. In a private law suit, a person who violates Section 8 may be liable to the person charged for the settlement service an amount equal to three times the amount of the charge paid for the service.

Examples of RESPA violations include:

- giving higher sales commission splits to agents who refer business to certain title companies or escrow agents;
- requiring agents to refer business to particular title companies or escrow agents in order to receive referrals of relocation business;
- allowing only those agents who refer business to particular title companies or escrow agents to be paid their commissions at settlement; and
- giving prizes and other benefits, for example, trips, sports event tickets, and agent-of-the-month ads in local newspapers, to those agents who referred business to particular title companies or escrow agents.

REFERRALS TO VENDORS AND THIRD PARTIES AND CONFLICTS OF INTEREST

Real estate agents and brokers are frequently asked by their principals, either sellers or buyers, to recommend reliable building inspectors, engineers, contractors, and repair people. In fact, much of the business of inspectors and contractors comes from referrals from real estate agents.

Obviously this represents a serious conflict of interest since agents are not compensated for their time and effort if the transaction does not close, and the findings of home inspector can sometimes determine whether the closing actually takes place. If an inspector finds a large number of serious defects in the home, the potential purchaser may choose not to buy. This may influence the agent to refer inspectors who, in exchange for the referral, are more apt to ignore the defects.

Real estate professionals should keep in mind that they are working for the benefit of their clients' best financial interests and not to serve the interests of third parties.

NEGLIGENT ADVICE

Negligence is the failure to exercise the care toward others which would reasonably be expected of a person in the circumstances or taking action which a reasonable person would not. In California, a real estate licensee who, while acting in that capacity, demonstrates negligence or incompetence is subject to discipline. The Real Estate Commissioner is empowered to

Q-2
#8-A
#12-d
Final

discipline a licensee in cases where the interests of clients or customers would be endangered by allowing the licensee to act.

Further, one who holds himself out as capable of giving expert advice or opinions is under a duty to do so and can be subject to a lawsuit for civil damages for the failure to discharge that duty. Should an agent give a careless opinion, he or she can be liable for any loss suffered by the client.

Standards of Care

Claims for negligence or other unprofessional conduct arise when agents are sued for failing to maintain accepted standards of care. This duty of care exists only where, by the nature of the relationship, the recipient does or should reasonably be expected to rely on the opinion. In fact, this criterion of a "special relationship" is the key element in imposing liability. Whether this relationship exists may depend on the circumstances under which the opinion is given. For example, advice given during an informal conversation at a cocktail party may not be held to the standard of negligence when the same or similar advice is given by a real estate agent to a seller within the context of agency.

FRAUD

Fraud is any act, expression, omission, or concealment calculated to deceive another to his or her disadvantage. California Real Estate Law, as found in the Business and Professions Code, the Regulations of the Real Estate Commissioner, and the Administrative Procedures Act, speaks to preventing fraud and misrepresentation.

The relationship between parties can make a difference in determining whether a statement or act is fraudulent. A misleading statement is more likely to be fraudulent when one party has superior knowledge in a transaction and knows that the other is relying on that knowledge than when two parties possess equal knowledge.

ACTUAL FRAUD

Actual fraud is knowingly making a false statement about a material fact with the intention to deceive. Actual fraud may also involve intentionally concealing a known material defect, for example, that a house has been flooded or that it has asbestos ceilings. The key element of actual fraud is the actual intent to deceive and thereby injure another.

Section 1572 of the Civil Code lists five acts which would be deemed actual fraud when committed by a party to a contract or with his or her connivance with intent to induce another to enter into the contract, or even simply to deceive the other party:

- the suggestion of a fact which is not true by one who does not believe it to be true;

- the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true though the person believes it to be true;
- the suppression of that which is true by one having knowledge or belief of the fact;
- a promise made without any intention of performing it; and
- any other act fitted to deceive.

CONSTRUCTIVE FRAUD

Constructive fraud is conduct that is considered fraud under the law despite the absence of intent to deceive because it has the same consequences as an actual fraud and is against public interests, for example, the violation of a public or private trust or confidence, the breach of a fiduciary duty, or the use of undue influence.

MISREPRESENTATION

Misrepresentation is a false statement of fact made by one party to another and which has the effect of inducing the second party to act. The misrepresentation must be both false and fraudulent in order to make the party making it responsible to the other for damages. An example of misrepresentation is the agent who, in order to secure a sale, tells prospective buyers that a seven-year-old roof is only one year old. An agent who tells buyers, with no basis in fact, that a large shopping complex will be built in an otherwise undeveloped area is perpetrating misrepresentation.

