

amount of time from the date of recording.

14. A real estate licensee cannot advertise to give or offer to give to a prospective note purchaser or lender, any premium, gift, or any other object of value as an inducement to make or purchase a promissory note secured directly or collaterally by a lien on real property or a real property sales contract.

A real estate licensee may offer an inducement to a prospective borrower; however, any advertisement or offer must include all of the conditions required to receive the offer and no fees, costs, or expenses may be increased by the licensee in order to offset to cost of giving the inducement.

Reference: Sections 10230, 10231, 10231.1, 10231.2, 10232, 10232.2, 10232.25, 10232.4, 10232.5, 10236.4, 10236.5, 10233, 10233.1, 10233.2, 10234, 10234.5, 10235, 10236.1; Regulations 2846, 2846.5, 2846.7, 2846.8, 2849.01, 2849.1

## **SECTION 9 – Article 6 – Multi-Lender (Fractionalized) Loans**

Article 6 applies only to the exemption from securities qualification claimed under Section 25102.5 of the Corporations Code and does not apply to transactions conducted pursuant to a permit issued by the Department of Business Oversight to qualify the offer and sale of securities under the Corporate Securities Law of 1968 or to any other exemption from securities qualification which may be claimed without complying with Article 6. Transactions conducted pursuant to the exemption from securities qualification must comply with each and every provision of Article 6.

### **Does the broker arrange loans for, sell existing notes to, or service loans for private individual, non-institutional lenders or note-purchasers where there are multiple (fractional) beneficial interests?**

*Correct Procedure:*

1. The notice - A broker must submit the Multi-Lender Transaction Notice (RE 860) to the Department within 30 days of:

- the broker's first multi-lender transaction;
- any material change to the information required in the notice; or
- becoming the servicing agent for notes upon which the payments due in any consecutive three-month period exceeds \$125,000 or the number of persons entitled to payments exceeds 120.

2. Advertising - All advertising must show the name of the broker and comply with Section 10235, Regulation 2848, and Section 260.302 of Title 10 California Code of Regulations. Referencing Article 6 in any advertising may be considered misleading or deceptive if the representation may be reasonably construed as an implication of merit or approval of the transaction.

3. The security - Loans must be directly secured by real property located in California. No collateral assignments are permitted. Loans cannot be, by their terms, subject to subordination to any subsequently created deed of trust. The notes cannot be promotional notes as defined in Section 10238(d).

4. Investor suitability determination - The broker must make reasonable efforts to ensure investor suitability by making certain:

- the investor has the capacity to understand the fundamental aspects of the investment;
- the investor can bear the economic risk of the investment; and
- the investment is suitable and appropriate for the investor.

The broker must obtain from the investor at least the age, investment objective, investment experience, income net worth, financial situation, and other investments of the investor.

A broker can be deemed to have complied with the investor suitability determination requirement by:

- having the investor complete the Investor Questionnaire, RE 870, and
- using the information from the questionnaire as an aid in the broker's determination of investor suitability.

The completed questionnaire should be obtained from each investor at least two business days – and not more than one year – prior to completing each sale. After obtaining an initial questionnaire, any subsequent questionnaire from the same investor need only reflect any updates from the immediately preceding questionnaire.

5. No self-dealing - The notes or interests must be sold by or through a broker, as principal or agent. At the time the interests are originally sold or assigned, neither the broker nor any affiliate of the broker can have an interest as an owner, lessor, or developer of the securing property, or any contractual right to acquire, lease, or develop the securing property. The two exceptions to this rule are when:

- The broker or affiliate of the broker is acquiring property pursuant to a foreclosure under, or sale pursuant to, a deed of trust securing the note for which the broker is the servicing agent.
- The broker or affiliate of the broker is reselling from inventory property acquired by the broker pursuant to a foreclosure under, or sale pursuant to, a deed of trust securing a note for which the broker is the servicing agent.

6. Maximum number of investors and investor qualification statements - The notes or interests cannot be sold to more than 10 persons who meet one or both of the qualifications based on income or net worth. The person must sign a specified statement which must be retained by the broker for a period of four years.

For the purposes of counting the number of investors:

- A husband and wife and their dependents, and an individual and his dependents, are counted as one person.
- A retirement plan, trust, business trust, corporation, or other entity that is wholly-owned by an individual and the individual's spouse or the individual's dependents is not counted separately from the individual. The investments of these entities are aggregated with those of the individual for the purposes of meeting the income and/or net worth requirements.
- "Institutional investors" enumerated in Sections 25102(i) or 25104(c) are not counted.
- A partnership, limited liability company, corporation, or other organization that was not specifically formed for the purpose of purchasing the security offered pursuant to Article 6 is counted as one person.

