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# BROKER-OWNED PROPERTIES MANAGED BY THE BROKER

Recent audits conducted by the Division of Real Estate's audit team indicate that there may be some misunderstanding surrounding broker-owned properties managed by the brokers themselves. To draw the distinction, many brokerage firms manage properties for licensed brokers within their firms, but that is not the topic of this article. *This article is specifically pertaining to properties owned by a licensed broker and self-managed*.

This article will provide clarification and expectations surrounding five specific Commission rules: Rule 5.11, Rule 5.17, Rule 6.5, Rule 6.17, and Rule 7.1. Additionally, § 12-10-201(6)(b), C.R.S. provides exemptions to the requirement to have a real estate broker's license, and this article will specifically address the outlined exemptions and what may not apply as an exemption.

## Rule 5.11 - Money Belonging to Others for Deposit by a Broker for Non-Real Estate Brokerage Services

In June 2020, the Real Estate Commission adopted changes to Rule 5.11 to specifically address money belonging to others for non-real estate activity. For many years, §12-10-217(1)(i), C.R.S. and Rule 5.2 (formerly E-1) have required a broker to place money belonging to others in a trust or escrow account. There is no exception. If you are a broker holding money belonging to others, you need to establish a fiduciary trust account and account for the funds as required by the Commission's accounting rules. Rule 5.11 specifically outlines activities not involving real estate brokerage services, which include but are not limited to guest deposits on short term rentals; security deposits for brokers' own rental properties; and deposits from a buyer when the broker is acting as a builder. In these scenarios, a broker is either required to deposit this money into the Brokerage Firm's trust or escrow account(s) (if required by the Brokerage Firm's Office Policy Manual) or into the broker's own trust or escrow account(s). The most common example that falls under Rule 5.11 appears to be tenant security deposits for brokers' own rental properties, including any broker-owned properties held in partnership, joint ventures, syndications, or other entities. In summary, if you are a licensed broker in the state of Colorado that manages your own rental property/properties outside of your brokerage, you will likely need to open a trust or escrow account to hold any tenant security deposits that you are in receipt of.

Rule 5.11 also requires brokers to comply with additional Rules under Chapter 5: Separate Accounts and Accounting including:

- Rule 5.2. Trust or Escrow Accounts – Each fiduciary account must include the word "trust" or "escrow" and include a label identifying the purpose of the

account, such as "sales escrow", "rental escrow", "security deposit escrow", or other abbreviated form defined in the deposit agreement.

- Rule 5.9. Conversion/Diversion Prohibited – Do not convert or divert money belonging to others
- Rule 5.10. Commingling Prohibited – Do not commingle money belonging to others with your own funds
- Rule 5.21. Production of Documents and Records – You must produce any document or record reasonably necessary for investigation or audit

In addition, Rule 5.11 requires brokers holding money belonging to others for non-real estate activity to perform a monthly two-way reconciliation. A two-way reconciliation requires that a journal be maintained. A journal is a record, in chronological order, of each transaction (credits and debits) that occurs in the account. In other words, a chronological record of all money received and disbursed from the account. A two-way reconciliation does not require a ledger which is a listing of each liability in the account. In other words, the ledger is a record of whose money is being held in the account. The main difference between a two-way reconciliation and the three-way reconciliation is the requirement of the ledger. The ledger allows you to better account for whose money is being held in the account whereas the journal simply records the transactions that occurred in the account. Regardless of which reconciliation is required, brokers have found value in maintaining a monthly ledger with the trust or escrow account to help ensure that there is never an overage in the account (which could be due to commingling) or a shortage in the account (which could be due to conversion/diversion). Both scenarios could result in license law violations.

It should be noted that if a broker is solely renting their property "short-term" through the use of a third-party vendor such as Airbnb or VRBO, which handles holding and accounting for the funds and transactions, a trust or escrow account is likely not required. This is because the third party (e.g. Airbnb, VRBO, etc.) is holding the money, not the broker. An example of where a trust account would be required is if the broker occasionally rents the property directly to a guest outside of the third-party vendor they may typically use. Often brokers have a mix of short-term vs. long-term rentals, even on the same property (seasonal short-term as an example), and at any time the broker collects and holds money, Rule 5.11 applies.

In some cases, a broker's non-licensed spouse manages the rental. However, if the broker's name is on the trust account, the broker is legally holding the money belonging to another and the funds must be in a fiduciary trust account and monthly reconciliations must be done.

**Interest Bearing Trust Accounts:** Commission Position Statement 5 (CP-5) – Interest Bearing Trust or Escrow Accounts states in part:

> "The Commission has taken the position that in the absence of a specific written agreement to the contrary, any interest accumulating on a Brokerage Firm's Trust or Escrow Account does not belong to the Brokerage Firm. The position is based upon section 12-10-217(1)(h), (i) and (t), C.R.S., and Rule 5.17, which prohibits a Broker or Brokerage Firm from taking any secret or undisclosed amount of compensation, commission, or profit, and establishes the protocols for how a Broker must handle the funds of another."

