California State Senate

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BANKING AND FINANCIAL INSTITUTIONS

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HARD MONEY LENDING

BACKGROUND PAPER

JOINT INFORMATIONAL HEARING OF THE

SENATE BANKING AND FINANCIAL INSTITUTIONS COMMITTEE
Juan Vargas, Chair

and the

SENATE BUSINESS, PROFESSIONS AND ECONOMIC DEVELOPMENT COMMITTEE
Curren Price, Chair

JOINT INFORMATIONAL HEARING ON HARD MONEY LENDING
BACKGROUND BRIEFING DOCUMENT
JANUARY 2012

BACKGROUND

In June 2011, investigative reporters Charles Piller and Robert Lewis of the Sacramento Bee co-authored a two-part series on "hard money" lending fraud in Nevada County. That investigation stirred interest among legislators, who wished to learn more about the topic, and who were concerned about the potential existence of regulatory gaps that could place consumers in harm's way.

On January 18, 2012, the Senate Banking and Financial Institutions Committee and Senate Business, Professions and Economic Development Committee will hold a joint oversight hearing to investigate these topics. This background paper is intended to provide a factual summary, which can be used by committee members and other interested parties to address the following questions:

- What is hard money lending?
- How is it regulated, and by whom?
- Is the existing regulatory structure protective of consumers who obtain hard money loans? Is it protective of persons who invest money used to fund hard money loans?
- Does the existing regulatory structure allow members of the regulated industry to engage in regulatory arbitrage (i.e., to structure their business activities in ways that allow them to pick and choose their regulator and the laws under which they are regulated, to ensure the least possible oversight)?
- Are changes to the laws under which hard money lenders and brokers raise and lend money necessary or desirable?

WHAT IS HARD MONEY LENDING?

California's codes do not define "hard money" lending. The phrase typically refers to the act of lending money to an individual or a business, without the involvement of a traditional financial institution. Commonly, borrowers who seek out hard money loans cannot obtain financing through other means. For these borrowers, money is hard to come by – thus "hard money" lending. Hard money lending is also known as private money lending, because the funds are typically provided by private investors, rather than institutional investors.

Hard money lenders typically lend to borrowers unable to obtain credit elsewhere, or to borrowers who need money more quickly than traditional lenders can fund a loan. Because most borrowers who obtain hard money loans have nowhere else to go for the money, the terms of hard money loans tend to be less favorable to borrowers than more traditional loans. Interest rates and points tend to be higher, and loan lengths tend to be shorter than those offered by more traditional lenders.

It is significant to note, however, that hard money lending is not a synonym for subprime lending. To be sure, some hard money loans are made to people with tarnished credit, whose low credit scores render them ineligible for more traditional forms of credit. However, significantly more hard money loans are made to people who have significant equity in their

property, but who lack a significant, steady source of income, lack the ability to document their sources of income, or who, for other reasons, have circumstances that render them ineligible for loans underwritten using the one-size-fits-all underwriting standards applied by traditional financial institutions. As regulators have tightened down on traditional lenders' underwriting standards, hard money lending has become a source of "credit of last resort" for more and more groups of people.

However, some of the recent federal and state changes to residential mortgage underwriting standards have also tightened down on the availability of credit from hard money lenders. Prior to recent statutory and regulatory changes, hard money lending was sometimes referred to as equity lending, because hard money lenders were far more willing than institutional lenders to lend based on the equity that a borrower had in his or her property; the existence of a steady income with which a borrower could make payments was less important than the existence of significant equity in the property.

Under recent changes to federal and state law, equity-based lending for residential purposes is no longer legal; instead, lenders must verify that a borrower has sufficient income to make both the monthly payments, and any scheduled balloon payment. This regulatory change is one of the primary reasons that most hard money loans currently made in California are made for commercial purposes. As federal and state regulations on residential lending have tightened, many hard money lenders in California have exited the residential mortgage lending market, and migrated to the commercial space.

Like residential hard money loans, commercial-purpose hard money loans fill a unique niche. While most commercial-purpose hard money loans bear striking similarities to residential-purpose hard money loans (i.e., they represent a source of credit to borrowers unable to obtain more traditional financing, due to the credit score, income stream, or other unique circumstances of the borrower seeking the loan), other commercial-purpose hard money loans reflect more subtle social pressures felt by traditional lenders. Many churches, for example, obtain financing through hard money lenders. Traditional lenders are reluctant to lend to churches, because of the difficulty in underwriting them, and out of fear that they might be in a position of having to foreclose on a church. On the flip side of the social scale, many x-rated establishments also obtain hard money loans, because traditional lenders do not wish to become the owners of x-rated establishments through foreclosure.

THRESHOLD BROKERS

Most hard money loans in California are made or arranged by licensed real estate brokers. Article 5 of the Real Estate Law establishes a separate category of real estate brokers known as threshold brokers. Threshold brokers are brokers who intend or reasonably expect to do any of the following in any consecutive 12-month period:

1. Negotiate a combination of 10 or more real property loans or business opportunities, or sales contracts or promissory notes secured by real property loans or business opportunities, in an aggregate amount of $1 million or more. The real estate licensee can

either act on behalf of another party (i.e., act as a broker), or can be the owner of the property or the sales contracts or notes (i.e., act as a lender).

2. Collect payments of at least $250,000, in the aggregate, on behalf of themselves, or on behalf of lenders, or owners of promissory notes secured by real property (i.e., act as a servicer).

Significantly, *if the lender or purchaser is an institutional lender,* loans or sales negotiated by a broker, or for which a broker collects payments or provides other servicing for the owner of the note or contract, are *not* counted toward the threshold broker criteria,. Institutional lenders include federal housing entities and government-sponsored enterprises (e.g., Fannie Mae, Freddie Mac, the Federal Housing Administration, and the Veterans Administration), depository institutions regulated by either the state or federal government, pensions and other profit-sharing funds with a net worth of at least $15 million, corporations registered with the Securities and Exchange Commission, the California Housing Finance Agency, a person licensed by the California Department of Corporations as a residential mortgage lender or servicer, or an institutional investor that issues mortgage-backed securities in accordance with a specified section of the California Financial Code. **For this reason, threshold brokers can generally be thought of as those who make, broker, and/or service mortgage loans on behalf of private individuals and small pension plans.**

The following are a few examples of activities in which threshold brokers can engage:

1. The broker can receive money from an individual investor or a small pension plan, and can lend that money out to an individual or a business owner seeking to purchase or refinance real property. In this instance, the threshold broker is acting as a broker.

2. The broker can arrange a loan made by an individual investor or a small pension plan directly to an individual or business owner seeking to purchase or refinance real property. In this instance, the threshold broker is acting as a broker.

