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**Real Estate  Law**  
**QUARTERLY REPORT**

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# Real Estate Law

## QUARTERLY REPORT

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## When is Rent Control Unconstitutional?

By Stephanie K. Osborne

A recent decision by the United States Court of Appeals for the 9<sup>th</sup> Circuit made it clear that a rent control ordinance that inures to the benefit of the vacating tenant as opposed to the real property owner simply because the property is under rent control does not substantially further any governmental purpose and is therefore unconstitutional.

To challenge a rent control ordinance, one carries the burden of proving that the particular regulation does not substantially advance a legitimate governmental interest and that the ordinance is not reasonably related to the objective sought to be achieved by that governmental entity.

This was the case in the matter of *City of Cotati v. Cashman* which was decided in July of 2004. In *Cotati*, two mobilehome park owners joined forces and challenged a local rent control ordinance alleging that the ordinance constituted a regulatory taking of their property in violation of the 5<sup>th</sup> Amendment. They further challenged the ordinance on the grounds that it permitted the vacating tenants to capture a profit on the sale of their mobilehome that was directly attributable to the rent control. Like condominiums, mobilehome parks occupy an unusual status in that there is dual ownership of the property involved. The mobilehome is owned by one person with the land underneath the mobilehome owned by another.

The operative provisions of the *Cotati* ordinance limited the annual rental increases park owners can charge for their spaces and further had a "vacancy control" measure

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### Stephanie K. Osborne



*Stephanie K. Osborne* is an attorney in the San Diego office of Borton, Petrini & Conron, LLP. She received her undergraduate degree from University of Wisconsin and her Juris Doctor from University of San Diego School of Law receiving high honors in trial advocacy.

Stephanie brings a wide variety of experience to Borton, Petrini & Conron, LLP with her experience as corporate counsel for a medical device start-up company, handling all corporate and commercial contracts including technology licensing agreements. Further enhancing her career she co-founded the firm Alliance Legal Group, LLP gaining civil litigation experience in business and employment law litigation, as well as landlord tenant law and personal injury litigation.

She is a member of the State Bar of California, Los Angeles County Bar Association and the San Diego County Bar Association.

# Handling DRE Audits

By *John Fu and Michael Caldarone*

Part One of a two-part feature

You are a mortgage broker licensed by the California Department of Real Estate. You work anywhere between 60-80 hours a week in an attempt to secure enough listings and/or loans to maintain your business. You also have a number of sales persons licensed under you; all of whom are conducting business activities on your behalf. All of a sudden, you receive a letter from the California DRE Auditing Department. The letter says, "The Department intends to perform an audit on your books and records within the ensuing three weeks. Violation of this notice or any violation found during the audit can lead to disciplinary action, which includes but is not limited to the revocation of your license." Suddenly, you begin to panic. Why is the DRE auditing me? What is wrong with my books and records? Is there anything that I need to do to bring my records up to date and in compliance? Are my trust accounts in balance? The list of questions goes on seemingly without end.

This is a typical initial reaction of a DRE broker when he or she is confronted with a Notice of Audit from the Department of Real Estate. This article will provide you with a basic understanding of the procedures, requirements, and perhaps your rights in a DRE audit.

There are typically five ways to trigger an audit. The most common way is when a disgruntled former employee reports certain fraudulent activities in your loan files. Another sure way to trigger an audit is by ignoring the DRE's inquiry. Typically, before any audit is scheduled, the DRE will provide you with an opportunity to explain a certain complaint that it may have received. These complaints are generally from disgruntled customers and will most likely not lead to any further actions by the DRE if you provide a proper and prompt response. You should also be very careful about anything you send to the DRE. This includes payments of your licensing fee. In the past 10 years that I have dealt with the Department of Real Estate, I have seen audits triggered because the brokers mistakenly used a client trust account check to pay for their licensing renewal fees. Finally, there are, of course, random audits. However, random audits are less common because the Department of Real Estate has always been understaffed. When you do receive an inquiry from the DRE, you must take it seriously and respond to it promptly. Otherwise, an audit will take place.

In the event an audit is scheduled, it is necessary to understand your obligations and rights pursuant to

## John Fu



*John Ka-Keung Fu* is an attorney in the Bakersfield office of Borton, Petrini & Conron, LLP. He received his undergraduate degree in economics from Loyola Marymount University and earned his Juris Doctor at Western State University, Irvine. He is a licensed California real estate broker and his complete fluency speaking and writing Chinese

(Mandarin and Cantonese).

