

## SECTION TWO

# SELECTED TOPICS IN PROPERTY MANAGEMENT



1. Harry lives and works in South Carolina where he is broker-in-charge of an office in Little River. He manages vacation rentals and long-term residential rental property in both North and South Carolina and maintains two separate escrow accounts at a federally insured bank located in Little River. He deposits all monies from the South Carolina properties into one escrow account and all monies from the North Carolina properties into the second escrow account.

May Harry legally deposit all monies from/for the North Carolina properties in the escrow account in Little River, SC \_\_\_\_\_ Why or why not? \_\_\_\_\_

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2. Norman, a licensed broker, has been managing several properties for a particular owner-client for 10 years. He and the owner are friends. Each month, tenants submit rent checks to Norman. The checks are made payable to the owner, and Norman takes them to the owner's banking institution and deposits them into the owner's account. Norman is careful to deposit the checks within 3 days of receipt. In turn, the owner pays Norman a management fee each month. Is this an acceptable practice? Why or why not? \_\_\_\_\_
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3. Sally, a licensed broker, has 15 salaried employees who help her lease units and collect rents in three multi-family residential properties Sally manages. To help her employees screen tenant applications, Sally adopts a policy rejecting any prospective tenant who has a criminal conviction.

Is Sally's policy lawful? Why or why not? \_\_\_\_\_

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4. You are the listing agent for a property that's been on the market for 8 months. Your owner-client tells you she needs income from the property and wants to rent instead of sell it. She asks you to find a renter. What should you do?
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# Learning Objectives

After completing this Section, you should be able to:

- describe changes in Landlord-Tenant Law & the Vacation Rental Act;
- explain legal tenant screening criteria;
- determine how a broker must handle trust monies; and
- describe when a broker may legally charge a fee for coordinating services.

## Residential Landlord-Tenant Law Changes

### 1. Escrow Account Requirements

Effective **June 19, 2015**: The General Assembly revised both the residential Tenant Security Deposit Act [G.S. 42-50] and the Vacation Rental Act [G.S. 42A-15] to allow an owner-landlord's escrow account to be maintained in a federally insured depository institution lawfully doing business in this State. The General Assembly again revised both statutes effective **June 2, 2017**, to add "or trust institution" as an acceptable depository institution. Accordingly, both laws now allow residential tenant security deposits and advanced payments for vacation rentals to be deposited into

**"... a trust account with a licensed and federally insured depository institution or a trust institution authorized to do business in this State."**

In other words, the institution IS NOT REQUIRED to have a physical location in North Carolina so long as it is:

- A) federally insured, and
- B) authorized to do business in North Carolina.

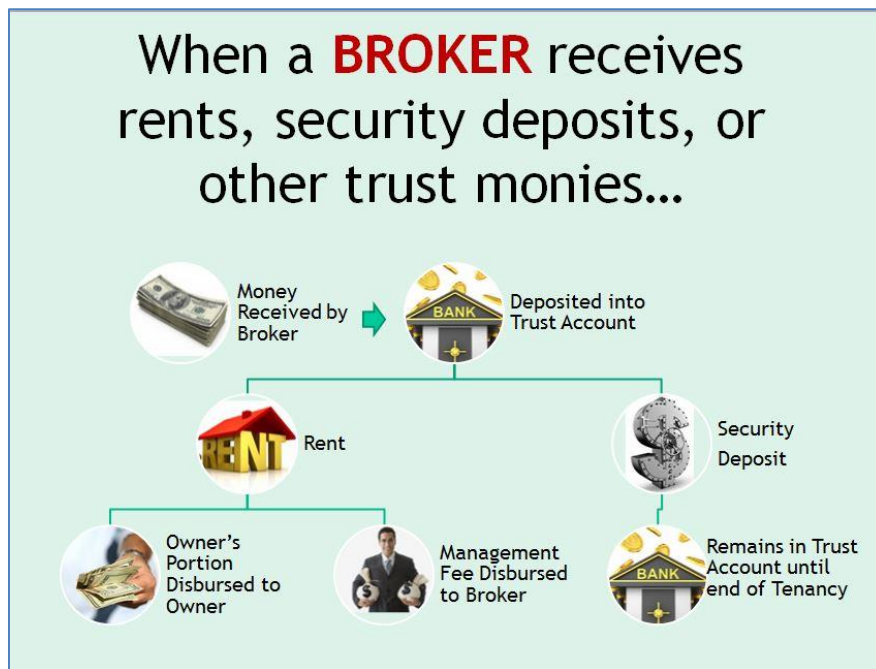
Note: Thanks to this revision, the definition of a permissible depository institution for landlords' escrow accounts under the Tenant Security Deposit Act and the Vacation Rental Act is similar to the definition of an acceptable "bank" under License Law.

## A Broker must deposit Rents, Security Deposits, and other monies into a Trust/Escrow Account

Any rents, security deposits, or other monies belonging to others collected or received by a *broker* must be:

- deposited into the broker's properly designated trust or escrow account,
- in a federally insured depository institution lawfully doing business in North Carolina, that
- agrees to make the account records available to the NC Real Estate Commission.

[See G.S. 93A-6(g) and Rule A .0117(b).]



### Additional Option for Owners of Properties used for Residential Leasing (not Vacation Rentals)

The Tenant Security Deposit Act (G.S. 42-50) still allows one additional option for owner-landlords\*, as follows:

An owner/landlord\* may post a bond rather than deposit the tenant security deposit in an escrow account.

Note that the Act **requires** a bond if the residential tenant security deposit is held in a trust account outside of NC. [See revised law at the end of this Section.]

\* This bond option is not available for brokers managing property for others.

In other words, an owner **MUST** deposit residential tenant security deposits into a trust or escrow account in a federally insured depository or trust institution authorized to do business in North Carolina *unless* the owner posts a bond in the amount of the tenant security deposit.



***What is the penalty if an owner fails either to deposit a residential tenant’s security deposit into a trust or escrow account or to post a bond for the deposit?***

The Tenant Security Deposit Act states:

“... The willful failure of a landlord to comply with the deposit, bond, or notice requirements of this Article shall void the landlord's right to retain any portion of the tenant's security deposit as otherwise permitted under G.S. 42-51....”

In other words, an owner who fails to post a bond or deposit the security deposit into a trust or escrow account must **refund the entire amount of the deposit to the tenant** even though the landlord would normally be entitled to retain some or all of the deposit for back rent or tenant damage to the property.

## **2. Tenant Appeal**

Effective **July 1, 2016**: If a magistrate’s eviction order and judgment are vacated (overturned) upon the tenant’s appeal, then any appearance fees awarded to the plaintiff are also vacated. [G.S. 42-46(f)]

This clarifies that if a magistrate’s order and/or judgment is vacated on appeal, then any court appearance fees awarded as part of that judgment or order are also set aside.

