



**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

A PERFORMANCE AUDIT
OF THE

REAL ESTATE DEPARTMENT

DECEMBER 1981

**A REPORT TO THE
ARIZONA STATE LEGISLATURE**



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AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

December 24, 1981

Members of the Arizona Legislature
The Honorable Bruce Babbitt, Governor
Mr. Richard B. Nicholls, Commissioner
Real Estate Department

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Real Estate Department. This report is in response to a January 30, 1980, resolution of the Joint Legislative Oversight Committee. The performance audit was conducted as a part of the Sunset review set forth in A.R.S. §§41-2351 through 41-2379.

The blue pages present a summary of the report; a response from Mr. Richard B. Nicholls, Commissioner of the Real Estate Department is found on the yellow pages preceding the appendices.

My staff and I will be pleased to discuss or clarify items in the report.

Respectfully submitted,

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Enclosure

OFFICE OF THE AUDITOR GENERAL

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REPORT 81-22

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SUMMARY

The Office of the Auditor General has conducted a performance audit of the Real Estate Department in response to a January 30, 1980, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as a part of the Sunset review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

The Real Estate Department was established on March 23, 1921, and was administered by the State Land Commissioner who served as an ex officio State Real Estate Commissioner until 1947. In 1947, the Legislature created a seven-member Real Estate Board, with a Real Estate Commissioner as chairman, to administer the Department. In 1950, the Board was given authority to appoint the Real Estate Commissioner who no longer was a member of the Board. Beginning in 1975, the Governor has appointed the Real Estate Commissioner.

Responsibilities of the Real Estate Department include:

- Licensing and regulation of real estate and cemetery brokers and salesmen.
- Regulation of the sale or lease of subdivided and unsubdivided lands.
- Regulation of cemetery sales.
- Administration of the Real Estate Recovery Fund.
- Administration of the Subdivision Recovery Fund.
- Investigation of consumer complaints regarding real estate matters.

We found the Real Estate Recovery Fund is unduly inaccessible to the public because of prior notice requirements, statute of limitations provision, no provisions for reimbursement of attorney fees and court judgment requirements. Only 45 claims totaling \$380,000 have been paid in the 17 years of the Fund's existence. As a result, the Real Estate Recovery Fund now has a balance of more than \$1 million and the interest earned on investments of the fund now exceeds the amount paid out in claims to consumers.

If the Recovery Fund were more accessible to the public it appears that the need for real estate broker bonds could be eliminated, thereby saving brokers approximately \$270,000 annually. (page 7)

We also found the process of requiring that the Real Estate Commissioner be notified of, and a public report prepared on, subdivided and unsubdivided land offered for sale or lease generally appears to be working well. However, there is a lack of preparation, or carelessness, which is resulting in inadequate site inspections. (page 17)

There is also a lack of regulation over splits and re-splits of land involving three or fewer lots. (page 17)

Our review also showed the staffing level of the Department of Real Estate investigation section can be reduced by at least three persons. Finally, because investigators cannot prove or disprove the validity of most complaints and do not make enough personal contacts with complainants during investigations, complainants are frequently dissatisfied with Department investigations. (page 25)

Consideration should be given to the following recommendations:

1. Amend A.R.S. §32-2188 to allow the Real Estate Commissioner to waive the prior notice requirement for good cause.
2. Expand the statute of limitations for actions against the recovery fund to six years.
3. Amend A.R.S. §32-2186 to allow claimants to recover attorney fees not to exceed a specified percentage of the claim awarded.
4. Eliminate the requirement that claimants obtain a court judgment and allow payment to be made following a Departmental hearing.
5. Eliminate statutory requirements for broker bonds.

6. The Department monitor the site inspection process to ensure that inspections are adequate.
7. The Legislature consider granting the counties authority, similar to that granted municipalities, to regulate splits and re-splits of land involving three or fewer lots.
8. Reduce the staffing level of the Department's investigative section by two investigators and eliminate the position of consumer representative.
9. The Real Estate Department develop and implement a productivity measurement program for the investigation section. In doing so the Department should seek assistance through the productivity program being developed by the Department of Administration.
10. The Real Estate Department should make every effort to increase personal contacts with complainants during the course of, and at the conclusion of, investigations.

INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Real Estate Department in response to a January 30, 1980, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as a part of the Sunset review process set forth in A.R.S. §§41-2351 through 41-2379.

The Real Estate Department was established on March 23, 1921, and was administered by the State Land Commissioner who served as an ex officio State Real Estate Commissioner until 1947. In 1947, the Legislature created a seven-member Real Estate Board, with a Real Estate Commissioner as chairman, to administer the Department. In 1950, the Board was given authority to appoint the Real Estate Commissioner who no longer was a member of the Board. Beginning in 1975, the Governor appoints the Real Estate Commissioner.

The original law of 1921 provided for the Department to regulate and license real estate brokers and salesmen. In 1937, legislation was enacted requiring owners, agents, or subdividers to notify the Commissioner of their intent to sell or lease subdivided lands. The Commissioner was required to investigate such subdivisions and to prepare and make public a report of his findings. If the proposed sale or lease constituted misrepresentation, deceit or fraud the Commissioner was authorized to issue an order prohibiting the sale or lease of the property. Current Arizona law now prohibits the sale or lease of land before the Commissioner's public report is prepared, and requires that all prospective customers be furnished a copy of the report.

Other significant developments in the history of the Department include:

- 1937 legislation requiring written examinations of all applicants for licensure,
- 1963 legislation which created the Real Estate Recovery Fund and provided for regulation of cemeteries,

- 1970 legislation which provided for the licensing of cemetery brokers and salesmen,
- 1975 legislation which placed the regulation of unsubdivided land under the Department, and
- 1976 legislation creating the Subdivision Recovery Fund.