3. The broker can fund a loan from a line of credit obtained from a depository institution, mortgage bank, or insurance company, or from personal funds, and then sell all or part interest in that loan to a private investor or investors. In this instance, the threshold broker is acting as a lender.

4. The broker can service any of the types of loans described immediately above (i.e., collect monthly mortgage payments from the borrower, and transmit them to the investor/pension plan).

According to DRE, there were 356 threshold brokers operating in California during 2010 (see Table 1). These brokers made, arranged, and serviced over $3.2 billion in loans.

Because they handle large amounts of money on a regular basis, threshold brokers are subject to special reporting and disclosure requirements not imposed on other real estate licensees. A

complete list of the threshold broker requirements is contained in Article 5 of Business and Professions Code (Sections 10230 et seq.). A summary of the key requirements is listed immediately below:

1. All loan funds accepted from lenders, prospective lenders, borrowers, or prospective borrowers must be placed into escrow or a trust account. Under no condition may funds be retained by a licensee for longer than 25 days, except pursuant to a written agreement with the party from whom the funds were obtained (B&P Sections 10231 and 10231.1).

2. Threshold brokers must file quarterly trust fund status reports, and an annual report prepared by a licensed California independent public accountant of the broker's trust fund financial statements. They must also file annual business activity reports in which they summarize the number and aggregate dollar amount of loans, trust deed sales, and real property sales negotiated; the number and aggregate dollar amount of promissory notes and contracts serviced by the broker or an affiliate of the broker; the number and aggregate dollar amount of late payment charges, prepayment penalties, and other fees or charges collected and retained by the broker under servicing agreements; default and foreclosure experience in connection with promissory notes and contracts subject to servicing agreements; commissions received by the broker for services performed as an agent in negotiating loans and sales of promissory notes and real property sales contracts; and aggregate costs and expenses paid by borrowers to the broker. (B&P Sections 10232.2 and 10232.25).

3. Threshold brokers who negotiate loans to be secured by a lien on real property or on a business opportunity must provide specified disclosure statements to the prospective lender (i.e., to the investor). This disclosure statement must include the address of the real property; the estimated fair market value of the property, as determined by an appraisal, or, in limited circumstances, by a broker price opinion; the age, size, type of construction, and a description of improvements to the property; information about the prospective borrower or borrowers; terms of the promissory note; information about all encumbrances that constitute liens against the property; provisions for servicing the loan; and information about any arrangement under which the prospective lenders, along with persons not otherwise associated with him or her, will be joint beneficiaries or obligees. (B&P Section 10232.5).

4. Threshold brokers who negotiate the sale of a real property sales contract or promissory note secured by a lien on real property must provide a specified disclosure statement to the prospective purchaser. This disclosure statement must include the address of the real property; the estimated fair market value of the property, as determined by an appraisal; the age, size, type of construction, and a description of improvements to the property; information relative to the ability of the trustor or vendee to meet his or her contractual obligations under the note or contract; terms of the contract or note, including the principal balance owing; provisions for servicing the note; and information about any arrangement under which the prospective purchaser, along with persons not otherwise associated with him or her, will be joint beneficiaries or obligees. (B&P Section

10232.5).

5. Threshold brokers are subject to special reporting and disclosure requirements, if they engage in self-dealing (i.e., if they solicit or accept funds that will be applied to a purchase or a loan transaction in which the broker will directly or indirectly obtain the use or benefit of the funds, other than for commissions, fees, and costs and expenses). Under rules contained in Article 5, if a broker seeks to engage in self-dealing, that broker must sign and send a copy of the disclosure statement that will be provided by the broker to the investor or the purchaser pursuant to Section 10232.5 to the Department of Real Estate, at least 24 hours before soliciting funds from any investor or executing any instrument obligating a purchaser or investor. (B&P Section 10232.1).

Table 1 summarizes some of the key threshold broker statistics tracked by DRE, using information contained in the annual reports submitted by threshold brokers. A copy of the most recent report published by DRE about the activities of its threshold brokers can be found here: http://www.dre.ca.gov/pdf_docs/composite_report_2009.pdf.

MULTI-LENDER LOANS ARRANGED BY REAL ESTATE BROKERS

Frequently, threshold brokers encounter situations in which a borrower is seeking more money than a single investor is willing to lend to one person. In situations like these, it is not uncommon for a threshold broker to pool money from multiple investors, for purposes of funding a loan. These situations are called multi-lender loans, and they are regulated by an additional article of the Real Estate Law (Article 6).

Threshold brokers may make, arrange, and/or service multi-lender loans, as long as funds from no more than ten investors are pooled into a single loan, and as long as these threshold brokers comply with the provisions of Article 6. However, it is important to note that compliance with Article 6 does not eliminate the requirement to comply with Article 5. Threshold brokers who engage in multi-lender loans must comply with the provisions of Article 5 (quarterly trust fund financial statements, annual audited financial statements, annual business activity reports, specified disclosure statements), as well as the provisions of Article 6.

Article 6 covers any transaction that involves the sale of or offer to sell a series of notes secured directly by interests in one or more parcels of real property, or the sale of undivided interests in a note secured directly by one or more parcels of real property equivalent to a series transaction. Technically, the threshold broker is creating a security, and is selling fractionalized interests in that security to investors. Because sales of securities are otherwise regulated by the Department of Corporations, Article 6 provides an exemption from the requirement to register that security with the Department of Corporations, provided the threshold broker complies with the provisions of Article 6.

Business and Professions Code Section 10238 provides an exhaustive list of all of the requirements of Article 6. The following discussion summarizes a few of the most significant requirements contained in that code section.

Under Article 6, the notes or interests may not be sold to more than 10 persons, each of which must certify that he or she meets the income and net worth requirements specified in Article 6 (the investment cannot exceed 10% of the investor's net worth, exclusive of home, furnishings, or automobiles; or, in the alternative, the investment cannot exceed 10% of the investor's adjusted gross income for federal income tax purposes for the last tax year, or as estimated for the current year).

Article 6 also limits sales of the security to persons who reside in California. The real property that is the subject of the security must be located in California, and the property that will secure the loan must be identified prior to soliciting investors. The investors who purchase the security must reside in California, and the borrower(s) must reside in California.

Furthermore, under Article 6, the rights of each purchaser of a fractionalized interest in the same security must be identical. The percentage owned in the note by each investor may vary (i.e., one investor may hold a 50% ownership interest, while five other investors may hold 10% each), and the purchase price of an interest may vary, to reasonably reflect changes in the market value of the loan between sales of the interests, but all of the notes and interests must be identical in their underlying terms, such as the right to direct or require foreclosure, and the right to and rate of interest. The only exception to this "equal rights" requirement is found in Civil Code Section 2941.9. That code section states that, in the event of default or foreclosure on the note, the holders of more than 50 percent of the recorded beneficial interests in the notes may decide the actions taken on behalf of all holders of the beneficial interests.