Example: A landlord sues to evict a tenant and to collect rents due from the tenant. The tenant does not appear at the hearing and judgment is entered in favor of the landlord. In addition to the eviction and rent due, the landlord is also awarded a court appearance fee. The tenant timely appeals the court’s decision, arguing that s/he wasn’t properly served with summons as required by law. The tenant also produces receipts for cash payments of rents that were accepted by the landlord. The tenant wins the appeal and the magistrate’s order is set aside/vacated. Consequently, the court appearance fees awarded to the landlord are set aside along with the eviction and the award of damages for unpaid rents.

## **Vacation Rental Act (S.L. 2016-98)**



***What is the definition of a “vacation rental” under the Act? In other words, how is a vacation rental different from a standard (long-term) residential rental?***

The Vacation Rental Act defines a vacation rental as:

1. a residential property
2. leased for vacation, leisure, or recreation purposes
3. for less than 90 days
4. by a person who has and intends to return to a permanent residence.



***Does the law require a vacation rental agreement to be in writing?***

Yes. Remember, that state law not only requires the vacation rental agreement to be in writing, but dictates certain content and mandatory disclosures. A broker who uses a lease agreement

that doesn't comply with state law "... *shall* be guilty of an unfair trade practice in violation of G.S. 75-1.1." [G.S. 42A-10(b).]

## Recent Amendments to the Vacation Rental Act

Effective **July 1, 2016**: The General Assembly enacted several amendments to the Vacation Rental Act that include two (2) new definitions and two (2) new statutes.

### 1. New Definitions

#### Advanced Payments

"All payments made by a tenant in a vacation rental agreement to a landlord or the landlord's real estate broker prior to occupancy for the purpose of renting a vacation rental property for a future period of time as specified in the vacation rental agreement." [G.S. 42A-4(1)]

#### Landlord

"An owner of residential property offered for lease as a vacation rental with or without the assistance of a real estate broker." [G.S. 42A-4(1a)]



1. What types of payments do vacation rental tenants make prior to occupancy?  
\_\_\_\_\_
2. If a broker collects advanced payments from a vacation rental tenant, must the broker deposit the payments in a trust or escrow account? \_\_\_\_\_

### 2. Law Changes

#### Earned Management Fees

When an owner of a property used for vacation rental purposes sells the property while there are vacation rental reservations/tenancies in place, a broker holding advanced **rent** payments at the time of sale/transfer of the property may deduct from the rent monies the amount of any fee earned under the terms of the vacation management agreement but not yet paid before transferring the balance of the advanced rents to the buyer. Further, the owner/seller must pay the buyer any amounts deducted by the broker. [G.S. 42A-19(b).]



Gerald owns a property that he uses as a vacation rental. He has hired XYZ Realty to manage the property on his behalf. Gerald decides to sell the property to Terri. Gerald and Terri enter into a sales contract.

XYZ Realty is holding advanced rent payments in the amount of \$5500 from tenants. Based on the terms of the property management agreement with Gerald, XYZ Realty is owed \$550 (10% of collected fees) in management fees. On the date of closing, XYZ Realty deducts \$550 from the collected advanced rent monies and transfers the balance of \$4950 to Terri.

Because the management fee was deducted, Terri has not received the entire advanced rent that is due to her. Who must pay her the \$550 difference? \_\_\_\_\_

#### **G.S. 42A-33. Responsibilities and liability of real estate broker.**

The Vacation Rental Act now specifies responsibilities and liabilities of a real estate broker.

***REMINDER: Brokers are also subject to License Law and Commission Rules.***

#### **G.S. 42A-33(a) states:**

A real estate broker managing a vacation rental property on behalf of a landlord shall do all of the following:

1. Manage the property in accordance with the terms of the written agency agreement signed by the landlord and real estate broker.
2. Offer vacation rental property to the public for leasing in compliance with all applicable federal and State laws, regulations, and ethical duties, including, but not limited to, those prohibiting discrimination on the basis of race, color, religion, sex, national origin, handicapping condition, or familial status.
3. Notify the landlord regarding any necessary repairs to keep the property in a fit and habitable or safe condition and follow the landlord's direction in arranging for any such necessary repairs, including repairs to all electrical, plumbing, sanitary, heating, ventilating, and other facilities and major appliances supplied by the landlord upon written notification from the tenant that repairs are needed.
4. Verify that the landlord has installed operable smoke detectors and carbon monoxide alarms.
5. Verify that the landlord has annually placed new batteries in a battery-operated smoke detector or carbon monoxide alarm. Failure of the tenant to replace the batteries as needed shall not be considered negligence on the part of the real estate broker.



In addition to the minimum standards set forth in the Vacation Rental Act, brokers must adhere to License Law and Commission Rules. List additional duties and responsibilities required of brokers engaged in property management under License Law and Commission Rules:

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## Liability

### G.S. 42A-33(b) states:

A real estate broker or firm managing a vacation rental property on behalf of a landlord client shall not become personally liable as a party in any civil action between the landlord and tenant solely because the real estate broker or firm fails to identify the landlord of the property in the vacation rental agreement.

Just as with long-term rental agreements, some brokers' lease agreements with vacation rental tenants do not include landlords' names. Similar to a change in the Landlord & Tenant Act, this statute makes it clear that just because a broker's name is the only name on a vacation lease agreement, the broker does not automatically assume personal liability for civil actions.

To be clear, the statute only states that the broker "shall not become personally liable as a party in any civil action between the landlord and tenant **solely because** the real estate broker or firm fails to identify the landlord of the property in the vacation rental agreement." It certainly is still possible that the vacation rental tenant may pursue civil action against the broker and landlord.

### Early Termination of Vacation Rental Agreement by Military Personnel - G.S. 42A-37

Another addition to the Vacation Rental Act is a provision allowing military personnel who receive deployment orders or permanent change in station orders to terminate a vacation rental lease.

1. The military member must provide the landlord or his agent a written Notice of Termination accompanied by either a copy of the orders or written verification signed by the member's commanding officer within 10 days of receipt of the orders.
2. The termination notice is effective upon the landlord's receipt (or the landlord's agent's receipt).
3. The military member is entitled to a refund of all advanced payments, except for non-refundable fees paid to third parties for goods or services on the tenant's behalf and administrative fees (not management fees), within 30 days of the termination.
4. A member's termination ends any obligation his/her spouse or dependents may have had under the lease.

5. The member's spouse has the same rights to terminate under the Statute as the member and the rights created under the new law "...may not be waived or modified by the agreement of the parties."

## **Disparate Impact: Use of Criminal Records in Residential Leasing**

### **Research and Statistics**

HUD's Office of General Counsel issued *Guidance on Application of Fair Housing Act Standards to the Use of Criminal Records by Providers of Housing and Real Estate-Related Transactions\** on April 4, 2016.