Furthermore, CP-5, states in part, "If interest will accrue on Money Belonging to Others…the lease agreement must contain a similar provision addressing interest earned on the security deposit. (Note: Some cities and counties mandate a set interest rate to be earned for a tenant's security deposit.)"

Essentially, a tenant must consent to forgo interest earned on their money, even if the interest is transferred to CARHOF.

**Rule 6.5 – Brokerage Relationships Disclosures in Writing**

Rule 6.5 requires that the brokerage relationship be established in writing prior to "eliciting or discussing confidential information from a Consumer for Real Estate Brokerage Services." There is no exception for broker-owned properties. Brokers who are managing their personally owned rental properties should use the Commission-approved Brokerage Disclosure to Tenant ("BDT") form to comply with Rule 6.5. Brokers that manage their personally owned rental properties should not use a BDT with their brokerage firm's information as that could be misleading and give the impression that the brokerage firm is involved in the transaction. If an auditor discovers that a broker is managing their personally owned rental property/properties and is using their brokerage firm's BDT, the audit corrections will require, in part, that the broker discloses to their tenant in writing that the property is being managed by the broker on their own behalf and that their brokerage firm is not involved in the transaction. The BDT should be utilized prior to receiving confidential information, which in most cases is provided with an application. Therefore, a BDT provided at the time of the lease, after an application has been received, may not be sufficient to comply with Rule 6.5.

A broker managing their own property cannot represent the tenant or be a transaction broker when managing their own property (see Commission Position Statement 16 - "Acting as a Transaction Broker in Particular Types of Transactions" for guidance).

**Rule 6.17 – Duty to Disclose Conflict of Interest and License Status**

Without exception, a disclosure needs to be made in writing that the broker is both an owner of the property and a licensed broker. Often, disclosures within the lease will state that the landlord is a licensed broker, and this is not sufficient. A broker can be a landlord and not an owner, therefore, a licensed broker who is also an owner needs to disclose both the true conflict of interest (ownership) and their license status. Some brokers have added this language onto the BDT, which is sufficient and ensures timely disclosure.

Recent audits have found instances where brokers with ownership interest have not provided any disclosures to their tenants because their unlicensed spouse handles the property management. However, this does not exempt the broker's requirement and duty to disclose conflict of interest and license status. Many examples of the broker interacting with the tenants, including discussions about maintenance, billing, etc. cover why the Rule 6.17 Disclosures must be made without exception. For additional resources, please also refer to Commission Position Statement 22 - Conflict of Interest (CP-22) which provides further guidance for brokers regarding the requirement to disclose conflicts of interest and license status.

## Rule 7.1 – Standard Forms

Rule 7.1 addresses Standard Forms, including but not limited to, Commission-Approved Forms (7.1.A.). Attorney Forms (7.1.B.), and Client Forms (7.1.C.). Rule 7.1.B. Attorney Forms addresses when it is appropriate to use an Attorney Form, and states in part, "A Broker may only use an Attorney Form if a Commission-Approved Form does not exist or is not appropriate for the transaction." Additionally, Commission Position Statement 15 – Leasing and Property Management (CP-15) states in part, "There are no Commission-Approved leases or Management Agreements. These forms must be drafted by an attorney engaged by the specific Brokerage Firm as set forth in Rule 7.1.B." A licensed broker, who is also a principal, is allowed to use their own contract forms. However, the broker is still under the jurisdiction of the Real Estate Commission and must conduct their activity in conformance with the license law and Commission's regulations. Due to the complexity of the statutes that govern landlord and tenant issues, the disparity in local regulations, and the frequency in which laws and regulations in this area of practice change, brokers are encouraged to have leases for their own properties drafted by a licensed Colorado attorney.

## The Exemptions - What Is and Is Not Exempt

§ 12-10-201, C.R.S. identifies the activities that require a real estate broker license, along with a list of activities that do not require a real estate broker's license. The exemptions from licensure allow individuals and businesses to conduct certain real estate activities without having to obtain a real estate broker's license. One of the

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"exemptions" specifically listed under 12-10-201(6)(b)(VII), C.R.S. states that a license is not required for "A natural person acting personally with respect to property owned or leased by that person or a natural person who is a general partner of a partnership, a manager of a limited liability company, or an owner of twenty percent or more of such partnership or limited liability company…"

This exemption, and the others listed under 12-10-201(6)(b), C.R.S., mean that a qualifying person is not required to have a real estate license. However, persons that otherwise qualify for an exemption that holds a real estate license, are still required to follow the applicable license law. For example, a licensed broker who is a manager of an LLC or has 20% or more ownership in the property would still need to provide relevant disclosures as addressed above as well as establish a trust or escrow account and account for any money belonging to others. In other words, the exemptions **DO NOT** exempt licensed brokers from the additional level of responsibilities that come with being a licensee.

If you are a broker engaging in non-real estate brokerage services, and you're handling monies belonging to others, there are several regulations that govern your activities. If you are engaged in this type of activity, any nuances or unique circumstances will be reviewed, and corrections may be required as needed.