Note that not every misrepresentation will make a party liable for damages, for example, a mere misstatement of a fact erroneously made and without fraudulent intent.

As a general rule, an agent should not structure a transaction that he or she does not feel comfortable with. More specifically, when the slightest question of propriety or format arises, an agent should not hesitate to retain legal counsel either for himself or for the client.

delaying exercise of the option until an offer has been received in excess of the option/listing price, unless there is a full disclosure of the circumstances to the owner. This strategy would allow the agent, knowing that a higher offer exists, to exercise the option to purchase at a lower price and resell to the party willing to pay the higher price.

CONTRACT FAMILIARITY

Familiarity with real estate contracts and contract law in general is essential to managing risk. If a real estate contract is not properly drafted and executed, it may be of no use.

LEGAL EFFECTIVENESS

Contracts may be valid, unenforceable, void, or voidable. An understanding of these concepts will help real estate professionals to avoid liability in preparing contractual agreements.

Valid

A contract is valid if it is legal in all respects, binding on both parties, and enforceable if necessary by law. It must contain the five essential elements explained in the discussion that follows. A valid contract has been signed freely and voluntarily by each party. There has been no fraud, force, or duress used to induce any party to sign.

Unenforceable

A contract is unenforceable if there is no way to prove the contract in court, for example, a contract that cannot be enforced because of the passage of time and the Statute of Limitations. However, the contract may be valid between the parties if they choose to be bound by it. Oral agreements may fall into this category.

Void

A contract that is void is not a contract at all. It has no legal effect because it does not contain the essential elements. It does not have to be formally rescinded.

Voidable

A voidable contract is one that is binding, but because of some deficiency, may be rejected or voided by one or more of the parties. Legal action may or may not be required to void the contract. However, until rejected or voided, it is valid and enforceable. A contract with a minor could be voidable, as could a contract gained by fraud. A contract signed under duress or undue influence could be voidable.

Q-3
#1-A

#14-c
Final

ESSENTIAL ELEMENTS

The elements essential to a valid contract are competent parties, lawful object, mutual consent, consideration and, in the case of a real estate contract, a written agreement.

Competent Parties

Competent parties are of legal age, sane, and capable of understanding what they are signing. Both buyer and seller must be competent.

Legal age in California is 18 years or older. Generally, minors may not enter into valid contracts. However, the following are considered of legal age even if they are under 18: anyone on active duty with any branch of the U.S. Armed Forces and anyone who has been legally married, even if the marriage has been terminated.

Lawful Object

A legal contract must involve a lawful object. This means that whatever the parties to the contract are called upon to do must be within the bounds of the law.

Mutual Consent

No one can be held to a promise made involuntarily.

Consideration

Consideration is what each party will give the other under the terms of the contract. Consideration can be anything of value. It can be money, a deed, an action, a promise not to do something – whatever the parties have agreed on.

Agreement in Writing

The Statute of Frauds requires that real property sales contracts and leases of one year or more must be in writing.

TERMINATION

Generally, a contractual agreement is concluded when its terms have been carried out, although some contracts specify conditions under which the agreement will terminate.

In the event one of the parties to the agreement does not perform according to the contract terms, the contract is breached. In such a case, the court may order damages or may order specific performance on the part of the offending

- select a fixed term of employment, for example, one year or at will (employment continues until either party gives proper notice to terminate);
- set grounds for termination for cause;
- provide a confidentiality provision requiring the employee or salesperson not to disclose confidential materials and information;
- include a noncompete provision restricting the employee or salesperson from participating in a business venture that competes with the broker within in a defined geographic region and for a reasonable period of time;
- establish compensation including any fixed bonuses or commissions;
- include a provision for dispute resolution, for example, mediation or arbitration; and
- establish that the broker owns any intellectual properties such copyrightable materials, software, etc.

TRUST FUND HANDLING

In addition to the laws and regulations discussed in detail in Chapter 1 with respect to the handling of trust funds, an activity that frequently presents a dilemma for real estate professionals is the one in which the real estate transaction fails.

The provision of the law which purports to sanction the handing over of all varieties of trust funds to a principal by the broker poses some real dilemmas for brokers when the trust funds in question are in the form of deposits toward purchase. The problems for the broker are particularly troublesome in those transactions where there has been an alleged breach by the buyer of what appears to be a binding contract to purchase the real property.

Since the law apparently permits a broker to hand over an earnest money deposit to the seller as soon as there has been an acceptance of the offer to purchase unless the terms of the contract otherwise provide, can the broker who has the money in his or her trust fund account refuse to turn it over to the seller upon demand when the seller concludes that the buyer has breached the contract?