The document states the following statistics:

- The United States' population represents only five percent of the world's population, yet nearly 25% of the world's prisoners are incarcerated in U.S. prisons (roughly 2.2 million).
- An average of 650,000 individuals have been released annually from prison since 2004, and 95% of current inmates will be released at some point.
- Studies indicate that after six or seven years with no offenses, the risk that a former convict may commit a new offense begins to approximate the risk that a person with no prior record will commit a new offense.
- In 2013, African-Americans represented approximately 12-12.4% of the U.S. population, but comprised 28.3% of all arrests and 36% of the prison population in 2014.
- Hispanics comprise 17% of the population but 22% of the prison population while Caucasians comprise roughly 62% of the population but only 34% of the prison population.

HUD found that nationally, "across all age groups, the imprisonment rates for African American males is almost six times greater than for White males, and for Hispanic males, it is over twice that for non-Hispanic White males."

### **Conclusion: Criminal records-based barriers to housing are likely to have a disparate impact on minority home seekers.**

HUD concluded:

Across the United States, African Americans and Hispanics are arrested, convicted and incarcerated at rates disproportionate to their share of the general population. Consequently, criminal records-based barriers to housing are likely to have a disproportionate impact on minority home seekers.

While having a criminal record is not a protected characteristic under the Fair Housing Act, criminal history-based restrictions on housing opportunities violate the Act if, without justification, their burden falls more often on renters or other housing market participants of one race or national origin over another (i.e., discriminatory effects liability). Additionally, intentional discrimination in violation of the Act occurs if a



housing provider treats individuals with comparable criminal history differently because of their race, national origin or other protected characteristic (i.e., disparate treatment liability).

**HUD specifically acknowledges that housing providers have a significant interest in protecting the safety and property of others and a prospective tenant’s previous criminal convictions may be one factor in that evaluation, but it shouldn’t be the lone factor.**

According to HUD’s *Guidance*:

...where a policy or practice that restricts access to housing on the basis of criminal history has a disparate impact on individuals of a particular race, national origin, or other protected class, **such policy or practice is unlawful under the Fair Housing Act** if it is not necessary to serve a substantial, legitimate, nondiscriminatory interest of the housing provider, or if such interest could be served by another practice that has a less discriminatory effect. [Emphasis added.]

The one conviction recognized by the Fair Housing Act as justification for denial of housing is a conviction of illegally manufacturing or distributing a controlled substance as defined under federal law. [21 United State Code 802.] Note that it must be a **conviction**, not merely an arrest, for the **manufacture or distribution** of a controlled substance, not use or possession of a controlled or illegal substance.

\*To read *Guidance on Application of Fair Housing Act Standards to the Use of Criminal Records by Providers of Housing and Real Estate-Related Transactions* in its entirety, go to:  
[https://portal.hud.gov/hudportal/documents/huddoc?id=HUD\\_OGCGuidAppFHASStandCR.pdf](https://portal.hud.gov/hudportal/documents/huddoc?id=HUD_OGCGuidAppFHASStandCR.pdf) .



1. What are some legal tenant-screening criteria? \_\_\_\_\_
2. May a prospective tenant’s arrest record be used to screen tenant applications? Why or why not? \_\_\_\_\_
3. True or False? Consistently refusing to rent to anyone that has any criminal conviction would remove the possibility of discrimination since the criterion is the same for everyone. \_\_\_\_\_ Explain your answer. \_\_\_\_\_
4. What factors might be used to determine if previous criminal convictions will affect tenant approval? \_\_\_\_\_
5. Would it be okay to deny tenancy to anyone convicted of the manufacture of crystal meth? \_\_\_\_\_
6. What procedures might a PM/landlord put in place to assure non-discriminatory use of criminal records in tenant screening? \_\_\_\_\_

## **HUD's Recommended Practices for Use of Criminal History**

- When evaluating a prior conviction, also consider:
  - What was the nature of the crime (violent/nonviolent, intentional/negligent) and how serious was it (misdemeanor/felony)?
  - How long ago did it occur?
  - How old was the individual?
  - Was the individual incarcerated or given probation?
  - What were the circumstances surrounding the event? Were there mitigating factors?
  - What has been the applicant's conduct since release?

Also: Consider giving the applicant an opportunity to explain any convictions that appear.

- Apply the policy uniformly to all applicants.
- Avoid blanket exclusions that deny housing to anyone with a criminal conviction.
- Never exclude prospective tenants based on arrests only. Arrests aren't proof of past criminal conduct and are often incomplete. Convictions are the proof of actual past criminal conduct.

**Following is a list of Do's and Don'ts provided by the National Association of REALTORS® in an April 7, 2016, article titled *Fair Housing Act: Criminal History-Based Practices and Policies*:**

<b>Criminal History-Based Housing Policies and Practices</b>	
<b>Do's</b>	<b>Don'ts</b>
Create tailored criminal history-based policies/practices.	Don't create arbitrary or overly-broad criminal history-based policies/practices.
Be sure to have clear, specific reasoning for the criminal history-based policy/practice that can be supported by evidence.	Don't maintain a policy/practice, or any portion thereof, that does not serve a substantial, legitimate, nondiscriminatory interest.
Exclude individuals only based on criminal convictions that present a demonstrable risk to resident safety or property.	Don't create exclusions based on arrest records alone.
Consider the nature and severity of an individual's conviction before excluding the individual based on the conviction.	Don't create a blanket exclusion of any person with any conviction record.
Consider the amount of time that has passed since the criminal conduct occurred.	Don't provide inconsistent explanations for the denial of a housing application.
Consider criminal history uniformly, regardless of an individual's inclusion in a protected class.	Don't use criminal history as a pretext for unequal treatment of individuals of a protected class.
Treat all applicants for housing equally, regardless of protected characteristics.	Don't use comparable criminal history differently for individuals of protected classes.
Conduct individualized assessments that take into account mitigating factors, such as facts and circumstances surrounding the criminal conduct, age at the time of the conduct, evidence of good tenancy before/after conduct, and rehabilitative efforts.	Don't make exceptions to a policy or practice for some individuals, but not make the same exception for another individual based on the individual's inclusion in a protected class.
Housing providers may exclude persons convicted of the illegal <u>manufacture</u> or <u>distribution</u> of a controlled substance. <sup>2</sup>	Don't include a blanket prohibition against individuals convicted of drug <u>possession</u> .

To read the *Fair Housing Act: Criminal History-Based Practices and Policies* article in its entirety, go to <https://www.nar.realtor/articles/fair-housing-act-criminal-history-based-practices-and-policies>.

At the end of this Section is a “Model Policy on Screening Applicants with Criminal Records” developed by the North Carolina Housing Finance Agency (NCHFA), the Department of Health and Human Services, and the North Carolina Justice Center for use by property managers participating in NCHFA programs. It is reprinted with the permission of the NCHFA.