The Department receives funding by a general fund appropriation. Revenues received from examination applications, license applications and license renewals are deposited directly into the State General Fund. Table 1 lists the revenues and expenditures of the Department for fiscal years 1977-78 through 1980-81.

TABLE 1
SUMMARY OF REAL ESTATE DEPARTMENT REVENUES,
FULL-TIME EQUIVALENT POSITIONS, AND EXPENDITURES FROM
FISCAL YEARS 1977-78 THROUGH 1980-81

	Actual 1977-78	Actual 1978-79	Actual 1979-80	Actual 1980-81
REVENUES	<u>\$1,358,519</u>	<u>\$1,935,211</u>	<u>\$1,735,464</u>	<u>\$1,917,644</u>
EXPENDITURES:				
Personal services	550,862	707,954	821,111	919,333
Employee related	101,256	134,935	152,388	174,373
Professional services	38,123	61,328	39,128	41,228
Travel:				
In State	21,449	24,760	25,297	26,182
Out of State	3,627	2,277	3,480	2,506
Other operating expenditures	184,963	197,518	174,367	179,671
Capital outlay	1,485	8,594	4,300	5,099
TOTAL EXPENDITURES	<u>901,765</u>	<u>1,137,366</u>	<u>1,220,071</u>	<u>1,348,392</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ 456,754</u>	<u>\$ 797,845</u>	<u>\$ 515,393</u>	<u>\$ 569,252</u>
NUMBER OF FTEs	<u>51</u>	<u>64</u>	<u>64</u>	<u>67</u>

The Auditor General expresses gratitude to the Real Estate Commissioner and his staff for their cooperation and assistance during the course of this audit.

SUNSET FACTORS

In accordance with A.R.S. §§41-2351 through 41-2379, nine factors are considered to determine, in part, whether the Real Estate Department should be continued or terminated.

SUNSET FACTOR: OBJECTIVE AND PURPOSE

IN ESTABLISHING THE DEPARTMENT

The 1921 legislation establishing the State Real Estate Department contained no statement of the objective and purpose in establishing the Department. The Real Estate Commissioner has stated:

"The department was established, and continues, to regulate the real estate business by administering the provisions of what is now Chapter 20, Title 32 of the Arizona Revised Statutes. Those provisions deal with: 1) licensing of real estate brokers and salesmen, 2) the regulation of those brokers and salesmen, 3) the sale of subdivided lands, 4) the administration of the real estate recovery fund, 5) the organization and regulation of cemeteries, 6) the sale and mortgaging of unsubdivided lands, and 7) the administration of the subdivision recovery fund."

SUNSET FACTOR: THE DEGREE TO WHICH

THE DEPARTMENT HAS BEEN ABLE TO RESPOND

TO THE NEEDS OF THE PUBLIC AND THE

EFFICIENCY WITH WHICH IT HAS OPERATED

The Department responds to the needs of the public through licensing persons involved in real estate, investigating allegations of wrong doing by its licensees and regulating land sales. However, the Department needs to change its' site inspection practices to ensure that such inspections are conducted efficiently and that the information gathered is complete and accurate. (page 19)

SUNSET FACTOR: THE EXTENT TO WHICH THE
DEPARTMENT HAS OPERATED WITHIN THE PUBLIC INTEREST

The history of the Department with regard to land fraud in Arizona contains instances in which the Department did not act in the public interest. Through legislative and administrative reform these problems have been addressed. The Real Estate Commissioner has stated:

"...it would be less than candid to say that the department has always operated within the public interest. Many years ago known felons were granted licenses and were approved as subdividers and developers of unsubdivided lands. However, with the institution of fingerprinting and more stringent procedures for doing background investigations, this problem has been alleviated in recent years.

On a more total scale the department views its primary function as being one of protecting the public. All of the various sections within the agency carry out their functions with protecting the public interest as their primary purpose."

SUNSET FACTOR: THE EXTENT TO WHICH RULES
AND REGULATIONS PROMULGATED BY THE DEPARTMENT
ARE CONSISTENT WITH THE LEGISLATIVE MANDATE

The Department completely recodified its rules and regulations in May and November of 1980.

All of the rule changes were reviewed by the Arizona Attorney General to ensure consistency with legislative mandate.

SUNSET FACTOR: THE EXTENT TO WHICH THE DEPARTMENT
HAS ENCOURAGED INPUT FROM THE PUBLIC BEFORE
PROMULGATING ITS RULES AND REGULATIONS AND THE
EXTENT TO WHICH IT HAS INFORMED THE PUBLIC AS TO ITS
ACTIONS AND THEIR EXPECTED IMPACT ON THE PUBLIC

The Department follows the statutorily prescribed procedures for public notification of meetings and proposed rule changes including posting notices of public hearings in its building and filing rules with the Secretary of State.

In addition, the Department has encouraged input from both industry and the general public and has furnished copies of drafts of proposed rules to all interested parties. The Department also held two, rather than one required, public hearings to encourage public input when it recodified its rules in May 1980.

SUNSET FACTOR: THE EXTENT TO WHICH THE DEPARTMENT HAS BEEN ABLE TO INVESTIGATE AND RESOLVE COMPLAINTS THAT ARE WITHIN ITS JURISDICTION

The Department investigates all of the complaints that it receives. However, the nature of most of the complaints the Department receives is such that the Department is unable to substantiate or refute a majority of complaint allegations. (page 28)

SUNSET FACTOR: THE EXTENT TO WHICH THE ATTORNEY GENERAL OR ANY OTHER AGENCY OF STATE GOVERNMENT HAS THE AUTHORITY TO PROSECUTE ACTIONS UNDER ENABLING LEGISLATION

The Attorney General has sufficient authority to prosecute actions under A.R.S. §32-2111.