There is no legal authority that provides a clear cut answer to this question. There are those knowledgeable in the Real Estate Law in California who contend that the broker holds the earnest money deposit after an apparent acceptance of the contract as an escrow holder rather than as an agent of the seller. While the Bureau of Real Estate does not accept this proposition, it does recognize that the broker is in a very difficult position when a transaction falls apart and either or both parties make demand for the earnest money.

To avoid having to make a decision as to who is entitled to an earnest money deposit and later possibly be held liable or subject to disciplinary action for having

made the wrong choice, the broker is probably well advised to file an interpleader action and deposit the funds with the court in which the action is brought. An interpleader action is a procedure used when two parties are involved in a lawsuit over the right to collect a debt from a third party, who admits the money is owed but does not know which person to pay. The funds are deposited with the court, and the court is asked to determine the rightful owner of the funds.

PRIVACY ISSUES

Privacy is an important issue today and many, including real estate buyers and sellers, worry that their personal information may fall into the wrong hands. Real estate agents and brokers must take steps to ensure that their clients' personal financial information remains confidential.

The California Civil Code requires all businesses to take reasonable steps to destroy, or arrange for the destruction of, a customer's records within its custody or control containing personal information which is no longer to be retained by the business by shredding, erasing, or otherwise modifying the information in those records to make it unreadable or undecipherable through any means.

"Personal information" means any information that identifies, relates to, describes, or is capable of being associated with, a particular individual, including, but not limited to, his or her name, signature, Social Security number, physical characteristics or description, address, telephone number, passport number, driver's license or state identification card number, insurance policy number, education, employment, employment history, bank account number, credit card number, debit card number, or any other financial information.

Any customer injured by a violation of this law may institute a civil action to recover damages.

Also keep in mind the fiduciary nature of the agency relationship. A fiduciary is a person or institution who manages money or property for another and who must exercise a standard care imposed by law. The fiduciary relationship is highlighted by good faith, loyalty, and trust. As such, an agent is obligated to safeguard the principal's lawful confidences, and this would include not divulging personal information without the principal's consent.

ANTI-TRUST ISSUES

Anti-trust issues are those which involve unlawful trade restraints such as price fixing, boycotts, and monopolies. Anti-trust laws protect economic freedom and opportunity by promoting competition in the marketplace. Competition in a free market benefits consumers through lower prices, better quality, and greater choice. Therefore, legislation has been enacted at both the federal and state levels to ban unfair or deceptive trade practices which constrain trade.

Violations of the anti-trust laws are typically the result of bad faith or fraud or are

Q-2
#2-A
#15-d
Final

NOTICE: Keep these questions, but mark your answers on the accompanying quiz answer form and return to:
REAL ESTATE LICENSE SERVICES, 5059 NEWPORT AVENUE #209, San Diego, California 92107.

15 Hours Combined Quizzes

On, April 1, 2011 the Bureau of Real Estate began enforcement of new regulations regarding how real estate licensees must do their continuing education courses to renew their licenses. In accordance with those new regulations, the student must do mandatory quizzes prior to taking the final exam(s). Please note that your score on the mandatory quizzes will not determine in any way if you pass or fail your course. Only the final will determine if you pass or fail the course.

After you answer your quizzes, please mail your answers to us. After we receive them, you may take your final exam. If you want the answers to the quizzes, you must send a self-addressed stamped envelope. The quiz answers will not be sent to you unless you send a self-addressed stamped envelope with one ounce First-Class postage attached.

To expedite the completion of your final exams and courses, you may complete your quizzes online by logging in with your email address and password to www.RELSTONEexams.com

Risk Management

Review for Section #1

For the course Risk Management, Quiz Section #1 is to be taken after reading pages 1-10.

- 1-1
1. Risk is the probability of a negative event and its consequences.
a. True b. False
- 6-4
2. Risk avoidance is the overall process of risk analysis and evaluation.
a. True b. False
- 8-1
3. Early warning systems to monitor river flooding and the construction of buildings capable of withstanding high-force hurricane winds are examples of risk reduction.
a. True b. False
- 8-5
4. Risk retention involves managing risk through insurance.
a. True b. False

Review for Section #2

For the course Risk Management, Quiz Section #2 is to be taken after reading pages 13-28.