# The Unintentional Property Manager



Betty is a full broker affiliated with XYZ Realty. She is the listing agent for a property that the seller has recently decided to convert into a rental property to generate income. The owner-client asks Betty to advertise the property for rent and find a tenant. Betty changes the listing in the MLS, locates a tenant, executes a lease agreement for one year, and accepts two checks from the tenant payable to the owner, one for the first and last month's rent and the other for the tenant security deposit. Betty mails both checks to the owner.

Has Betty complied with License Law and Commission Rules? Why or why not?

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## **Brokers must have Written Agency Agreements with Clients that specify Duties and Obligations**

The required written agency agreements with property owners that authorize the brokers/firms to act as agents for the owners must clearly list the duties and obligations of the parties.

The agreements must also contain a definite expiration date and anti-discrimination language specified in Rules 58A .0104(a) and (b).

If the services a broker intends to provide are not specified in an existing agency agreement, then either the existing agreement needs to be mutually amended or a new agency agreement should be executed.

For example, if a listing agent who was originally authorized to offer a property for sale is later asked to advertise that same property for lease and procure a tenant, the listing agent must execute a new agreement with the owner specifying those newly authorized duties.

## **A broker/firm that collects monies due to owners or pays expenses on behalf of owners must have a trust/escrow account.**

A broker who manages properties for others may NOT act as a courier for owners' funds. Any monies related to clients' properties (rents, security deposits, etc.) that are given to a broker must be deposited into the broker's trust account. A broker may NOT deposit funds directly into an owner's account, nor may a broker deliver funds directly to an owner.



**BIC ALERT:** In the scenario above, would Betty's broker-in-charge be held responsible for her leasing activities?

It is certainly possible. To determine whether the broker-in-charge is responsible, the Commission would evaluate:

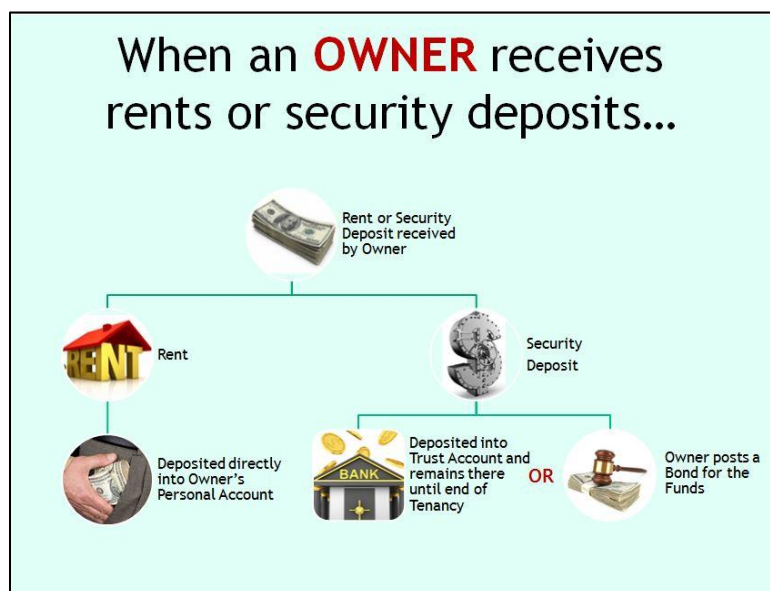
- the terms of Betty's independent contractor agreement and authorized activity;
- whether the company's office policy limits the brokerage activities in which it engages; and,
- whether the BIC was aware of the services Betty was offering.

## Brokers Managing / Leasing Properties They Own

Brokers who are managing/leasing their personally-owned properties are held to a higher standard than owners of properties who do not hold real estate licenses, as follows:

1. Broker-owners who are directly managing their personally-owned properties may either deposit residential tenant security deposits into trust/escrow accounts or use the option of posting bonds for the deposits.
2. Rent payments belong to owners. Owners managing their own properties may deposit rents into their own bank accounts. Thus, broker-owners who are directly managing their personally-owned properties may deposit rent payments into their own bank accounts.
3. If a broker-owner chooses to manage a personally-owned property through a real estate company that s/he owns, the broker must first have a written agency agreement with the real estate company, showing the broker-owner as client and the real estate company as property manager. If tenant security deposits are going to be held by the real estate company, the company should maintain a trust account that is separate from (and in addition to) the account that contains other clients' monies. If a separate company trust/escrow account is not used, the company will likely be commingling the broker's funds with other clients' funds. Further, the rents for the broker's properties may not be deposited into the company's trust account, as those funds are the broker's funds (so depositing the funds into the trust account would constitute commingling).
4. Broker-owners must disclose all material facts about the properties they are leasing and must provide the Lead-based Paint Disclosure, when applicable.
5. Broker-owners are encouraged to disclose to consumers that they have a real estate license, but Commission rules don't require the broker to include the "broker-owner" disclosure in the advertising of the property.

NOTE: If a broker is a member of the REALTOR® organization, the broker is required by the REALTOR® Code of Ethics to include "broker-owner" disclosure in all advertising.



## Broker Surcharges



A broker is managing a 30,000 square foot office building for a corporate owner. The broker shows and leases office space, collects tenant security deposits and monthly rents, pays the overhead expenses for the building, and oversees all custodial, maintenance, and repair needs. The broker has a standing relationship with several service providers. The providers invoice the broker for work performed and the broker pays the invoiced amounts. In turn, the broker adds an 8% surcharge to the invoiced amounts [for contracting and coordinating the work] and deducts the total charges from the rents collected before disbursing rents to the owner.

Is the broker's practice acceptable? Why or why not? \_\_\_\_\_

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## Broker Fees must be disclosed and authorized in the written agency agreement

Rule 58A .0109, "Brokerage Fees and Compensation," states, in relevant part:

(a) A licensee shall not receive, either directly or indirectly, any commission, rebate or other valuable consideration of more than nominal value from a vendor or a supplier of goods and services for an expenditure made on behalf of the licensee's principal in a real estate transaction without the written consent of the licensee's principal.

In other words, a broker must have a client's WRITTEN consent in order to receive consideration "of more than nominal\* value" for arranging the use of a goods / service provider on behalf of the client.

\*What is "nominal?" The last sentence of Rule A.0109(e) defines "nominal value" as meaning "...of insignificant, token or merely symbolic worth." It means a pittance, a trifle. It is not dependent upon nor related to the value of the property, goods, or services provided.

A broker must have written consent whether consideration is being paid to the broker by the service provider or the broker is charging the owner a service fee. Here are two possible examples:

- A broker pays a service provider directly for work performed on behalf of an owner-client. The broker then charges the invoiced amount plus a "service charge" to the owner-client.
- A broker pays a service provider for work performed on behalf of an owner-client. The service provider, in turn, pays the broker some agreed-upon fee for the referral.