SUNSET FACTOR: THE EXTENT TO WHICH THE DEPARTMENT HAS ADDRESSED DEFICIENCIES IN THE ENABLING STATUTES WHICH PREVENT IT FROM FULFILLING ITS STATUTORY MANDATE

The Department has actively addressed deficiencies in its enabling statutes. In 1981, the Department requested the introduction of five bills which would have 1) eliminated the requirement for brokers' bonds, 2) deleted requirements for license applicants to furnish character references, 3) allowed the Department to take disciplinary action against licensees for negligence, 4) removed commercial and industrial developments from the subdivision regulatory requirements, and 5) required subdividers and developers to place all earnest money deposits in neutral escrow deposit accounts. None of these bills were passed by the Legislature.

SUNSET FACTOR: THE EXTENT TO WHICH
CHANGES ARE NECESSARY IN THE LAWS OF
THE DEPARTMENT TO ADEQUATELY COMPLY
WITH THE FACTORS LISTED IN THIS SUBSECTION

The Department intends to request changes in its enabling legislation during the 1982 session which will 1) allow disciplinary action to be taken against licensees for negligence, 2) provide more specific legislation to regulate the sale of time-sharing properties, and 3) modify the prior notice requirement associated with the Real Estate Recovery Fund to allow waiver for good cause shown.

Further changes that should be considered are revisions of the statutes governing the Real Estate Recovery Fund to increase public protection in conjunction with elimination of the brokers' bonds. (page 7)

FINDING I

CHANGES ARE NEEDED TO MAKE THE REAL ESTATE RECOVERY FUND MORE ACCESSIBLE TO THE PUBLIC.

Effective July 1, 1964, Arizona statutes provide for a Real Estate Recovery Fund from which any person, except bonding companies when they are not principals in a real estate transaction, aggrieved by an act, representation, transaction or conduct of a duly licensed broker or salesman may recover actual or compensatory damages up to \$10,000. Our review of the operations of the Real Estate Recovery Fund revealed that it is unduly inaccessible to the public because of

- prior notice requirements,
- statute of limitations provisions,
- no provision for reimbursement of attorney fees, and
- court judgment requirements.

As a result, the Real Estate Recovery Fund has a balance of more than \$1 million. If the Recovery Fund were more accessible to the public it appears that the need for real estate broker bonds would be eliminated, thereby saving brokers approximately \$270,000 annually in bond premiums.

As of July 1, 1980, Arizona was one of 30 states that have real estate recovery funds. The other 29 states are listed below:

- | | |
|-------------|----------------|
| Alabama | Maryland |
| Alaska | Minnesota |
| Arkansas | Nevada |
| California | New Jersey |
| Colorado | New Mexico |
| Connecticut | North Carolina |
| Delaware | North Dakota |
| Florida | Ohio |
| Georgia | Oklahoma |
| Hawaii | Pennsylvania |
| Idaho | South Dakota |
| Illinois | Texas |
| Kansas | Utah |
| Kentucky | Virginia |
| Louisiana | |

Pertinent features of the Arizona Real Estate Recovery Fund are these:

- For an original license a broker pays \$20 into the Fund.
- For an original license a salesman pays \$10 into the Fund.
- The Fund's liability does not exceed \$10,000 for damages sustained regarding any one transaction.
- The Fund's liability does not exceed \$20,000 for any license.
- The Fund is not obligated for the acts of a broker or salesman while acting on his own behalf in property owned or controlled by him.
- If, on December 31 of every year, the balance remaining in the Fund is less than \$200,000, brokers and salesman shall pay \$10 and \$5, respectively, into the Fund when renewing their licenses.
- Upon payment from the Fund a broker or salesman's license is automatically terminated until the amount of payment is repaid in full, plus interest at the rate of six percent a year.
- Monies paid into the Fund shall be deposited into the State Treasury and invested and reinvested in the same manner as Funds of the State Employees Retirement System with earned interest deposited to the credit of the Fund.

In addition to the above provisions, A.R.S. §§32-2186 through 32-2193 contain prior notice requirements, statute of limitation provisions, no provision for reimbursement of attorney fees and court judgment requirements which appear to render the Fund unduly inaccessible to the public.

Prior Notice Requirement

A.R.S. §32-2188, subsection A, provides that

"When any aggrieved person commences action for a judgment which may result in collection from the real estate recovery fund, the aggrieved person shall notify the commissioner in writing, by certified mail return receipt requested, to this effect at the time of the commencement of such action." (Emphasis added)

If a person does not satisfy the above written notification requirement he is precluded from obtaining money from the Fund. Although the Department does not keep data on how many persons are excluded by this requirement, we identified at least 77 claims that are pending against broker bonds; however, only 32 prior notices have been filed with the Department. Thus, there are at least 45 persons engaged in legal actions to recover damages from brokers who have, by definition, failed to provide prior notice and will therefore not be eligible for payments from the Fund.

According to the Department's assistant Attorney General the prior notice requirement is the biggest obstacle preventing public access to the Fund, because 1) the requirement cannot be waived for good cause, 2) most lawyers will not file a notice unless they think they will recover from the Fund and this is not known at the commencement of the lawsuit, and 3) many lawyers do not know what the prior notice requirement implies as it is not a common statutory provision. The assistant Attorney General's comments were supported by two private attorneys who had recently been involved with claims against the Fund. The Department's assistant Attorney General recommends that the prior notice requirement be amended to allow the Commissioner to waive the requirement "for good cause shown," and the Department intends to request appropriate legislation during 1982.

Statute of Limitations

A.R.S. §32-2188, subsection A, establishes a two-year statute of limitations for collection from the Recovery Fund. This two-year limitation is considerably less than the six-year statute of limitations that applies to claims filed against bonds in Arizona and may contribute to the Fund's inaccessibility. The Department does not keep records on the number of claims that have been rejected because of the two-year statute of limitations. As a result, an exact assessment of the degree to which the two-year filing requirement impairs Fund accessibility cannot be made. However, it should be noted that of the 29 other states with real estate recovery funds, 20 have no statute of limitations specified.