- 14-4
1. The Statute of Frauds requires that all real estate contracts and leases be in writing.
a. True b. False
- 14-4
2. California real estate agents cannot enforce their contracts unless they are properly licensed.
a. True b. False
- 15-2
3. If a contract is usurious, the entire contract is void.
a. True b. False

- 16-4
4. Under California law, a broker may deposit trust funds in his personal bank account.
a. True b. False

- 18-3
5. Withdrawals from a broker's trust fund may be made only upon the broker's signature.
a. True b. False

- 18-4
6. An agent who places a client's money in his or her personal bank account is guilty of commingling.
a. True b. False

- 24-4
7. The owners of all residential dwellings must report the presence of lead-based paint or lead-based paint hazards to their agents and prospective buyers and renters.
a. True b. False

- 26-b
8. Negligence is the failure to exercise the care toward others which would reasonably be expected of a person in the circumstances.
a. True b. False

- 27-5
9. Actual fraud is knowingly making a false statement about a material fact with the intention to deceive.
a. True b. False

Review for Section #3

For the course Risk Management, Quiz Section #3 is to be taken after reading pages 31-39.

- 33-3
1. A contract is valid if it is legal in all respects.
a. True b. False
- 38-b
2. Price fixing is an anti-trust activity.
a. True b. False

15 Hours Combined Exams

FINAL EXAM ANSWER FORM INSTRUCTIONS

The Final Exam Answer Form is the blue answer card marked "SCANTRON FORM 90311-RELS." Before beginning your final exam, fill in your name and student file number on the line marked "NAME" on both sides of the form. Write the date on the "DATE" line and beginning time as the "HOUR".

The Final Exam Answer Form has room for 50 questions on each side. Answer 1 thru 15 multiple-choice questions. As you answer the questions on the final exam, make sure that you mark your answers in the appropriate row for each question number.

USE A NO. 2 PENCIL ONLY. Using a pencil other than a No. 2 may cause the computer to incorrectly score your final exam. For each answer, choose the best answer and fill in the appropriate box (A-D) on the Answer Form. Fill in the box completely and dark. For example, if your answer on question 11 was "B" you would do the following:

11. [A] [C] [D]

(Final)

THIS IS AN "OPEN BOOK" EXAMINATION. THE TEXTBOOK MAY BE USED DURING THE EXAM.

Risk Management

- P.1
1. Which of the following best describes risk?
a. the probability of a negative event and its consequences
b. a hazard
c. dangerous circumstances
d. an unforeseen event
- P.6
2. Which of the following approaches to risk management involves analysis of a hazard and its evaluation to determine if sufficient precautions have been taken to prevent harm or damage?
a. risk monitoring
b. risk assessment
c. risk reduction
d. risk avoidance
- P.8
3. Which of the following is not a risk reduction technique?
a. sprinkler systems
b. smoke detectors
c. lawn mowers
d. automobile air bags
- P.8
4. Self-insurance is a form of:
a. risk restraint
b. risk reduction
c. risk retention
d. risk control
- P.13
5. The Statute of Frauds requires that which of the following lease contracts be in writing?
a. all lease contracts
b. leases with terms of one year or less
c. lease contracts entered into by licensed real estate agents and brokers
d. leases with terms of one year or more
- P.14
6. Must California real estate agents be licensed in order for their contracts to be valid?
a. no, as long as they are working for a licensed broker
b. only if the contract is for the sale of real property
c. only if the contract is for a lease of one year or more
d. yes; they must be properly licensed in order to enforce their contracts
- P.15
7. If a contract is found to be usurious:
a. the entire contract is void
b. there is no effect on the contract
c. the contract is illegal
d. that part relating to the payment of interest is void
- P.18
8. Which of the following is not acceptable for depositing trust funds?
a. with an escrow agent
b. with the principal
c. with an agent's personal funds at a bank
d. in a trust fund account at a bank

- P.18
9. All of the following may make withdrawals from a broker's trust fund account EXCEPT:
a. a salesperson licensed to the broker
b. the broker's spouse
c. anyone under a written broker-salesperson agreement
d. an unlicensed employee with fidelity bond coverage

- P.18
10. An agent who places a client's money in his or her personal bank account is guilty of:
a. co-brokering
b. commingling
c. co-ownership
d. contamination

- P.24
11. Which of the following must be disclosed to potential home buyers?
a. the presence of lead-based paint
b. the presence of latex-based paint
c. the presence of oil-based paint
d. the presence of alkyd-based paint

- P.26
12. Failure to exercise the care toward others which would reasonably be expected of a person in the circumstances is termed:
a. carelessness
b. recklessness
c. inattentiveness
d. negligence

- P.27
13. Which of the following involves knowingly making a false statement about a material fact with the intention to deceive?
a. actual fraud
b. misrepresentation
c. active fraud
d. representation

- P.33
14. A contract that is legal in all respects is termed:
a. official
b. legitimate
c. valid
d. legitimate

- P.38
15. Conspiracies in restraint of trade and monopolistic practices are termed:
a. necessary evils
b. good business practice
c. healthy competition
d. anti-trust activities