7. Identical interests - The notes or interests must be identical in their underlying terms, including the right to direct or require foreclosure, rights to and rate of interest, and other incidents of being a lender. The sale to each purchaser must be upon the same terms, subject to adjustment for the face or principal amount or percentage interest purchased and for interest earned or accrued. There can be different selling prices for interests to the extent that the differences are reasonably related to changes in the market value of the loan occurring between the sales of the interests. The interest of each purchaser must be recorded pursuant to the requirements of Section 10234.

8. Maximum loan to value ratios, construction loans - The aggregate principal amounts of the notes or interests sold, including the balance of any senior encumbrances, are subject to maximum loan to value percentages. The percentages are based on the current market value of the property as determined by the broker or appraiser as required by Section 10232.6. This amount can be exceeded if mortgage insurance is obtained through a licensed insurer for the benefit of the holders of the notes or interests. The maximum loan to value percentages are:

- Single-family, owner-occupied - 80%
- Single-family, not owner-occupied - 75%
- Commercial and income-producing properties - 65%
- Single-family residentially zoned lot or parcel which as installed offsite improvements including drainage, curbs, gutters, sidewalks, paved roads, and utilities as required - 65%
- Land that produces income from crops, timber, or minerals - 60%
- Land that is not income producing but has been zoned for commercial or residential development - 50%
- Other real property - 35%

The percentages above can be exceeded when and to the extent that the broker determines that exceeding the percentages is reasonable and prudent considering all relevant factors pertaining to the property. However, in no event can the aggregate principal amounts of the notes or interests sold, including any senior encumbrances, exceed

80% of the current market value of improved real property or 50% of the current market value of unimproved real property, except in the case of a single-family zoned lot or parcel as described above which cannot exceed 65% of the current market value plus any insured amount as described above. The broker must keep a written statement of the material considerations and facts he relied upon in the transaction file. Either a copy of the statement or the information in the statement must be in the LPDS. A copy of the appraisal or broker's evaluation for each parcel or property securing the note must be delivered to each purchaser, and the broker must advise each purchaser of his right to receive a copy.

For construction and rehabilitation loans, the term "current market value" may be deemed to be the value of the completed project if all of the following safeguards are met:

- An independent neutral third-party escrow holder is used for all deposits and disbursements.
- The loan is fully funded, with the entire amount to be deposited in escrow prior to recording the deed of trust.
- A comprehensive, detailed draw schedule is used to ensure proper and timely disbursement to allow for completion of the project.
- The disbursement draws from the escrow account are based on verification from an independent qualified person, as defined in Section 10238(h)(4)(D), who certifies that the work completed to date meets the related codes and standards and that draws were made according to the construction contract and draw schedule.
- An appraisal is completed by a qualified and licensed appraiser in accordance with USPAP.
- In addition to the transaction documentation required pursuant to Section 10238(i), the documentation must include a detailed description of actions that may be taken in the event of a failure to complete the project, whether the failure is due to default, insufficiency of funds or other causes.
- The entire amount of the loan does not exceed \$2,500,000.
- If a note or interest is secured by more than one parcel of real property, for the purpose of determining the maximum amount of the loan, each property securing the loan must be assigned a portion of the loan that does not exceed the percentage of current market value described above.

9. Loan documentation for defaults - The documentation of a loan transaction must require that:

- a default upon any interest or note is a default upon all of the interests or notes; and
- the holders of more than 50% of the recorded beneficial interests of the notes or interests may govern the actions to be taken on behalf of all holders in accordance with Civil Code Section 2941.9 in the event of default or foreclosure for matters that require direction or approval of the holders, including designation of the broker, servicing agent, or other person acting on their behalf, and the sale, encumbrance, or lease of real property owned by the holders resulting from foreclosure or receipt of a deed in lieu of foreclosure.

The required terms may be included in the deed of trust, in the assignment of interests, or in any other documentation as is necessary or appropriate to make them binding on the parties.

10. Receipt of funds, trust accounts and CPA-prepared reports - No funds can be collected, or caused to be collected, from prospective lenders or note purchasers except as to a specific loan or note secured by a deed of trust that the broker owns, is authorized to negotiate, or is unconditionally obligated to buy.

All funds must be handled pursuant to Section 10145 for disbursement to the persons entitled to the funds upon recordation of their interests. The books and records of the broker or servicing agent, or both, must be maintained in a manner that clearly identifies transactions conducted pursuant to Article 6 and the receipt and disbursement of funds in connection with these transactions.

If a broker or affiliate of the broker is the servicing agent for notes or interests sold pursuant to Article 6 that have payments due in any consecutive three-month period which exceed \$125,000, or the number of persons entitled to the payments exceeds 120, the trust accounts of the broker must be inspected by a CPA and a Trust Account Report (Multi-Lender Transactions) (RE 852) must be submitted to the Department. The CPA will select at random a specified number of "sales" and "payments" as defined in Section 10238(j)(4) and (5) for inspection. The report must be submitted by the accountant to the broker or servicing agent and to the Department and is due to the Department within 30 days after the end of the broker's fiscal quarter (the same schedule and "threshold reports").