Non-Recovery of Attorney's Fees

A.R.S. §32-2186 provides that payments from the Recovery Fund may only be made for "...actual or compensatory damages...." As a result, claimants may not recover attorney fees or other costs involved in obtaining payments from the Fund. This nonprovision for attorney fees may exacerbate Fund inaccessibility in that it is frequently a lengthy legal process to access the Fund and often requires claimants to retain attorneys. According to one attorney, filing a claim against the Recovery Fund can double a claimant's legal costs.

For example, A.R.S. §32-2188, subsection C, specifies that in order to access the Fund a claimant must show:

"1. He is not a spouse of debtor, or the personal representative of such spouse.

"2. He has complied with all the requirements of this section.

"3. He has obtained a judgment as set out in subsection B of this section, stating the amount thereof and the amount owing thereon at the date of the application, and that in such action he had joined any and all bonding companies which issued corporate surety bonds to the judgment debtors as principals and all other necessary parties.

"4. He has caused to be issued a writ of execution upon such judgment and the officer executing the same has made a return showing that no personal or real property of the judgment debtor liable to be levied upon in satisfaction of the judgment could be found, or that the amount realized on the sale of them or of such of them as were found, under such execution, was insufficient to satisfy the judgment, stating the amount so realized and the balance remaining due on the judgment after application thereon of the amount realized.

"5. He has caused the judgment debtor to make discovery under oath, pursuant to §12-1631, concerning his property.

"6. He has made all reasonable searches and inquiries to ascertain whether the judgment debtor is possessed of real or personal property or other assets, liable to be sold or applied in satisfaction of the judgment.

"7. That by such search he has discovered no personal or real property or other assets liable to be sold or applied, or that he has discovered certain of them, describing them, owned by the judgment debtor and liable to be so applied, and that he has taken all necessary action and proceedings for the realization thereof, and that the amount thereby realized was insufficient to satisfy the judgment, stating the amount so realized and the balance remaining due on the judgment after application of the amount realized.

"8. That the following items, if any, as recovered by him have been applied to the actual or compensatory damages awarded by the court:

(a) Any amount recovered from the judgment debtor or debtors.

(b) Any amount recovered from the bonding company or companies.

(c) Any amount recovered in out of court settlements as to particular defendants."

Thus, while it cannot be empirically demonstrated, it seems reasonable to assume that the prospect of incurring substantial unreimbursed legal expenses may discourage some aggrieved persons from filing against the Fund.

It is noteworthy that persons filing claims against broker bonds can recover their attorney fees. According to the assistant Attorney General for the Department, it may be desirable to provide for some recovery of attorney's fees, but such recovery should be limited to a percentage of the claim awarded.

Eliminating the Requirement

For Court Judgments

Currently claimants are required to obtain a court judgment in order to obtain money from the Recovery Fund.

A.R.S. §32-2188, subsections B and E provide:

"B. When any aggrieved person recovers a valid judgment in any court of competent jurisdiction against any broker or salesman, for any act, representation, transaction, or conduct which is in violation of the provisions of this chapter or the regulations promulgated pursuant thereto, which occurred on or after July 1, 1964, the aggrieved person may, upon the termination of all proceedings, including reviews and appeals in connection with the judgment, file a verified claim in the court in which the judgment was entered and, upon ten days' written notice to the commissioner, may apply to the court for an order directing payment out of the real estate recovery fund, of the amount unpaid upon the judgment, subject to the limitations stated in this section.

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"E. The court shall make an order directed to the commissioner requiring payment from the real estate recovery fund of whatever sum it shall find to be payable upon the claim, pursuant to the provisions of and in accordance with the limitations contained in this section, if the court is satisfied, upon the hearing, of the truth of all matters required to be shown by the aggrieved person by subsection C of this section and that the aggrieved person has fully pursued and exhausted all remedies available to him for recovering the amount awarded by the judgment of the court."

By way of comparison, at least two of the other states with real estate recovery funds (Alaska and Kentucky) allow claims against their recovery funds to be paid following a Real Estate Department hearing. Similarly, in Arizona A.R.S. §32-1198.03 provides for the Division of Mobile and Manufactured Housing Standards to pay claims from the Division's trust account recovery fund following a hearing by the Division.

Allowing the Real Estate Department to pay claims against the recovery fund based on the results of a departmental hearing rather than a court judgment would greatly simplify the requirements a claimant must satisfy in order to obtain payment from the Fund.

\$1 Million Fund Balance

As of June 30, 1981, the Real Estate Recovery Fund had a balance of \$1,245,722. Table 2 summarizes the receipts, claims paid, interest earnings and ending balances of the Fund from its inception in fiscal year 1963-64 through 1980-81.

TABLE 2

SUMMARY OF RECEIPTS, CLAIMS PAID, INTEREST EARNINGS AND ENDING BALANCES OF THE REAL ESTATE RECOVERY FUND FROM ITS INCEPTION IN FISCAL YEAR 1963-64 THROUGH 1980-81*

<u>Fiscal Year</u>	<u>Receipts</u>	<u>Claims Paid</u>	<u>Interest Earnings</u>	<u>Ending Fund Balance</u>
1963-64	\$ 113,510			\$ 113,510
1964-65	131,360		\$ 1,336	245,906
1965-66	24,890	\$ 22	6,629	277,403
1966-67	17,680	10,000	9,156	294,239
1967-68	19,650	16,489	12,590	309,990
1968-69	37,790	35,294	12,195	324,681
1969-70	36,871	15,858	12,769	358,463
1970-71	53,220	54,328	18,910	376,265
1971-72	64,460	5,401	20,772	456,096
1972-73	52,631	42,088	25,344	491,983
1973-74	47,460	14,653	30,058	554,848
1974-75	47,510	24,207	32,489	610,640
1975-76	52,550	12,000	53,099	704,289
1976-77	55,670	20,000	54,377	794,608
1977-78	76,155	29,923	48,738	885,653
1978-79	85,378	73,963	59,078	956,887
1979-80	85,020	10,000	78,697	1,111,220
1980-81	83,829	16,751	67,424	1,245,722
	<u>\$1,085,634</u>	<u>\$380,977</u>	<u>\$543,661</u>	

As shown above, the fund balance has been increasing at a steady rate. The interest earned on investments of the fund alone has been greater than the amount paid out in claims to consumers.

