

Colorado Legislative Council Staff Fiscal Note

**STATE and LOCAL
REVISED FISCAL IMPACT**

(replaces fiscal note dated April 1, 2007)

Drafting Number: LLS 07-0268
Prime Sponsor(s): Sen. Groff
 Rep. Marshall

Date: May 2, 2007
Bill Status: House Second Reading
Fiscal Analyst: Gary J. Estenson (303-866-4976)

TITLE: CONCERNING THE REGULATION OF PERSONS PARTICIPATING IN MORTGAGE LOAN TRANSACTIONS, AND, IN CONNECTION THEREWITH, REQUIRING MORTGAGE BROKERS TO BE LICENSED, SPECIFYING PROHIBITED ACTS AND GROUNDS FOR DISCIPLINE OF LICENSEES, AND MAKING AN APPROPRIATION.

Fiscal Impact Summary	FY 2007-2008	FY 2008-2009
State Revenue		
<u>TOTAL</u>	<u>\$2,030,400 + Fines</u>	<u>\$126,400 + Fines</u>
General Fund	Fines	Fines
Cash Funds		
Mortgage Broker Licensing Cash Fund	1,651,200 + Fines	Fines
Fees - Background Checks	168,000	56,000
Fines Collection Cash Fund	< 5,000	< 5,000
Cash Funds Exempt - Pass Through Fees to FBI	211,200	70,400
State Expenditures		
<u>TOTAL</u>	<u>\$801,509</u>	<u>\$727,270</u>
Cash Funds		
Mortgage Broker Licensing Cash Fund	422,463	610,964
Cash Funds - Background Check Fees	167,846	45,906
Cash Funds Exempt - Pass Through Fees to FBI	211,200	70,400
FTE Position Change	5.8 FTE	6.6 FTE
Effective Date: January 1, 2008.		
Appropriation Summary for FY 2007-2008: See State Appropriations section.		
Local Government Impact: See Local Government Impact section.		

Summary of Legislation

Currently, under the Mortgage Broker Registration Act, regulatory oversight of mortgage brokers is limited to requiring that some mortgage brokers be registered with the Department of Regulatory Agencies, Division of Real Estate (DRE). Mortgage brokers who practice without valid registration are committing a class 1 misdemeanor. Additionally, the director of the DRE may suspend a mortgage broker's license under certain circumstances.

The bill, **as amended in the House Business Affairs and Labor Committee**, changes the name of the act to the Mortgage Broker Licensing Act, requires state licensure instead of registration, requires the DRE to regulate the professional behavior of mortgage brokers, and makes conforming amendments.

Mortgage Broker Licensing Requirements. Unless exempted under state law or operating under a temporary license, on and after January 1, 2008, any person who brokers mortgage loans must have a mortgage broker license. A mortgage broker registered under current law is required to be licensed upon registration expiration. Every active mortgage broker must also have an errors and omissions insurance policy. A mortgage broker who is also an attorney complies with this requirement if the mortgage broker/attorney has malpractice insurance with coverage for errors and omissions. The director of the DRE will determine the conditions of errors and omission coverage, including minimum coverage limits, permissible deductibles, and authorized exemptions. Persons currently brokering mortgage loans under a Federal Housing Administration (FHA) registration exemption will now require a mortgage broker license. Finally, the registration fee is changed to a licensing fee and the fee cap of \$200 is removed.

Mortgage Broker Training, Testing, and Continuing Education. Within three (3) years of applying for a mortgage broker license, a mortgage broker applicant must have completed a mortgage lending fundamentals course that includes at least nine (9) hours of instruction and a written examination approved by the director of the DRE. As a condition of license renewal, the director may require a mortgage broker to complete nine (9) hours of continuing education every three (3) years.

The director may contract with an independent testing service to develop, administer, and grade the written examinations and to develop, review, and approve continuing education courses. The contract may give the independent testing service the authority to recover from applicants costs incurred for providing testing and continuing education services.

Mortgage Broker Prohibitions. The bill lists 24 prohibited mortgage broker activities. The director of the DRE may assess an administrative fine, censure, temporarily suspend, or permanently revoke a mortgage broker for any violations. The director must revoke a mortgage broker license for any violation of the Colorado Consumer Protection Act (CCPA). Generally, the act prohibits mortgage brokers from:

- knowingly misleading a party in a real estate transaction;
- acting in the interest of more than one party without prior disclosure;
- mishandling or misusing money belonging to others;
- failing to keep adequate mortgage brokering and real estate records for a period of four (4) years;
- attaining licensure after entering a plea of guilty, entering a plea of no contest, or being convicted of certain crimes;
- violating state or federal fair housing laws;
- demonstrating incompetency as a mortgage broker; and
- engaging in fraud or deceit.

