Trust Funds

Real estate brokers and salespersons receive trust funds in the normal course of doing business. They receive these funds on behalf of others, thereby creating a fiduciary responsibility to the funds' owners. Brokers and salespersons must handle, control and account for these trust funds according to established legal standards. While compliance with these standards may not necessarily have a direct bearing on the financial success of a real estate business, non-compliance can result in unfavorable business consequences. Improper handling of trust funds is cause for revocation or suspension of a real estate license, not to mention the possibility of being held financially liable for damages incurred by clients.

This publication discusses the legal requirements for receiving and handling trust funds in real estate transactions as set forth in the Real Estate Law and the Regulations of the Real Estate Commissioner. It describes the requisites for maintaining a trust fund bank account and the precautions a licensee should take to ensure the integrity of the account. It explains and illustrates the trust fund record keeping requirements under the Business and Professions Code and the Commissioner's Regulations.

The discussions and examples in this publication involve real property sales and property management trust account transactions. Other types of real estate activities involving trust funds, although subject to the same laws and regulations, may also have to comply with additional legal and regulatory requirements. While these other types of transactions may require records significantly different from those illustrated, the record keeping fundamentals still apply.

GENERAL INFORMATION

Trust Funds and Non-Trust Funds

Since trust funds must be handled in a special manner, a licensee must be able to distinguish trust funds from non-trust funds. Trust funds are money or other things of value that are received by a broker or salesperson on behalf of a principal or any other person, and which are held for the benefit of others in the performance of any acts for which a real estate license is required. Trust funds may be cash or non-cash items. Some examples are cash, a check used as a purchase deposit (whether made payable to the broker or to an escrow or title company), a personal note made payable to the seller, or even an automobile's "pink slip" given as a deposit.

The discussions in this publication pertain to real estate trust funds received by licensees, and not to non-trust funds such as real estate commissions, general operating funds, and rents and deposits from broker-owned real estate. These other types of funds, as long as not commingled with trust funds, are not subject to the Real Estate Law and Commissioner's Regulations. It should be noted, however, that under certain circumstances the California Department of Real Estate (DRE) does have the jurisdiction to look into transactions involving non-trust funds.

Why a Trust Account?

A trust account is set up as a means to separate trust funds from non-trust funds. Although it can certainly be argued that keeping trust funds in a trust account will not prevent a dishonest broker from misusing the funds, separating client's funds from the broker's own funds provides a better physical and accounting control over the trust funds.

An important reason for designating a trust fund depository as a trust account is the protection afforded principals' funds in situations where legal action is taken against the broker or if the broker becomes incapacitated or dies. A broker who holds and properly accounts for trust funds in a true trust account will be able to successfully prevent or defend the freezing of trust funds pending litigation against the broker or during probate.

Trust funds also have better insurance protection if deposited into a trust account. The general counsel of the FDIC, in an opinion in 1965, held that funds of various owners which are placed in a custodial deposit (trust account) in an insured bank will be recognized for insurance purposes to the same extent as if the owners' names and interests in the account are individually disclosed on the records of the bank, provided the trust account is specifically designated as custodial and the name and interest of each owner of funds in the account are disclosed on the depositor's records. Each client with funds deposited in a trust account maintained with a federally insured bank is insured by the FDIC up to $250,000, as opposed to just $250,000 for the entire account, as long as the regulatory requirements are met.

Trust Fund Handling Requirements

A typical trust fund transaction begins with the broker or salesperson receiving trust funds from a principal in connection with the purchase or lease of real property. According to Business and Professions Code Section 10145, trust funds received must be placed into the hands of the owner(s) of the funds, into a neutral escrow depository, or into a trust account maintained pursuant to Commissioner's Regulation 2832 not later than three business days following receipt of the funds by the broker or by the broker's salesperson.