In an attempt to protect investors, Article 6 limits the loan-to-value ratio of loans made pursuant to its provisions. Under Article 6, the aggregate principal amount of the notes or interests sold by a broker, together with the unpaid principal amount of any encumbrances upon the real property that are senior to the notes or interests sold by the broker, may not exceed specified percentages of the property's current fair market value (e.g., 80 percent of the current fair market value of improved real property, 50 percent of the current fair market value of unimproved property zoned for commercial or residential use, and 35% of the fair market value of other unimproved land).

In another move to protect investors, self-dealing is prohibited on Article 6 loans, regardless of whether prospective investors or purchasers are notified by the broker of his or her intent to self-deal.

There is no limit to the number of multi-lender loans that a broker can make, arrange, or service, pursuant to Article 6. Some of the larger threshold brokers administer dozens of multi-lender loans at the same time, and some of the larger investors own fractionalized interests in multiple Article 6 loans at the same time. Multi-lender loans can represent a significant source of profit for investors and real estate licensees who understand the market and who take on borrowers able to pay back their obligations; they can also represent a significant source of investment risk to those who invest too heavily in these loans, and/or to those who choose their borrowers less wisely.

ADDING A LAYER OF COMPLICATION: STATE AND FEDERAL SECURITIES LAWS

The two types of lending described above (one investor/one borrower, multi-investor/one borrower – all regulated by a single regulator) are fairly simple, within the universe of different types of hard money lending. However, once one ventures beyond the simplest forms of hard money lending, the topic must be subdivided into two halves to allow further discussion of the regulatory regime. One of these two halves involves raising money from investors; the other, related half involves investing that money in real estate ventures. Sometimes, as described in the pages above, both activities are overseen by the same regulator. Other times, as described in the pages below, the act of raising money is administered by a one regulator (typically the Department of Corporations), and the act of investing that money in real estate ventures is administered by a different regulator (typically the Department of Real Estate, although the Department of Corporations sometimes regulates this activity, as well).

RAISING MONEY FROM INVESTORS: SECURITIES PERMITS AND SECURITIES LAW EXEMPTIONS

Generally speaking, when an individual or a business is seeking to raise money from more than one individual, for purposes of placing that money into more than one investment, federal and state securities laws are triggered. California law defines a security (Corporations Code Section 25019) in multiple ways (e.g., as any note; stock; treasury stock; membership in an incorporated or unincorporated association; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral trust certificate; preorganization certificate or subscription; transferable share; investment contract; and myriad other definitions).

In the context of securities permits for hard money lending, the California Corporations Code contemplates the regulation of three types of securities transactions, including: 1) sale of a fractionalized interest in a specific note or portion thereof; 2) sale of a member interest in a limited liability company or limited partnership that holds more than one note; and 3) sale of a note payable by the issuer, with the note secured by an underlying pool of trust deeds. All three types of these securities transactions can involve the use of investor money to extend credit to others, for the purchase or financing of one or more parcels of real property.

Persons who wish sell securities in California may opt to do so either by obtaining a securities issuance permit from the Department of Corporations, or by utilizing one of several permitting exemptions contained in the Corporations Code. Securities, of course, are not limited to real estate; they can involve interests in a multitude of different business opportunities. It is also important to note that not all real estate securities involve hard money lending. A securities issuer can seek to raise money from investors, for the purpose of purchasing real estate. **It is only when an issuer seeks to raise money from investors for the purpose of funding one or more private money loans that the security involves hard money lending.**

REAL ESTATE SECURITIES

The discussion below is limited to a description of the ways(s) in which California law treats those who wish to raise money from investors, for purposes of investing that money, in part or in whole, in real estate.

Options for those who wish to issue real estate securities include the following:

1) Exemption from permitting contained in Corporations Code Section 25102.5: Corporations Code Section 25102.5 provides a permitting exemption for "a transaction that is the sale of a series of notes secured directly by an interest in the same real property, or the sale of undivided interests in a note secured directly by real property equivalent to a series transaction, that complies with all of the provisions of Article 6 (commencing with Section 10237) of Chapter 3 of Part 1 of Division 4 of the Business and Professions Code." In practice, this exemption means that if a real estate licensee complies with Article 6 of the Real Estate Law (described in more detail immediately above), that licensee does not require a securities permit issued by DOC in order to raise money from investors.

2) Exemption from permitting contained in Corporations Code Section 25102: Section 25102 contains several different subdivisions, which describe certain money-raising activities that may be undertaken, without requiring a securities permit from DOC. The criteria to qualify for each of the different subdivisions is different, as are the requirements of those who claim exemptions under each subdivision. Three of the most commonly used subdivisions include the following:

    a. 25102(e): Provides an exemption for any offer or sale of any evidence of indebtedness, whether secured or unsecured, and any guarantee of that indebtedness, in a transaction not involving a public offering. Through rule, DOC has restricted the 25102(e) exemption to issuers who extend a private offering to 25 or fewer people, and who sell that offering to 10 or fewer people. All of the offerees must either have a pre-existing personal or business relationship with the offeror or its partners, officers, directors, or controlling persons, or the issuer must believe that, by reason of their business or financial experience, the offerees could reasonably be assumed to have the capacity to protect their own interests in connection with the transaction. (Regulation 260.102.2).

    Persons who rely upon an exemption pursuant to Section 25102(e) need not file any paperwork with DOC, nor submit any filing fee. For all intents and purposes, they operate on an honor system, where they are expected to adhere to the terms of the exemption. DOC has no way to check on whether they are or are not acting in compliance with the exemption, because it receives no notification about who is relying upon the exemption.

b. 25102(f): Provides an exemption for any offer or sale of any security in a transaction (other than an offer or sale to a pension or profit-sharing trust of the issuer) that meets all of the following criteria: i) sales of the security are made to an unlimited number of accredited investors and up to 35 other persons, who are not accredited investors; ii) all purchasers either have a preexisting personal or business relationship with the offeror, or can reasonably be assumed to have the capacity to protect their own interests in connection with the transaction, by reason of their business or financial experience, or the business or financial experience of their professional advisers; iii) each purchaser represents that he or she is purchasing for his or her own account, and not with a view to or for sale in connection with any distribution of the security; and iv) the offer and sale of the security is not accomplished through the publication of any advertisement.