* The amounts appearing in Table 2 are unaudited and were obtained from several sources as Real Estate Department staff were unable to provide us with complete data. We cannot attest to the accuracy of these amounts, but provide them as best estimates.

In our opinion, the ever increasing fund balance is largely a function of excessive consumer inaccessibility to the Fund.

Broker Bonds Could Be Eliminated

A.R.S. §32-2124, subsection H, requires brokers to carry a \$5,000 corporate surety bond in addition to paying into the Real Estate Recovery Fund and states:

"H. The commissioner shall require of the applicant, if for a broker's license, a corporate surety bond, to be approved by him, in the amount of five thousand dollars for each calendar year in which the license will be effective. The bond shall be conditioned upon the faithful compliance of the broker with the provisions of this chapter, and that he will conduct the business of real estate broker or cemetery broker in a reliable and dependable manner. All bonds shall be in favor of the state, for the benefit of any person injured by the wrongful act, default, fraud or misrepresentation of the broker in his capacity as such, and any person so injured may bring suit on the bond in his own name. No additional bond shall be required from officers of a corporation or members of a partnership licensed to act as a real estate broker or cemetery broker while in the employment of a corporation or partnership."

If the Real Estate Recovery Fund were made more accessible, the need for this dual coverage could be eliminated. In that eventuality, brokers in Arizona would save an estimated \$270,000 in bond premiums per year. In 1981, the Department requested that House Bill 2172 be introduced which called for the elimination of brokers' bonds. The bill was not passed by the Legislature.

CONCLUSION

The Real Estate Recovery Fund is unduly inaccessible to the public because of prior notice requirements, statute of limitation provisions, no provisions for reimbursement of attorney fees and court judgment requirements. As a result, the Real Estate Recovery Fund now has a balance of more than \$1 million.

If the Recovery Fund were more accessible to the public it appears that the need for real estate broker bonds would be eliminated, thereby saving brokers approximately \$270,000 annually.

RECOMMENDATIONS

Consideration should be given to the following recommendations:

1. Amend A.R.S. §32-2188 to allow the Commissioner of Real Estate to waive the prior notice requirement for good cause.
2. Expand the statute of limitations for actions against the recovery fund to six years.
3. Amend A.R.S. §32-2186 to allow claimants to recover attorney fees not to exceed a specified percentage of the claim awarded.
4. Eliminate the requirement that claimants obtain a court judgment and allow payment to be made following a Departmental hearing.
5. Eliminate statutory requirements for broker bonds.

FINDING II

IN GENERAL THE DEPARTMENT REGULATES THE SALE OR LEASE OF SUBDIVIDED AND UNSUBDIVIDED LANDS EFFECTIVELY; HOWEVER, IMPROVEMENTS ARE NEEDED.

Arizona law requires developers to provide the Real Estate Commission with certain written information and the Real Estate Department to publish a public report prior to the property proposed for sale or lease being offered to the public.

Our review revealed that customers are being provided the public reports as required by law and that with few exceptions the customers find the reports to be both useful and informative. However, there are two areas that need improvement:

1. There is a lack of preparation, or carelessness, resulting in inadequate site inspections of some of the sites on which public reports are to be issued. In some instances these site inspections, which are used to both verify and gather data used in the public reports, have been performed on the wrong sites.
2. There is a lack of regulation over land splits of two or three parcels that are exempt from notification and public report procedures. These splits are resulting in many of the same problems the public report processes were designed to combat and are creating problems for counties.

Statutory Requirements

Arizona Revised Statutes §§32-2181 and 32-2195.01 require that the Real Estate Commissioner be notified before subdivided* or unsubdivided** lands are offered for sale or lease. The owner, agent or subdivider must provide the Commissioner, in writing, comprehensive and detailed information about the land including:

- the legal description and area of land;
- the condition of the title to the land;
- provisions made for permanent access to the land;
- the availability of sewage disposal facilities and other public utilities including water, electricity, gas and telephones;
- the availability of an assured water supply as certified by the Director of water resources, where required; and
- proposed uses of the land.

Following receipt of the information the Commissioner is required to examine the land and issue a public report. This report includes the information provided to the Commissioner plus any other information the Commissioner determines is necessary. The owner, agent or subdivider must then furnish a copy of the public report to each purchaser/lessee. The land may not be sold or leased before the Commissioner issues the public report. If the land is sold or leased before the report is issued, the sale or lease is voidable by the purchaser/lessee.

* Subdivided lands include both improved and unimproved lands that are divided into four or more lots. It does not include land where each lot or parcel is greater than 36 acres nor does it include the leasing of apartments or offices.

** Unsubdivided land covered by these requirements includes four or more contiguous parcels of land in which each parcel is greater than 36 acres but less than 160 acres.

The process of requiring that the Commissioner be notified and a public report be issued generally appears to be working well in that the public reports are disclosing potentially troublesome aspects of the land to buyers, particularly when the land is located outside areas having normal services. Information contained in public reports that we reviewed included the following:

"Prospective purchasers are advised that earnest money deposits, down payments and other advanced monies will not be placed in a neutral escrow. Such monies will be paid directly to the seller and may be used by the seller. This means the purchaser assumes a risk of losing such monies if the seller is unable or unwilling to perform under the terms of the purchase contract."