All proceedings involving mortgage broker disciplinary actions or license denial may be conducted by the director or before an administrative law judge. The director or an administrative law judge may issue a subpoena compelling witness testimony and the production of records.

Loan Originator Requirements. All documents related to a loan agreement must be provided to the borrower at least one (1) business day prior to the closing date. No blank spaces in the loan agreement are permitted. If the transaction involves residential real property, earnest money paid to the seller will not be refunded unless the seller knew that a loan document contained a material omission, misstatement, or defect.

State Revenue

Total state revenue will increase by \$2,030,400 in FY 2007-08 and by \$126,400 in FY 2008-09. Revenue components are discussed below.

Registration Fees. The bill eliminates the current exemption for mortgage brokers operating under the authority of the FHA. The DRE is required to set the registration fee at an amount to cover direct and indirect expenditures associated with regulating mortgage brokers. The current fee is \$200 and the fiscal note estimates that the fee will be reduced to \$172 in FY 2007-08. Therefore, the addition of an estimated 9,600 mortgage brokers will generate an additional \$1,651,200 in FY 2007-08. Since registrations are valid for a three (3) years, no additional fee revenue is anticipated until FY 2010-11. Consequently, FY 2007-08 fee revenue will be used to fund SB 07-203 for three (3) fiscal years.

Administrative Fines. The director of the DRE may investigate any mortgage broker for mortgage broker violations. A person violating the act is subject to an administrative fine of up to \$1,000 in the first instance and between \$1,000 and \$2,000 per violation for second and subsequent violations. Any administrative fines collected will be credited to the Mortgage Broker Licensing Cash Fund. Additionally, new prohibitions for loan originators are enforced under the CCPA. Civil penalties under the CCPA are up to \$2,000 per violation or up to \$10,000 per violation if the victim is over the age of 60. CCPA fine revenue is credited to the General Fund. While compliance with the bill's requirements is expected to be high, moderate fine revenue is expected. However, the increase in fine revenue cannot be quantified.

Criminal Fines. By removing the FHA exemption, more mortgage brokers will be licensed and subject to criminal misdemeanor penalties. Per Section 18-1.3-501, C.R.S., the penalty for a class 1 misdemeanor is 6 to 18 months imprisonment in a county jail, a fine of \$500 to \$5,000, or both. Fine revenue not otherwise appropriated is deposited into the Fines Collection Cash Fund. Because the courts have the discretion of incarceration or imposing a fine, the impact to state revenue cannot be determined. However, a minimal amount of fine revenue (< \$5,000 per year) is assumed under the bill. Finally, the bill authorizes a fine of not more than \$5,000 against business entities that engage in prohibited activities related to mortgage loan brokering. Fine revenue from business entities cannot be quantified.

Department of Public Safety, Colorado Bureau of Investigation (CBI). The CBI will receive \$379,200 in FY 2007-08 and \$126,400 in FY 2008-09 from mortgage brokers for criminal history checks. Criminal history checks are \$39.50 each and will be done on 9,600 mortgage brokers in FY 2007-08 currently operating under an FHA exemption. Of the \$39.50, \$22.00 passes through to the FBI to cross-check criminal histories against the national criminal database. The total pass through amount to the FBI is \$211,200 in FY 2007-08. The remaining \$17.50 is retained by the CBI to cover background check costs, totaling \$168,000 in FY 2007-08.

State Expenditures

Total state expenditures will increase by \$801,509 and 5.8 FTE in FY 2007-08 and by \$727,270 and 6.6 FTE in FY 2008-09. Cost components are discussed below.

Department of Regulatory Agencies, Division of Real Estate (DRE). Currently, the DRE must ensure that 4,800 mortgage brokers are properly registered. By removing the FHA exemption and requiring licensure, the fiscal note estimates that an additional 9,600 mortgage brokers will require licensing, bringing total licensure to 14,400 mortgage brokers. The DRE will also need personnel to investigate mortgage broker compliance with loan product offerings and consumer disclosures. Additionally, staff will be needed to conduct revocation proceedings against brokers who have:

- had a license, registration, or certification revoked or suspended within the last five (5) years for fraud, material misrepresentation, theft, or breach of a fiduciary duty;
- been enjoined within the last five (5) years from engaging in deceptive conduct related to mortgage loan brokering; or
- engaged in mortgage brokering activities prohibited by the bill.

Department of Law legal services will be needed to assist in rule promulgation and to represent the DRE in administrative disciplinary proceedings against mortgage brokers. Legal services are billed at a rate of \$67.77 per hour. Total legal service hours needed in FY 2007-08 are estimated at 875 hours due the bill's effective date and inherent delays in administrative actions in the first year. FY 2008-09 legal services are estimated to increase to 3,450 hours.

Finally, computer programming modifications will need to be made to the existing system to establish new features to track different type of revocations, suspensions, and disciplinary actions, ensure that registrants and licensees have errors and omissions coverage, monitor hearings and outcomes, and make certain information accessible to the public. Table 1 summarizes DRE expenditures under SB 07-203.