In either situation, the broker must have the owner-client's written consent to receive consideration for the services provided.

Requiring a client's *written* consent for such consideration seeks to ensure that a client will be aware of his/her broker's potential financial interest or incentive in selecting the provider. Further, a broker should disclose to a client any personal relationship with/to or ownership interest in the service provider. The principal has a right to know from whom his/her agent is receiving any consideration so

the principal may assess any potential bias or self-interest the agent may have that may be contrary to the agent's duty to promote the principal's interests above the agent's interests.

**BOTTOM LINE:** Any fees a broker intends to charge an owner-principal for brokerage services to be provided must be clearly disclosed and authorized in the written agency agreement with the owner, whether in a sales or lease transaction. ***Rule A.0109(a) applies to all real estate transactions!***

## Chapter 42 and 42A Revised Laws

[Strikethroughs = deleted language; Bold/Underline = new language.]

### § 42-50. Deposits from the tenant.

Security deposits from the tenant in residential dwelling units shall be deposited in a trust account with a licensed and ~~insured bank or savings institution located in the State of North Carolina~~ **federally insured depository institution** ~~lawfully doing business in this State~~ **or a trust institution authorized to do business in this State**, or the landlord may, at ~~his~~ **the landlord's** option, furnish a bond from an insurance company licensed to do business in North Carolina. The security deposits from the tenant may be held in a trust account outside of the State of North Carolina only if the landlord provides the tenant with an adequate bond in the amount of ~~said~~ **the** deposits. The landlord or ~~his~~ **the landlord's** agent shall notify the tenant within 30 days after the beginning of the lease term of the name and address of the bank or institution where ~~his~~ **the tenant's** deposit is currently located or the name of the insurance company providing the bond.

### § 42A-15. Trust account uses.

A landlord or real estate broker may require a tenant to pay all or part of any required rent, security deposit, or other fees permitted by law in advance of the commencement of a tenancy under this Chapter if these payments are expressly authorized in the vacation rental agreement. If the tenant is required to make any advance payments, other than a security deposit, whether the payment is denominated as rent or otherwise, the landlord or real estate broker shall deposit these payments in a trust account in ~~an insured bank or savings and loan association in North Carolina~~ **a federally insured depository institution** ~~lawfully doing business in this State~~ **or a trust institution authorized to do business in this State** no later than three banking days after the receipt of these payments. These payments deposited in a trust account shall not earn interest unless the landlord and tenant agree in the vacation rental agreement that the payments may be deposited in an interest-bearing account. The landlord and tenant shall also provide in the agreement to whom the accrued interest shall be disbursed.

## SESSION LAW 2016-98

AN ACT TO AMEND THE VACATION RENTAL ACT TO CLARIFY THE ROLE OF REAL ESTATE BROKERS IN TRANSACTIONS BETWEEN LANDLORDS AND TENANTS, TO PROTECT MEMBERS OF THE ARMED FORCES BY ALLOWING TERMINATION OF RENTAL AGREEMENTS UPON TRANSFER OR REDEPLOYMENT, TO CLARIFY THE PROCEDURE FOR AWARDED AND COLLECTING CERTAIN COURT FEES IN EVICTION PROCEEDINGS

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The General Assembly of North Carolina enacts:

### **PART I. CHANGES TO THE VACATION RENTAL ACT/SUMMARY EJECTMENT/ RESIDENTIAL RENTAL AGREEMENTS**

**SECTION 1.1.** G.S. 42A-4 reads as rewritten:

#### **§ 42A-4. Definitions.**

The following definitions apply in this Chapter:

(1) Advanced payments. – All payments made by a tenant in a vacation rental agreement to a landlord or the landlord's real estate broker prior to occupancy for the purpose of renting a vacation rental property for a future period of time as specified in the vacation rental agreement.



(1a) Landlord. – An owner of residential property offered for lease as a vacation rental with or without the assistance of a real estate broker.

(1b) through (1f) Reserved.

(1g) Real estate broker. – A real estate broker as defined in G.S. 93A-2(a).

(2) Residential property. – An apartment, condominium, single-family home, townhouse, cottage, or other property that is devoted to residential use or occupancy by one or more persons for a definite or indefinite period.

(3) Vacation rental. – The rental of residential property for vacation, leisure, or recreation purposes for fewer than 90 days by a person who has a place of permanent residence to which he or she intends to return.

(4) Vacation rental agreement. – A written agreement between a landlord or his or her real estate broker and a tenant in which the tenant agrees to rent residential property belonging to the landlord for a vacation rental. (1999-420, s. 1; 2016-98, s. 1.1.)

**SECTION 1.2. G.S. 42A-19(b)** reads as rewritten:

"(b) Except as otherwise provided in this subsection, upon termination of the landlord's interest in the residential property subject to a vacation rental agreement, whether by sale, assignment, death, appointment of receiver or otherwise, the landlord or the landlord's agent, or the real estate broker, shall, within 30 days, transfer all advance rent paid by the tenant, and the portion of any fees remaining after any lawful deductions made under G.S. 42A-16, to the landlord's successor in interest and thereafter notify the tenant by mail of such transfer and of the transferee's name and address. **If a real estate broker is holding advanced rents paid by the tenant pursuant to a vacation rental agreement at the time of the termination of the landlord's interest, the real estate broker may deduct from the advanced rents transferred to the landlord's successor in interest any management fee earned by the real estate broker prior to the transfer. The written agency agreement between the landlord and the real estate broker shall govern when the fee has been earned. If the real estate broker deducts an earned management fee from the advanced rents, the landlord shall be responsible to the landlord's successor in interest for the amount deducted.** For vacation rentals that end more than 180 days after the recording of the interest of the landlord's successor in interest, unless the landlord's successor in interest has agreed in writing to honor the vacation rental agreement, the landlord or the landlord's agent, or the real estate broker, shall, within 30 days, transfer all advance rent paid by the tenant, and the portion of any fees remaining after any lawful deductions made under G.S. 42A-16, to the tenant. Compliance with this subsection shall relieve the landlord or real estate broker of further liability with respect to any payment of rent or fees. Funds held as a security deposit shall be disbursed in accordance with G.S. 42A-18."

**SECTION 1.3.** Article 5 of Chapter 42A of the General Statutes reads as rewritten:

Article 5.  
Landlord and Tenant Duties.

**§ 42A-31. Landlord to provide fit premises.**

A landlord of a residential property used for a vacation rental shall:

(1) Comply with all current applicable building and housing ~~codes~~**codes to the extent required by the operation of the codes. However, no new requirement is imposed if a structure is exempt from a current building or housing code.**

...