.....

"Depths to water on the properties...range from 1,200 to 1,400 feet. Depths to water greater than 400 feet exceed normal practice for domestic wells drilled in Arizona."

.....

"Developer has made no provisions to provide any utility services, therefore, purchasers will have to bear the expense of obtaining utility service if and when it becomes available."

.....

"Developer also advised that the roads will not be built according to the minimum standards of the County."

.....

"NOTE: The county will not maintain the roads until they have been constructed to minimum standards and the county approves and accepts them for maintenance. If the streets are not accepted for the maintenance, the future cost of maintenance will have to be paid by the adjacent propertyowners."

Inadequate Site Inspections

Once the Real Estate Commissioner has been notified of an intent to sell subdivided or unsubdivided lands, and has received the required information, he is required by statute to examine the land in question. This examination includes a site inspection by the Department staff.

Site inspections are made to verify the information presented to the Commissioner about the nature of the land. Such items as the location and type of roads, evidence of utilities, evidence of water lines, flood conditions, topography and type of soil are examined.

Site inspections also provide the opportunity to gather additional data that might not be normally disclosed through the information provided by the owner or agent.

We found a number of site inspections are not being performed adequately. We were able to document five instances, occurring within a 30-day period, in which site inspections had to be repeated because the first inspection was inadequate. In three of these instances the inspections had to be repeated because reported data, such as the existence of water lines, was not verified. In two other instances the inspections had to be repeated because they were performed on the wrong site.

In addition, we were informed by the Department's subdivision section staff of nine other instances in which site inspections were inadequate and had to be repeated. We were unable to fully document those instances because the Department does not document and report such occurrences.

Inadequate site inspections appear to be caused by either a lack of preparation or carelessness on the part of the inspector. Department files contain sufficient information to preclude inadequate inspections. Further, if the person performing the site inspection is uncertain about any aspect of the inspection, including how to locate the site, he can contact the developer or sales agent. Such contacts are routinely made by some inspectors. On the other hand, those persons who inspected the wrong sites either did not make such contacts, or turned down developer offers of accompaniment during the inspection.

As a result of inadequate inspections, data critical to the preparation of the public report may not be properly gathered and verified, the State incurs the cost of the reinspections,* and proposed land sales are unnecessarily delayed.

Unregulated Land Splits

Arizona statutes exclude land parcel splits involving three or fewer lots from the reporting requirements in A.R.S. §§32-2181 and 32-2195.01. If the three or fewer lots proposed for sale are within the boundaries of a municipality and involve a new street, they fall under the regulation of the municipality. However, when such lots are outside the municipality, no regulation exists.

Failure to provide for regulation of these parcel splits is resulting in many of the same problems the notification and public report processes were designed to prevent. For example, a 640-acre section in Maricopa County was, over an eight-year period, split and resplit until there were 130 parcels for sale. None of these parcels were subject to the reporting requirements of A.R.S. §§32-2181 and 32-2195.01. When splitting occurs on such a magnitude, numerous problems can arise. Some of these problems include:

- parcels without adequate access (landlocked parcels)
- parcels with overextended or inadequate utilities
- parcels with flooding and drainage problems
- inadequate legal descriptions
- lots which cannot be used for their intended purposes because the lot sizes fail to meet zoning requirements.

* A.R.S. §§32-2182 and 32-2195.02 provide for the owners or agents to pay for the actual costs of the examination of the land. The State, however, assumes the costs of reinspections if the first inspection is inadequate. For six instances of reinspection we identified, the cost of reinspection ranged from approximately \$36 to approximately \$178.

One solution to the problem of unregulated land sales would be to give the counties jurisdiction over sales of three lots or less, much the same as the municipalities have. Under the provisions of A.R.S. §9-463.01, municipalities may regulate parcels split into two or three lots if a new street is created. Such regulation includes establishing requirements concerning streets, utilities, sewers and other improvements as well as ensuring compliance with rules for flood control and groundwater management. Further, surveyed plat maps of the parcels must also be provided. The Arizona Association of County Planning Directors has prepared and submitted such legislation numerous times during the past ten years.

CONCLUSION

The process of requiring that the Real Estate Commissioner be notified of, and a public report prepared on, subdivided and unsubdivided land offered for sale or lease generally appears to be working well. However, there is a lack of preparation, or carelessness, which is resulting in inadequate site inspections. There is also a lack of regulation over splits and resplits of land involving three or fewer lots.

RECOMMENDATIONS

Consideration should be given to the following recommendations:

1. The Department monitor the site inspection process to ensure that inspections are adequate.
2. The Legislature enact legislation granting the counties authority, similar to that granted municipalities, to regulate splits and resplits of land involving three or fewer lots.

FINDING III

THE STAFFING LEVEL OF THE DEPARTMENT INVESTIGATION SECTION
CAN BE REDUCED. IN ADDITION, STEPS NEED TO BE TAKEN TO REDUCE
COMPLAINANT DISSATISFACTION WITH INVESTIGATIONS.

The Arizona Real Estate Department employs ten investigators and investigates approximately 800 consumer complaints* per year. These investigations have resulted in 140 hearings held by the Department in the past three fiscal years with the following outcomes: 44 revocations of licenses, 36 suspensions of licenses, 32 fines, five licensees placed on probation and ten licensees issued cease and desist orders. Another nine licensees were denied the right to renew their licenses.