Accredited investors are defined under federal securities laws. The definition is intended to reflect investors who have the sophistication to look out for their own financial interests. The term includes financial institutions, securities broker-dealers, large pension plans, corporate entities with assets in excess of $5 million, and other large, financially sophisticated entities. It also includes private individuals whose individual net worth, or joint net worth with their spouse, exceeds $1 million at the time of their purchase, exclusive of their primary residence. In the alternative, a private individual qualifies as an accredited investor if they had individual income in excess of $200,000 in each of the two most recent years, or joint income with their spouse in excess of $300,000 in each of those years, and a reasonable expectation of reaching the same level of income in the year of their purchase.

Persons wishing to raise money pursuant to an exemption claimed under Section 25102(f) are required to notify the Commissioner of Corporations and pay a filing fee, no later than 15 calendar days after the first sale of a security in a transaction in California. The form governing the notice requests the name and contact information of the issuer, the issuer's state of incorporation, the title of the class or classes of securities to be sold, and the value of the securities sold or proposed to be sold, both in California and in total. Filing fees range from $25 to $300, depending on the value of securities proposed to be sold. Failure to file a form with DOC pursuant to Section 25102(f) does not disqualify the issuance of the security.

Existing law does not require persons who file for 25102(f) exemptions to submit annual reports, documenting the amounts raised, nor the purpose to which those funds were put. Exemptions claimed pursuant to Section 25102(f) are good for the length of the offering.

According to DOC, approximately 20,000 to 35,000 people file forms with DOC annually, claiming exemptions under Section 25102(f); see statistics in Table 2. It is unknown how many of these exemptions are filed by persons who are soliciting

money for real estate ventures, nor how many of these real estate ventures involve hard money lending.

c. 25102(n): Provides an exemption for any offer or sale of any security in a transaction that meets all of the following criteria: i) the issuer is not a "blind pool" issuer, as that term is defined by the Commissioner of Corporations; ii) sales of securities are made only to qualified purchasers or other persons the issuer reasonably believes, after reasonable inquiry, to be qualified purchasers; iii) each purchaser represents that he or she is purchasing for his or her own account, and not with a view to or for sale in connection with any distribution of the security; iv) each natural person purchaser is provided with a disclosure statement that meets the disclosure requirements of federal Regulation D (17 CFR 230.501 et seq.), at least five business days before they purchase or commit to purchase the security; v) the offer and sale of the security is made by way of a general announcement, whose content is strictly limited; and vi) telephone solicitation by the issuer is not permitted, until and unless the issuer determines that the prospective purchaser being solicited is a qualified purchaser.

For purposes of Section 25102(n), qualified purchasers are those who meet one or more of several criteria listed in that subdivision. Generally speaking, these criteria describe persons with some degree of financial sophistication. If they are individuals, they are persons who, either individually or jointly with their spouse, either have a minimum net worth of $250,000 and had, during the immediately preceding tax year, gross income in excess of $100,000, and reasonably expect gross income in excess of $100,000 during the current tax year; or, who have a minimum net worth of $500,000, not including their home, home furnishings, and automobiles. The amount of the investment by any natural person may not exceed 10% of that person's net worth.

DOC defines a blind pool as one in which money is raised from investors, before the property or properties on which loans will be extended by the pool is/are identified. In essence, investors are "blindly" buying into the pool, based on the experience of the pool manager, and are trusting the pool manager to invest their money wisely, without knowing against which properties money will be lent.

Persons wishing to raise money pursuant to an exemption claimed under Section 25102(n) are required to notify the Commissioner of Corporations and pay a filing fee, when they publish a general announcement informing the public about the existence of the security, or when they initially offer the security, whichever is earlier. Issuers are also required to file a form with the commissioner within 10 business days following the close or abandonment of the offering. Failure to file the initial form and pay the filing fee renders the exemption unavailable to the issuer, and subjects the issuer to an administrative penalty of up to $1,000. Failure to file the second form does not affect the availability of the exemption or generate a monetary penalty.

The initial form requests the name and contact information of the issuer, the issuer's state of incorporation, the title of the class or classes of securities to be sold, a copy of the general announcement accompanying the offering, and copies of disclosure statements and subscription agreements. Filing fees are $600.

According to DOC, between 20 and 50 people file forms with DOC annually, claiming exemptions under Section 25102(n); see statistics in Table 2. It is unknown how many of these exemptions are filed by persons who are selling real estate-related securities, though the general announcements required to be submitted by 25102(n) filers could provide some limited information about the nature of the offering.

Existing law does not require persons who file for 25102(n) exemptions to submit annual reports, documenting the amounts raised, nor the specific purposes to which those funds were put. Exemptions claimed pursuant to 25102(n) good for up to 210 days following submission of an initial filing.

3) Exemption from permitting contained in Corporations Code Section 25102.1:
Corporations Code Section 25102.1 provides a permitting exemption for issuers who are claiming an exemption from federal permitting laws pursuant to Securities and Exchange Commissioner Rule 506, and who file a copy of their federal Form D with DOC and pay a filing fee to DOC. Under SEC Rule 506, an exemption is eligible to issuers that meet all of the following requirements: a) the securities offering is not marketed via a general solicitation or advertising; b) the securities are sold to an unlimited number of accredited investors and up to 35 other persons. All non-accredited investors must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment; c) a company must give non-accredited investors any information it provides to accredited investors; d) a company must be available to answer questions from prospective purchasers; e) a company must submit financial statements to the SEC; and f) the securities are restricted, and cannot be sold by purchasers for at least one year.

Issuers that claim Rule 506 exemptions must file a Form D with both the SEC and DOC, which (according to the SEC) "is a brief notice that includes the names and addresses of the company's owners and stock promoters, but contains little other information about the company." A Form D also includes the date of the first sale in the offering.

According to DOC, about 5,000 to 9,000 persons make Rule 506/Section 25102.1 filings annually; see statistics in Table 2. It is unknown how many of these exemptions are filed by persons who are selling real estate-related securities.

Exemptions claimed pursuant to Rule 506 and Section 25102.1 are good for one year.

Issuers are required to submit an annual amendment to the SEC, if their offering will last longer than one year. At present, issuers are not required to additionally submit a copy of this annual amendment to DOC. However, DOC staff state that they anticipate requiring these forms to be filed with DOC, once DOC's computer systems can be linked to the SEC's securities tracking system.

4) Obtaining a permit pursuant to Corporations Code Section 25113: A securities issuer who does not wish to be constrained by the limitations of Sections 25102, 25102.1, or 25102.5, or who wants extra assurance that he or she is operating in full compliance with securities laws, may apply for a permit to issue securities, pursuant to Section 25113. A securities permit issued pursuant to Section 25113 is good for up to one year. The permit may be obtained for a series of single lending transactions or for a group of lending transactions commonly known as a pool.