**(6) Provide a minimum of one operable carbon monoxide alarm per rental unit per level, either battery-operated or electrical, that is listed by a nationally recognized testing laboratory that is OSHA-approved to test and certify to American National Standards Institute/Underwriters Laboratories Standards ANSI/UL2034 or ANSI/UL2075, and install the carbon monoxide alarms in accordance with either the standards of the National Fire Protection Association or the minimum**

protection designated in the manufacturer's instructions, which the landlord shall retain or provide as proof of compliance. A landlord that installs one carbon monoxide alarm per rental unit per level shall be deemed to be in compliance with standards under this subdivision covering the location and number of alarms. The landlord shall replace or repair the carbon monoxide alarms within three days of receipt of notification if the landlord is notified of needed replacement or repairs in writing by the tenant. At least every six months, the landlord shall ensure that a carbon monoxide alarm is operable and in good repair. Unless the landlord and the tenant have a written agreement to the contrary, the landlord shall place new batteries in a battery-operated carbon monoxide alarm annually and the tenant shall replace the batteries as needed during the tenancy. Failure of the tenant to replace the batteries as needed shall not be considered as negligence on the part of the tenant or the landlord. A carbon monoxide alarm may be combined with smoke alarms if the combined alarm does both of the following: (i) complies with ANSI/UL2034 or ANSI/UL2075 for carbon monoxide alarms and ANSI/UL217 for smoke alarms and (ii) emits an alarm in a manner that clearly differentiates between detecting the presence of carbon monoxide and the presence of smoke. This subdivision applies only to dwelling units having a fossil-fuel burning heater, appliance, or fireplace and in any dwelling unit having an attached garage. Any operable carbon monoxide detector installed before January 1, 2015, shall be deemed to be in compliance with this subdivision.

These duties shall not be waived; however, the landlord and tenant may make additional covenants not inconsistent herewith in the vacation rental agreement.

...

**"§ 42A-33. Responsibilities and liability of real estate broker.**

**(a) A real estate broker managing a vacation rental property on behalf of a landlord shall do all of the following:**

- (1) Manage the property in accordance with the terms of the written agency agreement signed by the landlord and real estate broker.**
- (2) Offer vacation rental property to the public for leasing in compliance with all applicable federal and State laws, regulations, and ethical duties, including, but not limited to, those prohibiting discrimination on the basis of race, color, religion, sex, national origin, handicapping condition, or familial status.**
- (3) Notify the landlord regarding any necessary repairs to keep the property in a fit and habitable or safe condition and follow the landlord's direction in arranging for any such necessary repairs, including repairs to all electrical, plumbing, sanitary, heating, ventilating, and other facilities and major appliances supplied by the landlord upon written notification from the tenant that repairs are needed.**
- (4) Verify that the landlord has installed operable smoke detectors and carbon monoxide alarms.**
- (5) Verify that the landlord has annually placed new batteries in a battery-operated smoke detector or carbon monoxide alarm. Failure of the tenant to replace the batteries as needed shall not be considered negligence on the part of the real estate broker.**

**(b) A real estate broker or firm managing a vacation rental property on behalf of a landlord client shall not become personally liable as a party in any civil action between the landlord and tenant solely because the real estate broker or firm fails to identify the landlord of the property in the vacation rental agreement."**

**SECTION 1.4.** Article 6 of Chapter 42A of the General Statutes is amended by adding a new section to read:

**"§ 42A-37. Early termination of vacation rental agreement by military personnel.**

**(a) Any member of the Armed Forces of the United States who executes a vacation rental agreement and subsequently receives (i) an order for deployment with a military unit for a period**

overlapping with the rental period or (ii) permanent change of station orders requiring the member to relocate on a date prior to the beginning of the lease term may terminate the member's vacation rental agreement by providing the landlord or landlord's agent with a written notice of termination within 10 calendar days of receipt of the order. The notice must be accompanied by either a copy of the official military orders or a written verification signed by the member's commanding officer. Termination of a lease pursuant to this subsection is effective immediately upon receipt of the notice by the landlord or landlord's agent. All monies paid by the terminating member, with the exception of nonrefundable fees paid to third parties as described in G.S. 42-16(a), in connection with the vacation rental agreement shall be refunded to the member within 30 days of termination of the agreement.

(b) A member's termination of a vacation rental agreement pursuant to subsection (a) of this section shall also terminate any obligation a spouse or dependent of the member may have under the vacation rental agreement.

(c) The right to terminate a vacation rental agreement as described in subsection (a) of this section shall extend to the spouse of any member of the Armed Forces of the United States. A spouse exercising the right to terminate a rental agreement shall provide the same notice as described in subsection (a) of this section.

(d) The provisions of this section may not be waived or modified by the agreement of the parties."

SECTION 1.6. G.S. 42-44 reads as rewritten:

"§ 42-44. General remedies, penalties, and limitations.

...

(c1) A real estate broker or firm as defined in G.S. 93A-2 managing a rental property on behalf of a landlord shall not be personally liable as a party in a civil action between the landlord and tenant solely because the real estate broker or firm fails to identify the landlord of the property in the rental agreement.

...."

SECTION 1.7. G.S. 42-46 reads as rewritten:

"§ 42-46. Authorized fees.~~late fees and eviction fees.~~

...

(f) Court-Appearance Fee. – Pursuant to a written lease, a landlord may charge a court-appearance fee in an amount equal to ten percent (10%) of the monthly rent only if the tenant was in default of the lease;~~lease and~~ the landlord filed, served, and prosecuted successfully a complaint for summary ejection and/or monies owed in the small claims court; ~~and neither party appealed the judgment of the magistrate court.~~ If the tenant appeals the judgment of the magistrate, and the magistrate's judgment is vacated, any fee awarded by a magistrate to the landlord under this subsection shall be vacated.

(g) Second Trial Fee. – Pursuant to a written lease, a landlord may charge a second trial fee for a new trial following an appeal from the judgment of a magistrate. To qualify for the fee, the landlord must prove that the tenant was in default of the lease and the landlord prevailed. The landlord's fee may not exceed twelve percent (12%) of the monthly rent in the lease.

(h) Limitations on Charging and Collection of Fees.

- (1) A landlord who claims fees under subsections (e) through (g) of this section is entitled to charge and retain only one of the above fees for the landlord's complaint for summary ejection and/or money owed.
- (2) A landlord who earns a fee under subsections (e) through (g) of this section may not deduct payment of that fee from a tenant's subsequent rent payment or declare a failure to pay the fee as a default of the lease for a subsequent summary ejection action.
- (3) It is contrary to public policy for a landlord to put in a lease or claim any fee for filing a complaint for summary ejection and/or money owed other than the ones expressly authorized by subsections (e) through (g) of this section, and a reasonable attorney's fee as allowed by law.
- (4) Any provision of a residential rental agreement contrary to the provisions of this section is against the public policy of this State and therefore void and unenforceable.
- (5) If the rent is subsidized by the United States Department of Housing and Urban Development, by the United States Department of Agriculture, by a State agency, by a public housing authority, or by a local government, any fee charged pursuant to this

section shall be calculated on the tenant's share of the contract rent only, and the rent subsidy shall not be included."