In reviewing the investigative section of the Real Estate Department we found that

1. Staffing of the investigations section could be reduced by at least three positions (two investigators and the consumer representative).
2. Due to the nature of the types of complaints received, the Department cannot prove or disprove the validity of a complaint in a majority of the cases.
3. The inability to prove or disprove the validity of a complaint combined with insufficient personal contacts with the complainants during the investigations frequently result in complainant dissatisfaction with the Department's investigations.

* Department complaint totals for 1980 show 1,667 complaints investigated. However, this figure includes Department-initiated investigations, background checks on license applicants and responses to public inquiries for information.

Staffing Can Be Reduced

During the course of the audit we became concerned about the productivity and staffing level of the investigations section. The section has ten investigators, assisted by one consumer representative, who each investigate an average of only 80 complaints a year. Although we found the investigators have additional duties,* we believe the number of complaints handled per investigator is still low when compared to the investigations section of the Arizona Department of Insurance.

Comparing the investigations sections of both departments we found both sections investigate consumer complaints, fingerprint and conduct background investigations of applicants, and perform other special investigations for their departments. A significant difference occurs, however, in the number of consumer complaints that are handled by each section as shown below.

	<u>Number of Investigators</u>	<u>Annual Number of Consumer Complaints</u>
Insurance	9	4,500
Real Estate	10	800

Part of this difference in the number of complaints processed can possibly be explained by additional and differing duties; for example, Real Estate investigators also monitor licensing examinations, inspect subdivisions and conduct surveys of brokers while Insurance investigators do not. Part of the difference in the number of complaints processed might also be explained by inherent differences between complaints about insurance versus complaints about real estate. Nevertheless, we believe the fact that the Insurance Department processes six times more complaints per investigator than does Real Estate is significant.

* Investigators in Arizona perform a wide variety of duties in addition to investigating complaints including: monitoring continuing education courses, investigating backgrounds of applicants, monitoring licensing examinations, inspecting subdivisions and auditing brokers. The time required to perform these duties is unknown.

In addition, the investigators have recently been relieved of two additional duties. Beginning in October 1981, investigators no longer are required to do fingerprinting and background investigations, because the Federal Bureau of Investigation discontinued processing fingerprints for one year. Also effective October 1981, investigators no longer conduct site inspections of subdivisions. That function will be performed by the Department's subdivision staff.

Further, according to the Department's Chief Investigator, the Department is receiving fewer complaints and the nature of complaints has become more general and presents fewer difficult investigations.

The above changes coupled with the low volume of complaints processed per investigator as compared to the Insurance Department, leads us to estimate that the staffing of the section could be reduced by at least two investigators and that the position of consumer representative could be eliminated.

Should the investigations section be reduced by three positions we believe further study should still be made of the productivity of the investigations section. A staffing level of eight investigators would result in investigators averaging approximately 100 complaint investigations per year or one-fifth the number of complaints investigated by each Department of Insurance investigator.

The Department of Administration (DOA) is currently developing a productivity management project using the services of an outside consultant. The project is being pilot tested in the DOA Personnel Division and will be ready for expansion to other agencies in January 1982. We believe the Real Estate Department should seek assistance from DOA in conducting a productivity study of its investigations section.

Inability to Prove or Disprove Validity of Complaints

The majority of the consumer complaints received by the Department are complaints that cannot be easily proved or disproved. Complaints about alleged misrepresentations, earnest money agreements and duty to clients often involve allegations that promises or agreements made verbally by a broker or salesperson were broken. In most instances there are no witnesses to the alleged agreements and/or the written documents pertaining to the transaction (such as the earnest money agreement) conflict with the alleged verbal agreements. In these cases it becomes the complainant's word against the broker's and the Department cannot prove or disprove the complaint.

Other complaints require the Department to show that a licensee knowingly and intentionally acted in a manner that was not in his client's best interest. Difficulty in showing a licensee's intent, particularly on the basis of a single complaint, prevents the Department from proving or disproving the validity of some of these complaints. Additionally, the Department cannot address 16 percent of the consumer complaints it receives because it either has no jurisdiction or is barred by statutes of limitation.

We estimate the Department is unable to prove or disprove the validity of 56 percent of the consumer complaints it receives.

Frequent Complainant Dissatisfaction

The inability to prove or disprove the validity of the majority of consumer complaints combined with insufficient personal contacts with the complainants frequently results in complainant dissatisfaction. A majority of the complainants do not believe the Department investigators are fair and impartial, nor do they believe the investigators do all they can do to resolve complaints.

The Office of the Auditor General surveyed complainants about their experiences in filing a complaint with the Department. Questions asked the complainants addressed such areas as the fairness and impartiality of the investigators, whether the investigators did all they could to resolve the complaint, and additional steps that should be taken to improve the Department's complaint process. Results of the survey showed high levels of complainant dissatisfaction, particularly when compared to the results of a survey of persons filing complaints with the Arizona Department of Insurance which was made in preparing Report No. 79-4, A Performance Audit of the Arizona Department of Insurance. Comparisons of the results of the two surveys are shown below:

Question: Do you believe the Department investigator was fair and impartial?

	<u>Yes</u>	<u>No</u>	<u>No Answer</u>
Insurance Complainants	70%	15%	15%
Real Estate Complainants	30	56	14

Question: Do you believe the investigator did all he could to resolve your complaint?

	<u>Yes</u>	<u>No</u>	<u>No Answer</u>
Insurance Complainants	60%	29%	11%
Real Estate Complainants	25	65	10

Question: If you had another complaint would you file with the Department?

	<u>Yes</u>	<u>No</u>	<u>No Answer</u>
Insurance Complainants	73%	13%	14%
Real Estate Complainants	46	46	8

Many complainants also provided written comments with their answers to the survey questions. These comments coupled with their suggestions for improving the complaint investigations most frequently addressed the lack of personal contact between the investigators and the complainants. It appears that the Department's extensive use of letters in the investigative process coupled with the inability to prove or disprove the validity of the majority of the complaints results in complainant perceptions that the Department is biased and not doing all it can to resolve complaints. Complainants appear to equate a lack of personal contact with a lack of interest and effort.