If a permit is obtained for a series of single lending transactions, the issuer is soliciting investors to fund each of the lending transactions separately. If a permit if obtained for a pool, the issuer (i.e., the pool manager) is soliciting investors to purchase one or more shares in the pool of investments.

Section 25140 of the Corporations Code authorizes the Commissioner to deny the issuance of a permit to an applicant under Section 25113, "unless he or she finds that the proposed plan of business of the applicant and the proposed issuance of securities are fair, just, and equitable, that the applicant intends to transact its business fairly and honestly, and that the securities which it proposes to issue and the methods to be used by it in issuing them are not such as, in his or her opinion, will work a fraud upon the purchaser thereof."

Regulation 260.140.112.2 requires that each issuer in possession of a securities permit must "make every reasonable effort to assure that the persons being offered or sold program interests, by reason of their educational, business, or financial experience, can be reasonably assumed to have the capacity to understand the fundamental aspects of the program and meet the suitability standards imposed." The issuer and its representatives "must ascertain that the investor can bear the economic risk of an investment in the program and that the program interests are appropriate for the investor's investment objectives, portfolio structure, and financial situation."

Virtually all of the requirements of Section 25113 are contained in regulations issued by the Commissioner of Corporations (See Title 10 of the California Code of Regulations, Chapter 3, Subchapter 2, Article 4, Subarticle 10: Real Estate Programs, beginning at Section 260.140.110.1).

Some of the key elements of Subarticle 10 include its suitability standards for investors, its experience and net worth requirements for those to whom the securities permit is issued, and the rules regarding the fiduciary duty that a securities issuer has to an investor. DOC staff indicate that different sets of suitability standards, experience, and

net worth requirements are imposed, based on the nature of the security. Staff has flexibility to adjust permit requirements, as they see fit. Blind real estate pools (pools in which investors are investing without prior inspection or knowledge of the properties against which loans will be made) are subject to more stringent requirements than pools or single loan transactions in which investors have prior knowledge of the properties in which their money will be invested.

According to DOC regulations for real estate securities offerings (Regulation 260.140.112.3), each investor must either have a minimum annual gross income of $30,000 and a net worth of $30,000 or, in the alternative, a minimum net worth of $75,000, where net worth is determined exclusive of home, home furnishings, and automobiles. However, higher suitability standards can be required by the commissioner for higher-risk offerings, and lower suitability standards may be approved by the commissioner for lower-risk offerings. Because of their potential risk to investors, hard money lending offerings are typically subject to the highest suitability standards allowable under the rules by DOC. These more stringent suitability standards require investors to have a gross income of at least $65,000 and a net worth of at least $250,000, or, in the alternative, a net worth of at least $500,000. All investors are also capped at investing a maximum of 10% of their net worth into a single offering. (Though there is no prohibition against an investor placing several different 10% bets simultaneously, and in that way investing the majority of their net worth in a variety of different real estate securities offerings).

DOC regulations regarding the experience requirements of those responsible for real estate securities offerings depend on the nature of the offering. If the entity to which the permit is issued has specified the properties in which it expects to offer interests, DOC regulations require that the general partner, or the principal operating officer of the general partner, if the general partner is not an individual, must have at least two years of relevant real estate or other experience demonstrating the knowledge and experience to acquire and manage the type of properties being acquired (Regulation 260.140.111.1). If the entity to which the permit is issued has not specified the properties in which it expects to offer interests (something called a non-specified property program in DOC regulations), the experience requirements are greater. In addition to the experience requirements stated in Section 260.140.111.1, a general partner, or if a general partner is not an individual, the operating officer of the general partner, must have at least 5 years experience in the real estate business in an executive capacity, plus at least two years experience in the management and acquisition of the type of properties to be acquired (or must otherwise must demonstrate to the satisfaction of the Commissioner that they have sufficient knowledge and experience to acquire and manage the type of properties proposed to be acquired by the non-specified property program; Regulation 260.140.115.2).

Persons providing services to either type of program (specified or non-specified) must have at least four years of relevant experience or demonstrate sufficient knowledge and experience to both the issuer and to DOC to perform the services proposed.

(Regulation 260.140.111.1).

DOC regulations do not distinguish between specified and non-specified programs in the net worth requirements they apply to those who receive securities permits for real estate offerings. The general partner must have an aggregate financial net worth equal to the lesser of $1 million or the greater of $100,000 or 5% of the gross amount of all offerings sold within the prior 12 months plus 5% of the gross amount of the current offering. The Commissioner has the authority to require the general partner to present evidence of his or her ability to maintain this net worth for at least 3 years after completing the offering. (Regulation 260.140.111.2).

Persons to whom a securities permit are issued have a fiduciary responsibility for the safekeeping and use of all funds and assets of the program, and may not employ or permit another to employ such funds or assets except for the exclusive benefit of the program. (Regulation 260.140.111.5).

According to DOC, approximately 175 to 350 permits are issued annually pursuant to Section 25113 (see Table 2). Roughly one quarter of those permits are issued for securities involving hard money lending. Securities permits are usually good for one year. Permit fees equal $200 plus 0.20% of the value of the securities offering, capped at $2,500 per permit.

The extent to which DOC monitors the performance of those to whom permits are issued depends in large part on whether they seek new permits annually, or whether their permit application is of the "one and done" variety. DOC requires considerable financial information from each permit applicant as part of the application process. The department also requires performance information in connection with its review of the investor disclosures included in the permit applicant's offering materials. If a permit recipient applies for a new permit, its financial information and performance data are typically compared to the information submitted by that applicant in the prior year. DOC can and does adjust the requirements it applies to permit-holders, based on this additional information.

However, if a permit recipient does not apply for a new permit from DOC, no additional financial or other performance data are requested, and DOC does not typically investigate permit holders to verify their compliance with permit conditions. The only instances in which DOC investigates permitholders who do not apply for new permits is when it receives a complaint from an investor.

RELATIVE ADVANTAGES AND DISADVANTAGES OF RAISING MONEY VIA A SECURITIES LAW EXEMPTION VERSUS VIA A PERMIT

Although the lengthy discussion above regarding securities law exemptions and securities law permits is necessary to provide a thorough explanation of the various ways under which investors can be solicited to invest in hard money securities, it begs for simplification. Which of the

options makes the most sense for a person seeking investors to fund hard money loans? Unfortunately, there is no single answer. In practice, it depends. The following explanation is an attempt to condense an extremely complicated set of rules into a few simple rules of thumb. The explanation below involves gross generalizations; it does not apply to all situations.