Table 1. Division of Real Estate Expenditures Under SB07-203.		
Cost Components	FY 2007-08	FY 2008-09
Personal Services	\$68,440	\$128,737
FTE	1.8	3.0
Operating Expenses and Capital Outlay	6,885	4,505
Information Technology	101,490	
Miscellaneous Legal	59,299	233,807
Total - Mortgage Broker Cash Fund	\$236,114	\$367,049

Department of Law. The bill increases the number of persons covered under the CCPA and expands prohibitions by loan originators under the act. Based on the bill's effective date, for FY 2007-08 the Department of Law will require 1.6 FTE investigators and 0.8 FTE attorney to investigate and prosecute civil allegations of these new violations. Investigations and prosecutions under the CCPA are complex and most cases require extensive pleadings, discovery, and lengthy trials. Lease space will be needed to house new staff. Finally, miscellaneous costs will be incurred for litigation expenses and travel costs. The amended bill allows the Mortgage Broker Licensing Fund to be used for Department of Law costs for CCPA enforcement. Table 2 lists Department of Law expenditures.

Table 2. Department of Law Expenditures Under SB07-203.		
Cost Components	FY 2007-08	FY 2008-09
Personal Services	\$165,354	\$220,472
FTE	2.3	3.0
Operating Expenses and Capital Outlay	8,541	7,505
Lease Space	6,188	8,250
Miscellaneous	6,266	7,688
Total - Mortgage Broker Cash Fund	\$186,349	\$243,915

Department of Public Safety, CBI. For FY 2007-08, the CBI, requires \$167,846 and 1.7 FTE for criminal history checks. The CBI will need staff to process and maintain fingerprint records, search Colorado databases for applicant criminal history, and submit fingerprints to the FBI. Additionally, staff will require training in proper fingerprinting techniques, supplies, and office equipment. These expenditures were not included in the previous fiscal note. In FY 2007-08, the number of background checks is estimated at 9,600. Since most background checks will occur during the first year of the program, the CBI will not require additional staff in FY 2008-09. Finally, of the \$379,200 collected from mortgage brokers for background checks, \$211,200 will pass through to the FBI to cross-check applicants with the national criminal database.

Department of Personnel and Administration (DPA). The bill may increase the number of administrative hearings in the DPA, Office of Administrative Courts for license denial or disciplinary actions against mortgage brokers. However, this bill alone does not generate the need for more administrative law judges. Should a number of bills pass this session and significantly impact the DPA, it is assumed that any additional resources will be addressed through the annual budget process.

Judicial Branch. Because the bill increases the number of persons subject to the Mortgage Broker Registration Act and expands violations to include penalties under the CCPA, the number of civil case filings may increase. However, the caseload cannot be quantified at this time.

Expenditures Not Included

Pursuant to a Joint Budget Committee policy, funding for the items noted below will not be included in fiscal note expenditure estimates. However, indirect costs are calculated for the purpose of identifying the "per applicant" cost of a new or revised fee to reflect the total direct and indirect costs required to support a particular program.

- group health, life and dental insurance
- inflation indices
- amortization equalization disbursements
- supplemental amortization equalization disbursements
- short-term disability
- leased space
- indirect costs

Local Government Impact

Civil and Criminal Enforcement. The bill may increase civil and criminal enforcement responsibilities for district attorneys under the CCPA. Local governments are responsible for funding the majority of the costs associated with district attorney offices. However, since civil and criminal cases will be spread out among numerous district attorney offices, costs to local governments are expected to be minimal.

Criminal Penalties. The penalty for a class 1 misdemeanor is six (6) to 18 months imprisonment in a county jail, a fine of \$500 to \$5,000, or both. Because the courts have the discretion of incarceration or imposing a fine, the impact at the local level cannot be determined. The cost to house an offender in county jails varies from \$45 to \$50 per day in smaller rural jails to \$62 to \$65 per day for larger Denver-metro area jails. For the current fiscal year, the state reimburses county jails a daily rate of \$48.96 to house state inmates. It is assumed that the impact of this new misdemeanor will be minimal and will not create the need for additional county jail space.

State Appropriations

The fiscal note indicates the following department appropriations for FY 2007-08:

Regulatory Agencies	<u>\$ 422,463</u>	Total and 1.8 FTE Cash Funds-Mortgage Broker Cash Fund
Law	<u>\$ 245,648</u>	Total and 2.3 FTE Cash Funds Exempt Transfer from DORA
Public Safety	<u>\$ 397,046</u>	Total and 1.7 FTE
	167,846	Cash Funds
	211,200	Cash Funds Exempt Pass Through to FBI

Departments Contacted

Regulatory Agencies
Personnel and Administration

Public Safety
District Attorneys

Law