**SECTION 1.8.** G.S. 93A-2(c)(6) reads as rewritten:

- "(6) Any salaried person employed by a licensed real estate broker, for and on behalf of the owner of any real estate or the improvements thereon, which the licensed broker has contracted to manage for the owner, if the salaried employee's employment is limited to: exhibiting units on the real estate to prospective tenants; providing the prospective tenants with information about the lease of the units; accepting applications for lease of the units; completing and executing preprinted form leases; and accepting security deposits and rental payments for the units only when the deposits and rental payments are made payable to the owner or the broker employed by the owner. The salaried employee shall not negotiate the amount of security deposits or rental payments and shall not negotiate leases or any rental agreements on behalf of the owner or broker. However, in a vacation rental transaction as defined by ~~G.S. 42A-4(3)~~, **G.S. 42A-4(6)**, the employee may offer a prospective tenant a rental price and term from a schedule setting forth prices and terms and the conditions and limitations under which they may be offered. The schedule shall be written and provided by the employee's employing broker with the written authority of the landlord."

**SECTION 1.9.** This Part becomes **effective July 1, 2016**. Nothing in this Part shall be construed as being applicable to or affecting any litigation pending on that date.

The Model Policy on Screening Applicants with Criminal Records developed by NCHFA, DHHA, and the NC Justice Center is reprinted here.

## **Model Policy on Screening Applicants with Criminal Records**

### **Screening Process**

- In an addendum to the application form, the management company will explain its policies and procedures on criminal activity and will inform the applicant of his or her right to request a reasonable accommodation. The addendum will also inform the applicant of his or her opportunity to submit with the application evidence of mitigating circumstances if the admissions criteria provides for an individualized assessment of the applicant's specific criminal activity.
- The management company will conduct a criminal background check on each adult member of an applicant household. An adult means a person 18 or older.
- If the criminal background report reveals negative information about a household member and the management company proposes to deny admission due to the negative information, the subject of the record (and the applicant, if different) will be provided notice of the proposed adverse action and an opportunity to dispute the accuracy of the record. The notice will include the name, address, and telephone number of the agency that composed the criminal record report and inform the applicant of his or her right to dispute the accuracy of the criminal record report as well as his or her right to a free copy of the criminal record report.
- If the applicant does not contact the management company to dispute the accuracy of the criminal record within 10 days, the management company will send a written notice of ineligibility to the applicant stating the specific reason for denial. If the applicant did not contact the management company within the specified time period due to a disability, the management company will provide a reasonable accommodation extending the dispute period as is reasonable.

### **Admissions Criteria**

- If a member of an applicant household has been convicted of a felony offense involving the sale or manufacture of a controlled substance, the management company:
  - Will deny admission if the conviction, or exit from incarceration, occurred within 5 years of application;
  - May deny admission if the conviction, or exit from incarceration, occurred more than 5 years but within 10 years of application;
  - Will not deny admission if the conviction, or exit from incarceration, occurred more than 10 years before application.
- If a member of an applicant household has been convicted of a violent felony offense, the management company:
  - Will deny admission if the conviction, or exit from incarceration, occurred within 5 years of application; and
  - May deny admission if the conviction, or exit from incarceration, occurred more than 5 years before application.
- If a member of an applicant household has been convicted of a nonviolent felony offense, the management company:

- May deny admission if the conviction, or exit from incarceration, occurred within 7 years of application;
  - Will not deny admission if the conviction, or exit from incarceration, occurred more than 7 years before application.
- If a member of an applicant household has been convicted of a violent misdemeanor, the management company:
  - Will deny admission if the conviction, or exit from incarceration, occurred within 2 years of application;
  - May deny admission if the conviction, or exit from incarceration, occurred more than 2 years before application.
- If a member of an applicant household has been convicted of a nonviolent misdemeanor offense, the management company:
  - May deny admission if the conviction, or exit from incarceration, occurred within 5 years of application; and
  - Will not deny admission if the conviction, or exit from incarceration, occurred more than 5 years before application.
- A violent felony is a Class A, B, C, D, E, F, or G felony or any felony requiring registration on the sex offender registry. A nonviolent felony is a Class H or I felony.
- A violent misdemeanor is a Class A1 misdemeanor or a misdemeanor requiring registration on the sex offender registry. A nonviolent misdemeanor is a Class 1, 2, or 3 misdemeanor.
- 
- The management company will not consider an arrest or charge that was resolved without conviction. In addition, the management company will not consider expunged or sealed convictions. The management may deny admission if an applicant has pending charges at the time of application.
- Where the management company “may deny” admission to a household based on a criminal conviction or pending criminal charge, the management company will conduct an individualized assessment of the criminal record and its impact on the household’s suitability for admission. This individualized assessment will include consideration of the following factors: (1) the seriousness of the criminal offense; (2) the relationship between the criminal offense and the safety and security of residents, staff, or property; (3) the length of time since the offense, with particular weight being given to significant periods of good behavior; (4) the age of the household member at the time of the offense; (5) the number and nature of any other criminal convictions; (6) evidence of rehabilitation, such as employment, participation in a job training program, education, participation in a drug or alcohol treatment program, or recommendations from a parole or probation officer, employer, teacher, social worker, or community leader; and (7) tenancy supports or other risk mitigation services the applicant will be receiving during tenancy.
- If the applicant’s criminal conviction was related to his or her disability, the management company will consider a reasonable accommodation.

Revised: 12-10-15

# Answers to Discussion Questions

## Page 17 Scenarios

1. Harry lives and works in South Carolina where he is broker-in-charge of an office in Little River. He manages vacation rentals and long-term residential rental property in both North and South Carolina and maintains two separate escrow accounts at a federally insured bank located in Little River. He deposits all monies from the South Carolina properties into one escrow account and all monies from the North Carolina properties into the second escrow account. May Harry legally deposit all monies from/for the North Carolina properties in the escrow account in Little River, SC? Why or why not?

*Answer: It depends. If the federally insured bank located in Little River, South Carolina is legally authorized to do business in North Carolina, then Harry may legally deposit the monies from/for the North Carolina properties in the account.*

2. Norman, a licensed broker, has been managing several properties for a particular owner-client for 10 years. He and the owner are friends. Each month, tenants submit rent checks to Norman. The checks are made payable to the owner, and Norman takes them to the owner's banking institution and deposits them into the owner's account. Norman is careful to deposit the checks within 3 days of receipt. In turn, the owner pays Norman a management fee each month. Is this an acceptable practice? Why or why not?