Most commonly, those seeking to raise money to fund hard money loans rely on one of three options: 1) they follow Article 5 of the Real Estate Law; 2) they follow Articles 5 and 6 of the Real Estate Law; or 3) they obtain a business plan permit pursuant to Corporations Code Section 25113.

A hard money lender holding a real estate broker license will rely on Article 5 when he or she is pairing a single California investor with a single California borrower. Article 5 covers single-lender, private money loans.

A hard money lender holding a real estate broker license will rely on Articles 5 and 6 when he or she is pairing from two to ten California-based investors with a single California borrower. Article 6 covers multi-lender, private money loans.

Securities permits are typically sought when issuers have more complicated sets of transactions than those allowable under Articles 5 and 6. For example, Article 6 requires each investor in a given loan to be treated identically. If an issuer wants the ability to treat different investors differently (perhaps offering lower servicing fees to those who invest larger amounts of money), that issuer would gravitate toward a 25113 permit. Similarly, if an issuer wanted to fund one or more loans incrementally, he or she would seek out a 25113 permit, because Article 6 does not authorize incremental loan funding. A Section 25113 permit would also be appropriate (in lieu of using Article 6), if an issuer wants to seek out investors to fund a pool of mortgages (a situation in which a large number of investors – far more than ten -- hold relatively small shares in a large number of loans, thus spreading their exposure across a large number of properties). It is also important to note that one does *not* require a real estate broker license in order to apply for a Section 25113 securities permit; a real estate broker license *is* required of those who seek to follow Article 5 or Articles 5 and 6 of the Real Estate Law.

The 25102(f) and 25102(n) exemptions are typically not used to solicit investors for hard money lending purposes, because a separate filing needs to be made for each separate transaction, a requirement that creates significant paperwork and reporting requirements for an issuer seeking to fund multiple loans. Nothing precludes their use for hard money lending solicitations; there are simply more efficient ways of raising money for hard money lending purposes.

Similarly, those seeking investors for hard money lending purposes do not tend to claim the exemption offered under Section 25102(e). Although 25102(e) has no paperwork filing requirements, it limits the pool of potential investors who may be solicited to a maximum of 25, all of whom must have a pre-existing personal or business relationship with the issuer, or whose financial advisors must have that relationship. These constraints limit this exemption's utility for those seeking to raise money for hard money transactions.

The one instance in which neither Article 5 or 6, nor a business plan permit, nor any of the 25102 exemptions make sense for use by an issuer seeking to raise money from investors for hard money lending involves the solicitation of funds from investors based outside California. California's permitting exemptions can only be used to raise money from California investors. In contrast, the federal permitting exemption contained in SEC Rule 506 (and parroted in Corporations Code Section 25102.1) allows issuers to solicit investors across state lines. Thus, an issuer could elect to operate under Articles 5 and 6 or pursuant to a business plan permit for his/her activities related to California investors, and to operate under SEC Rule 506/Corporations Code Section 25102.1 for his/her activities related to out-of-state investors.

LENDING OUT MONEY THAT HAS BEEN RAISED VIA A SECURITIES PERMIT OR A PERMIT EXEMPTION

Once money is raised from investors, a state lending license is required to lend it out and to broker the loan. The two most common licenses used for these purposes are the real estate broker license issued by DRE and California Finance Lenders Law (CFLL) license issued by DOC. Of the two, real estate broker licenses allow a broader range of lending and brokering activities. For example, a real estate broker can make a whole loan, arrange a whole loan, make a fractional loan, arrange a fractional loan, sell an existing loan, and service a mortgage loan.

In contrast, a CFLL licensee can make a whole loan, but cannot make or arrange a fractional loan. A CFLL licensee can sell an existing loan, but only to an institutional investor. A CFLL licensee may only broker a loan on behalf of another CFL licensee. A CFLL can only service a loan that it makes and retains, or a loan that it sells to an institutional investor.

Just as they authorize different types of activities, the Real Estate Law and the CFLL impose different types of requirements on their licensees. Some of the requirements imposed on real estate licensees that make, arrange, and broker loans secured by real property are summarized above, in the sections describing Articles 5 and 6 of the Real Estate Law. Generally speaking, these include requirement that hard money lenders and brokers provide special disclosure statements to investors and borrowers involved in hard money lending transactions, submit quarterly and annual trust fund financial statements and business activity reports to DRE, and adhere to specified loan-to-value caps on hard money loans. In addition to these requirements, all real estate brokers, whether or not they are subject to Articles 5 and 6, have a fiduciary duty to place their clients' interests above their own.

Like threshold brokers, CFL licensees are required to submit annual reports to DOC summarizing their lending and brokering activities. CFL licensees are also subject to periodic regulatory examinations, which occur once every three to five years, as DOC staffing levels permit. CFLL licensees must also comply with net worth and surety bond requirements, which do not apply to DRE licensees. However, the CFLL lacks any restrictions on loan-to-value ratios, and generally does not impose a fiduciary duty on its licensees. The only situations in which CFLLs must act as fiduciaries are situations in which a CFLL brokers a mortgage (the fiduciary duty is to the borrower in this case, not to the party on whose behalf the CFLL is acting as a broker).

IS REGULATORY ARBITRAGE POSSIBLE?

Table 3 summarizes some of the key similarities and differences among the three most commonly used business models to solicit investor funds for hard money lending. Persons knowledgeable about the rules surrounding hard money privately acknowledge that regulatory arbitrage occurs, and a review of Table 3 highlights a few of the reasons why this is true.

However, knowledgeable industry insiders also stress that the choice of one's business model is the greatest determining factor in one's choice of regulator and law(s) under which to operate.

As described above, a business plan permit obtained from DOC pursuant to Corporations Code Section 25113 allows the holder much greater flexibility to solicit investors to fund hard money loans than Articles 5 and 6 of the Real Estate Law. For example, an issuer seeking to place more than ten investors into a given loan cannot do so under the Real Estate Law, nor do Articles 5 and 6 allow for the incremental funding of hard money loans, nor for differential treatment of investors. Yet, all of these activities are authorized, if the issuer holds a business plan permit or operates pursuant to a securities law exemption. Generally speaking, the simpler one's hard money business plan, the more likely the issuer is to use Articles 5 and 6 of the Real Estate Law, and the more complicated one's business plan, the more likely the issuer is to obtain one or more business plan permits from DOC.

Yet, these distinctions are blurred somewhat by the existence of securities law exemptions. Far less is known about those who operate under securities law exemptions, because so little information is requested of, and obtained from, these individuals and businesses. Persons who raise money under securities law exemptions are essentially trusted to comply with the rules applicable to those exemptions. DOC does not examine those who claim exemptions, nor does it even know who some of these entities are (as noted above, those persons who rely on 25102(e) exemptions are not required to file any paperwork with DOC). DOC is reliant upon complaints from the general public to identify persons who are relying on securities permit exemptions, but are failing to comply with the rules applicable to those exemptions.