CONCLUSION

The staffing level of the Department of Real Estate investigations section can be reduced by at least three persons. In addition, because investigators cannot prove or disprove the validity of most complaints and do not make enough personal contacts with complainants during investigations, complainants are frequently dissatisfied with Department investigations.

RECOMMENDATIONS

Consideration should be given to the following recommendations:

1. The staffing level of the Department's investigative section should be reduced by two investigators, and the position of consumer representative should be eliminated.
2. The Real Estate Department should develop and implement a productivity measurement program for the investigations section. In doing so the Department should seek assistance through the productivity program being developed by the Department of Administration.
3. The Real Estate Department should make every effort to increase personal contacts with complainants during the course of, and at the conclusion of, investigations.

RICHARD B. NICHOLLS
STATE REAL ESTATE
COMMISSIONER



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State of Arizona
Department of Real Estate

December 18, 1981

Mr. Douglas R. Norton
Auditor General
Legislative Services Wing
Suite 200
State Capitol
Phoenix, Arizona 85007

Dear Mr. Norton:

The response to the performance audit completed by your office will be brief. Given the number and complexity of the statutory duties undertaken by the Real Estate Department, the areas of criticism, constructive though they may be, are minor and confirm our strong belief that the Department has come a long way in improving its performance. This, I believe, is largely responsible to a knowledgeable staff.

With respect to Finding I, the Department agrees with the assessment of the Auditor General that access to the Recovery Fund has been limited by the prior notice requirements and statute of limitations imposed by law. As noted, the Department has already submitted proposed amendments to Section 32-2188 which authorizes the Commissioner to waive the prior notice requirement if the public interest will not be adversely affected. This should insure an equitable result. Additionally, the Department has no objection to an expansion of the statute of limitations to the six years recommended. However, this recommendation might be altered slightly if the elimination of the court judgment requirement is enacted by the Legislature.

Currently the Department's jurisdiction over the acts of its licensees is limited to a five-year statute of limitations. (Section 32-2153) If the Department is to assume direct control of the Recovery Fund it would be consistent to also limit those actions to five years. Assuming this statutory change and the resulting direct control over the fund, the Department would have no objections, to the payment, out of that fund, of reasonable attorney's fees much the same as is provided in Section 12-341.01.

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Regarding Finding II, the Department feels that the audit has placed undue emphasis on a very few inspections that needed to be repeated. This is especially true in light of the audit's conclusion that the entire site inspection process "appears to be working well".

The "carelessness" reported by the Auditor General can be attributed to human error when conducting an inspection of largely undeveloped parcels of property. This, of course, means that there are often no established landmarks and there is often poor access at the time of inspection. Inspections typically are not a serious problem in the performance of statutory duties. The Department feels that the audit gives the point undue and unnecessary emphasis.

Finally, and with respect to the same issue, it should be noted that primary responsibility for these inspections has been redelegated to the Department's Subdivision Section.

As to Finding III, a few general comments seem to be in order. The observations (b) and (c), as found on page 25, are correct. The nature of investigations, especially those involving misrepresentations, are difficult to prove as indicated in your report. Obviously, because they are difficult does not mean they should not be undertaken. There is a tenent in law which states that "misrepresentation is the easiest to allege and the hardest to prove". Your audit confirms this. The dissatisfaction of complainants in the Department's ability to prove a complaint is probably the complainant's lack of understanding that in a disciplinary proceeding they, the complainant, would at best be a witness for the State. This lack of understanding may be our investigators' inability to put the complaint in the proper perspective with the complainant. This agency is not an arbitrator. We have no statutory authority to demand the return of money or the execution of contractual obligations. Both are civil matters. It should be noted, however, that since January of 1978, when we started keeping figures on monies returned to complainants, the Department has been instrumental in effecting the return of more than one and a half million dollars to the Arizona public through the Department's investigative activities.

I do not agree with the recommendation of Finding III (a) on the reduction of three positions (two investigators and the consumer representative). The thrust of this recommendation appears to have stemmed from the comparison with the Department of Insurance

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and the Department of Real Estate. I believe no comparison can reasonably be made as the types of complaints handled by the Department of Insurance are not as complex as real estate complaints.

It is my understanding a good many complaints of the Insurance Department concern claims against companies and are disposed of rather quickly.

In the past four years this agency has gone to almost as many proceedings against licensees seeking suspensions or revocations of licenses for improper conduct as in the past 56-year history of this agency. I feel that the number of hearings has gone a long way to calm the waters in the market place relating to dealing in Arizona land. One does not have to be a great historian to recall the national stories on land fraud which were a daily occurrence just a few years ago. The Legislature, in enacting stronger laws (HB 2064, 1978) and in giving this Department adequate staffing, has addressed those problems responsibly. The number of disciplinary hearings that this agency has conducted in the past four years could only have taken place with adequate staffing. Also, it might be noted that since 1980 our consumer representative has taken 21,945 telephone calls as well as conducted 1,616 individual interviews. With the reduction in staff suggested by you, these telephone calls and interviews would naturally have to be absorbed by the investigative section. A reduction in staff appears inconsistent with your recommendation that the investigators should be in the field more and make more contacts with complainants.

In my opinion your recommendation for a reduction in staff is an invitation to the status quo of the 1960s and early 70s land fraud era. I would be hopeful that the Legislature in their wisdom would not wish to take this kind of gamble.

Your staff has spent considerable time and effort in this audit. Their contacts with my staff have been positive. Your recommendations generally are beneficial and should assist in the responsible administration of this Department.

Sincerely,



R. B. NICHOLLS
COMMISSIONER
DEPARTMENT OF REAL ESTATE