*Answer: No. Commission Rules require Norman to deposit trust monies into a trust/escrow account. Other than checks for Due Diligence Fees and Earnest Money Deposits, Norman may not "deliver" checks made payable to someone else. Norman may either direct the tenants to make checks payable to his firm and deposit the checks into his firm's trust/escrow account OR direct the tenants to mail the rent checks directly to the owner.*

3. Sally, a licensed broker, has 15 salaried employees who help her lease units and collect rents in three multi-family residential properties Sally manages. To help her employees screen tenant applications, Sally adopts a policy rejecting any prospective tenant who has a criminal conviction. Is Sally's policy lawful? Why or why not?

*Answer: Probably not. Sally is inviting an inquiry by HUD. As noted in the concluding paragraphs of HUD's General Counsel's Guidance:*

*While the Act does not prohibit housing providers from appropriately considering criminal history information when making housing decisions, arbitrary and overbroad criminal history-related bans are likely to lack a legally sufficient justification. Thus, a discriminatory effect resulting from a policy or practice that denies housing to anyone with a prior arrest or any kind of criminal conviction cannot be justified, and therefore such a practice would violate the Fair Housing Act.*

4. You are the listing agent for a property that's been on the market for 8 months. Your owner-client tells you she needs income from the property and wants to rent instead of sell it. She asks you to find a renter. What should you do?

*Answer: First, determine whether your firm's policies allow you to act in this capacity. Next, determine whether your current agency agreement authorizes you to act in this capacity. If it does not, enter into a written agency agreement for the services to be provided **before** providing those services.*

## **Page 21 For Discussion**

1. What types of payments do vacation rental tenants make prior to occupancy?

*Answers will include rent, security deposit, sales or occupancy tax, administrative fees, etc.*

2. If a broker collects advanced payments from a vacation rental tenant, must the broker deposit the payments in a trust or escrow account?

*Answer: Yes.*

## **Page 22 For Discussion**

Gerald owns a property that he uses as a vacation rental. He has hired XYZ Realty to manage the property on his behalf. Gerald decides to sell the property to Terri. Gerald and Terri enter into a sales contract.

XYZ Realty is holding advanced rent payments in the amount of \$5500 from tenants. Based on the terms of the property management agreement with Gerald, XYZ Realty is owed \$550 in management fees. On the date of closing, XYZ Realty deducts \$550 from the collected advanced rent monies and transfers the balance of \$4950 to Terri.

Because the management fee was deducted, Terri has not received the entire advanced rent that is due to her. Who must pay her the \$550 difference?

*Answer: Gerald must pay Terri the \$550 difference.*

## **Page 23 For Discussion**

In addition to the minimum standards set forth in the Vacation Rental Act, brokers must adhere to License Law and Commission Rules. List additional duties and responsibilities required of brokers engaged in property management under License Law and Commission Rules:

*Answers will include agency duties, timely delivery of executed documents, material fact disclosure, etc.*

## **Page 25 For Discussion**

1. What are some legal tenant-screening criteria?

*Answers will include credit-based criteria, first-come/first-served, employment history, etc.*



2. May a prospective tenant's arrest record be used to screen tenant applications? Why or why not?

*Answer: No. Arrests are not a reliable indicator of past criminal activity.*

3. True or False? Consistently refusing to rent to anyone that has any criminal conviction would remove the possibility of discrimination since the criterion is the same for everyone. Explain your answer.

*Answer: False. HUD Guidelines caution against blanket exclusions. Studies on criminal convictions support claims of disparate impact on some protected classes such as race or ethnic background.*

4. What factors might be legally used to determine if previous criminal convictions will affect tenant approval?

*Answers may include: nature and severity of the crime, how long ago the conviction occurred, the age of the person at the time of conviction, whether there were mitigating circumstances, and the person's conduct since the conviction.*

5. Would it be okay to deny tenancy to anyone convicted of the manufacture of crystal meth?

*Answer: Yes. Conviction (not arrest) for the illegal manufacture and/or distribution of a controlled substance can be a blanket exclusion per HUD Guidelines (but not mere possession of a controlled substance).*

6. What procedures might a PM/landlord put in place to assure non-discriminatory use of criminal records in tenant screening?

*Answers may include: use of clear, specific reasoning for the criminal history-based policy/practice that can be supported by evidence; consideration of the nature and severity of an individual's conviction before excluding the individual based on the conviction; use of individualized assessments that take into account mitigating factors, such as facts and circumstances surrounding the criminal conduct, age at the time of the conduct, evidence of good tenancy before/after conduct, and rehabilitative efforts.*

## **Page 28 For Discussion**

Betty is a full broker affiliated with XYZ Realty. She is the listing agent for a property that the seller has recently decided to convert into a rental property to generate income. The owner-client asks Betty to advertise the property for rent and find a tenant. Betty changes the listing in the MLS, locates a tenant, executes a lease agreement for one year, and accepts two checks from the tenant payable to the owner, one for the first and last month's rent and the other for the tenant security deposit. Betty mails both checks to the owner.

Has Betty complied with License Law and Commission Rules? Why or why not?

*Answer:*

*No. Considerations include:*

*Does the listing agreement authorize XYZ Realty to advertise the property for lease, procure a tenant, and accept trust monies, i.e., rent and security deposit payments?*

*If not, then Betty and the company need a written agency agreement with the owner specifying what property management services will be provided for what compensation and when the agency agreement will terminate.*

*May Betty take possession of checks for rent or security deposits made payable to someone other than her or the brokerage company for the purpose of delivering them to the named payee?*

*NO! Brokers should not be couriers of funds belonging to others. There are only two instances under the trust account rules when a broker may accept and safeguard a check payable to someone other than the broker or brokerage company, namely: A) a due diligence fee payable to the seller; and B) an earnest money deposit payable to a third party escrow agent. Any other monies that touch a broker's hand must be deposited into the broker's trust account and, once honored, disbursed to the appropriate payees.*

*Does Betty maintain a trust account?*

*It's doubtful, since she's conducting her sales brokerage activities as an affiliated agent with XYZ Realty, in which event any trust monies received by Betty should be deposited into the company's brokerage escrow account within three banking days of Betty's receipt and proper entries made on the journal and property ledger sheet.*

## **Page 30 For Discussion**

A broker is managing a 30,000 square foot office building for a corporate owner. The broker shows and leases office space, collects tenant security deposits and monthly rents, pays the overhead expenses for the building, and oversees all custodial, maintenance, and repair needs. The broker has a standing relationship with several service providers. The providers invoice the broker for work performed and the broker pays the invoiced amounts. In turn, the broker adds an 8% surcharge to the invoiced amounts [for contracting and coordinating the work] and deducts the total charges from the rents collected before disbursing rents to the owner.

Is the broker's practice acceptable? Why or why not?

*Answer: It depends. If the surcharge is disclosed and authorized in the written agency agreement, it would be acceptable.*