ENFORCEMENT ACTIONS

Real estate licensees who violate the Real Estate Law may be issued an order to desist and refrain from engaging in specific activity, can have their licenses suspended or revoked, and/or can be issued a bar order, which bars them from engaging in any real estate-related activity for three years. As of July 1, 2012, a real estate licensee is also subject to a citation and/or a fine, if found to be operating in violation of the law. In addition to its authority to impose these administrative penalties, DRE also has the authority to refer more serious enforcement cases to local district attorneys, for criminal prosecution.

DRE also has the authority to take enforcement action against individuals who lack a real estate license, but who act in a manner that requires one. Although there is no license to suspend or revoke in these cases, DRE may issue one or more desist and refrain orders to unlicensed

persons, may refer them to local district attorneys for criminal prosecution, and may, as of July 1, 2012, issue them citations and/or impose fines on them.

Enforcement data provided by DRE suggests that brokers engaging in hard money brokering and lending transactions are disciplined at rates that are slightly higher than those of DRE's broader licensee population. On the basis of a review of data from 2008 through 2011, it appears that DRE typically takes formal disciplinary action against 2% to 4% of its threshold broker population in any given year (approximately ten disciplinary actions per year, out of a threshold broker population of approximately 400). DRE disciplines less than 1% of its broader licensee population on an annual basis.

Persons who violate state securities laws are subject to administrative, civil, and/or criminal sanctions. Purchasers who are harmed by a securities issuer are entitled to rescind their purchase of the security, and to receive damages, calculation of which is specified in law. Issuers lose their right to sell the security that is the subject of the violation, and, in more serious cases, can be subject to civil and/or criminal penalties. Table 4 includes statistics provided by DOC regarding their securities law disciplinary actions during recent years. DOC was unable to provide cumulative data for time periods prior to June 2009, because they lacked a database capable of tracking this information before then. The department is currently in year three of a five-year plan to upgrade its databases, to help it better track disciplinary actions.

DOC did, however, manually review all 332 securities law enforcement actions taken since June 2009. Approximately one third of those actions involved real estate securities, but only 22 involved hard money lending. Of those 22 cases, 9 involved rogue actors, who were operating without a securities permit and without having filed any exemption paperwork with DOC; 11 involved violations of securities permits; and 2 involved bad acts by persons operating pursuant to permitting exemptions. Unfortunately, the number of cases involved is too small to draw any conclusions about which population (permitted, exempt, or rogue) commits the greatest number of securities law violations.

POSSIBLE AREAS TO IMPROVE REGULATORY OVERSIGHT AND CONSUMER/INVESTOR PROTECTION

Staff has identified the following recommendations for improving regulatory oversight and consumer/investor protection.

1. Finding: DOC fails to require those who rely on subdivision (e) of Corporations Code Section 25102 to file a form with DOC, claiming the exemption. This is in contrast to subdivisions (f) and (n) of Section 25102, which do require filings. Without a filing requirement, DOC has no idea how many persons are operating under 25102(e), nor does it have any knowledge of their identities, nor the purposes for which they are seeking to raise funds.

   Recommendation: Amend Section 25102(e) to add a filing requirement, and to condition

the availability of the exemption on submission of the required filing by the issuer.

2. Finding: Some of the securities law exemptions available under the Corporations Code condition the availability of the exemption on the filing of paperwork by the issuer, summarizing the offering (e.g., 25102(n) and 25102.1). In contrast, Section 25102(f) requires a filing by the securities issuer, but does *not* condition the availability of the exemption on submission of the filing. For this reason, DOC lacks an accurate count of the number of persons who operate under 25102(f) exemptions, and has no knowledge of the identity of these persons.

   Recommendation: Amend Section 25102(f) to condition the availability of the exemption on submission of the required filing by the issuer.

3. Finding: DOC does not track the extent to which securities exemptions are filed by persons seeking to raise money from investors for use toward real estate investments, nor does it track compliance with the terms of exemption filings. Yet, approximately one third of all securities law actions brought by DOC involve securities issuers who sought to raise money for real estate investments.

   Recommendations:

   a. Require those who file claims of exemption with DOC for purposes of issuing real estate securities to file separate paperwork with DOC, containing more information about the nature of their offerings. At a minimum, this would help provide DOC with more information about the segment of the issuer population that appears to pose the greatest risk to the investment public. It could also help DRE and DOC focus regulatory scrutiny on these issuers, to ensure that they are complying with the provisions of the Real Estate and/or CFLL, when expending the money raised by investors in real estate ventures.

   b. Once it has compiled a few years of these additional data, DOC should be required to report to the Legislature, summarizing the information, and recommending any statutory or regulatory changes it believes are necessary or appropriate to better regulate the practice of raising money for real estate investment.

   c. To the extent resources are available, thought should also be given to requiring DOC to examine a sample of those who have filed permitting exemptions, to check on compliance with the provisions of their filing documents.

4. Finding: Although DOC captures considerable information about the activities of its permit holders from permit applications, the department is not required to summarize this information, nor report it to the Legislature. This contrasts with DRE, which not only collects considerable information from its licensees on a quarterly and annual basis, but also publishes an annual report, summarizing the activities of its threshold brokers (those

operating under Articles 5 and 6 of the Real Estate Law).

Recommendation: Amend state law to require DOC to publish an annual report, summarizing the activities of its permit holders. Authorize DOC to perform periodic examinations of those to whom it issues permits.

5. Finding: DOC relies on its regulations to develop the contents of securities permits it issues. These regulations, in turn, were developed over a period of decades, as California's securities laws evolved. The result is a hodgepodge of regulations, which is nearly indecipherable, except by subject matter experts at DOC. Anyone wishing to review California's laws and regulations, seeking information about the suitability standards, experience requirements, and net worth requirements imposed by DOC on those to whom securities permits are issued, faces a nearly impossible task.

   Recommendation: DOC should improve the transparency of its regulations for those who issue real estate securities. It should review its regulations for clarity and consistency, and modify/reorganize its regulations so they can be better understood by those seeking to use them.

6. Finding: DOC does not track how many persons it jointly regulates under both securities laws and lending laws. For this reason, even though its California Finance Lenders Law licensees may be operating under a securities permitting exemption or under a securities permit, DOC examiners conducting reviews of CFLL licensees don't know to check for compliance with the exemption or the permit.

   Recommendation: DOC should survey its CFLL licensees to determine which of these licensees is soliciting money from investors pursuant to a securities permit or a securities permit exemption. It should augment its examinations of CFLL licensees to check for compliance with any outstanding permit or permit exemption.