John's experience includes working on cases which range from real estate transactions, mortgage compliance, administrative hearings in defense of DRE licenses, mediations, arbitration and estate planning/probate.

He is a member of the California State Bar and has been admitted to the United States District Court.

## Michael C. Caldarone



*Michael C. Caldarone* is an attorney in the Bakersfield office of Borton, Petrini & Conron, LLP. He received his undergraduate degree from Pomona College with a degree in English with a minor in philosophy. He received his masters degree in dispute resolution from Pepperdine University. He received his Juris

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Michael brings a wide variety of experience to Borton, Petrini & Conron, LLP with his experience as a mediator with the California Center for Conflict Resolution and the California Academy of Mediation Professionals in Los Angeles County.

Michael's primary areas of emphasis at Borton, Petrini & Conron, LLP are business transaction and litigation.

the California Business and Professions Codes and the California Codes of Regulation. Generally, the DRE auditors are very cooperative in terms of setting the date and time of the audits for you. Typically, such audits are set three weeks to a month in advance. Their notice letter will consist of a list of items that they want to see. DRE auditors have a right to review all documents connected with regulated activities. However, they may also ask you to talk. The department refers to this interview as an “informational interview.”

**You need to understand that you do not have any obligation to talk to the DRE auditor.** Pursuant to California Business and Professions Code section 10148, the department has the right to obtain documents you are required to retain three years after the completion of the regulated activity. They may also obtain further documents not previously requested if they have a valid reason to do so, and if such a request does not constitute harassment. **However, nowhere in section 10148 does it require the broker or anyone else to speak.** If you are not accompanied by an attorney, you should seriously consider remaining silent. I have seen countless brokers unwittingly disclose inappropriate information by talking too much. The old saying of, “Better to be thought as a fool than to open your mouth and remove all doubt,” applies here. The DRE auditor may even appear to be very nice and cooperative in order to make you feel comfortable talking. This is very disarming to an unwary broker. Do not ever assume that the DRE auditor is there to help you. According to **DRE Counsel David Seals**, it is not the job of the Department of Real Estate to help the licensees. Therefore, do not become overly relaxed when the auditor appears to be friendly and nice.

Remember, the only obligation that a broker has in an audit pursuant to section 10148 is to provide the documents requested by the Department of Real Estate.

Part two of this article will explore other considerations relevant to DRE audits, including the value of pre-auditing your files. For any questions or consultations, please feel free to contact the author at the Law Offices of Borton, Petrini & Conron, LLP at (661) 322-3051. ❖

## When is Rent Control Unconstitutional?

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that prevented mobilehome park owners from charging a new base rent or increasing the existing rent for a mobilehome space when ownership of a mobilehome coach is transferred and the coach remains in place. Under this ordinance, a successor tenant is allowed the same rent previously charged to the vacating tenant. The purpose of the ordinance was allegedly to stabilize mobilehome park rental rates and to maintain affordable owner-occupied housing.

In *Cotati*, the 9th Circuit court held that, unlike ordinary rent control ordinances, an ordinance that permits incumbent tenants to capture a profit from a sale of their mobilehome based on the present value of the reduced rent fails to substantially advance a state’s interest in creating or maintaining affordable, owner-occupied housing.

The court focused on this factor and found the rent control ordinance did not advance a state interest in controlling rent and was, therefore, an unconstitutional taking of the property owners’ rights. The lesson in *Cotati* is that any change in earnings or profits because of vacancy or otherwise which affects land usage must inure to the benefit of the property owner.

Rent control has been in force in a number of major American cities for decades. Over the years, apartment owners, mobilehome park owners, and other real estate interests invested millions in campaign contributions to support anti-rent control legislation. One real estate lobbyist explained, “it is a small investment when you consider a billion dollars or more in apartment real estate values are at stake.” Some form of rent regulation now exists in more than 17 California jurisdictions. Rent control regulations can have many levels, but they often take the form of regulating the allowable amount of rent increases, stipulating when an increase can be instituted, and mandating “just cause” evictions.

If you face challenges as a result of a rent control ordinance, we suggest you seek the assistance of legal counsel. Your rights depend on it. If you would like to discuss this issue or require further information, please contact me at [sosborne@bpclaw.com](mailto:sosborne@bpclaw.com). ❖

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