7. Finding: DRE's Article 6 imposes loan-to-value caps on multi-lender hard money loans, and imposes suitability requirements on those who invest in multi-lender hard money loans. Both of these investor protections are absent from DRE's Article 5.

   Recommendation: Import the investor protections contained in Article 6 into Article 5, to better protect investors who invest in single-lender hard money loans.

8. Finding: The greatest harm to investors who invest in bogus or fraudulent investment schemes, or whose investments fall victim to a depressed real estate market, are experienced by those persons who deviate from suitability standards imposed by DRE and DOC, and who invest significant portions of their life savings in the failed venture. Although no investor is supposed to be allowed to place more than 10% of his or her net worth into any single investment, most of those who experience significant investment losses from real estate ventures were not dissuaded from investing large sums by the securities issuers who took their money.

Recommendation: Thought should be given to amending both the Real Estate Law and the Corporations Code, to place a strict cap on the total percentage of one's net worth that an investor may place into real estate ventures. Currently, an investor may place up to 10% of his or her net worth into a single investment, but is not restricted from making multiple 10% investments in several different real estate ventures. This appears to be a loophole, which fails to adequately protect enthusiastic investors who fall victim to the sales pitches of multiple, different securities issuers.

Greater penalties should also be imposed on securities issuers who accept funds from investors, in violation of the suitability requirements imposed under state and federal law. At present, most securities issuers rely on a statement from their investors that the investor meets specified suitability standards. Thought should be given to requiring securities issuers to perform additional due diligence to confirm an investor's suitability, rather than simply allowing issuers to rely on a statement from the investor that the investor qualifies.

TABLE 1
DEPARTMENT OF REAL ESTATE-LICENSED THRESHOLD BROKER STATISTICS
SOURCE: DEPARTMENT OF REAL ESTATE

YEAR	NUMBER OF REPORTING THRESHOLD BROKERS	NUMBER OF REPORTING THRESHOLD BROKERS WHO REPORTED MULTI-LENDER LOANS	NUMBER OF INVESTORS	AGGREGATE LOAN VOLUME (LOANS ARRANGED)	AGGREGATE LOAN VOLUME (LOANS MADE, ARRANGED, AND SERVICED)
1999	265	139	11,538	$2,069,802,563	$5,245,951,294
2000	284	146	12,436	$1,982,890,000	$5,557,315,732
2001	300	159	10,946	$1,934,794,593	$5,875,020,497
2002	300	164	14,389	$3,137,267,103	$6,979,735,315
2003	304	163	14,532	$3,463,577,413	$7,735,299,800
2004	316	161	15,624	$4,591,432,394	$9,568,346,300
2005	336	164	19,008	$5,752,308,541	$11,296,530,871
2006	352	173	52,151	$4,955,277,278	$10,915,401,388
2007	352	166	18,293	$3,297,352,381	$8,717,486,336
2008	336	153	9,851	$1,856,677,952	$4,736,158,094
2009	362	146	5,864	$1,124,818,260	$3,187,684,385
2010	356	137	5,801	$1,170,887,095	$3,200,846,199

TABLE 2
NUMBER OF SECURITIES PERMITS ISSUED AND EXEMPTIONS CLAIMED EACH YEAR
SOURCE: DEPARTMENT OF CORPORATIONS

YEAR	25113 PERMITS ISSUED	25102(f) EXEMPTION FILINGS	25102(n) EXEMPTION FILINGS	RULE 506/SECTION 25102.1 FILINGS
2004	337	34,140	37	6,646
2005	310	36,051	50	7,593
2006	307	32,846	28	8,306
2007	334	30,201	29	8,750
2008	232	24,861	34	8,074
2009	186	20,482	21	5,649
2010	172	19,018	22	6,111

TABLE 3

COMPARISON OF KEY REQUIREMENTS/LIMITATIONS OF HARD MONEY LAWS

	Corporations Code Section 25113 Permit	**Real Estate Law Articles 5 and 6 (Corporations Code Section 25102.5 Exemption)**	**Real Estate Law Article 5**
Maximum Number of Investors Per Loan	Unlimited (unless capped via permit conditions)	Up to ten	One
Investor suitability requirements	Maximum of 10% of net worth per investment, plus a minimum annual gross income of $30,000 and minimum net worth of $30,000, or a minimum net worth of $75,000 per investor (higher minimums can be specified in permits – highest possible is $65K gross income and $250K net worth or $500K net worth).	Maximum of 10% of net worth per investment	None
Disclosure of potential risks to potential investors?	Required	Required	Required
Issuer net worth requirements?	The lesser of $1 million or (the greater or $100,000 or 5% of the gross amount of all offerings sold within the prior 12 months plus 5% of the gross amount of the current offering	None	None
Fiduciary duty to place interests of investors above interests of licensee?	No	Yes	Yes
Cap on total amount of $$ that can be raised from investors per offering?	No (unless specified in the permit)	No	No

TABLE 3

COMPARISON OF KEY REQUIREMENTS/LIMITATIONS OF HARD MONEY LAWS

	Corporations Code Section 25113 Permit	**Real Estate Law Articles 5 and 6 (Corporations Code Section 25102.5 Exemption)**	**Real Estate Law Article 5**
Periodic Reporting	No (though a new permit application must be submitted annually, and each permit application must contain financial statements and loan performance data)	Quarterly and annual trust fund financial statements, annual business activity reporting	Quarterly and annual trust fund financial statements, annual business activity reporting
Annual Report From Department To Legislature Summarizing Information Regarding Hard Money Licensees/Permit Holders?	No	Yes	Yes

TABLE 4
DISCIPLINARY ACTIONS BROUGHT BY DOC FOR SECURITIES LAW VIOLATIONS

	TOTAL SECURITIES LAW DISCIPLINARY ACTIONS (All types)	CRIMINAL ACTIONS INVOLVING REAL ESTATE	ADMINISTRATIVE ACTIONS INVOLVING REAL ESTATE	CIVIL ACTIONS INVOLVING REAL ESTATE	PERCENTAGE OF THE TOTAL REPRESENTED BY REAL ESTATE
June 2009 through December 2009	98	21	14	0	36%
January through December 2010	127	21	14	0	28%
January through August 2011	107	20	18	3	38%

NOTE: Some of the cases involving real estate did not involve the solicitation of funds for use in hard money lending transactions (though there is no breakdown of how many real estate cases do and do not fall into the hard money category). At present, DOC is also unable to provide a breakdown of how many disciplinary cases involved persons who received 25113 permits, persons who claimed securities law permitting exemptions, and persons who were operating completely outside the law (no filings, no permits).