

Department of Legislative Services
 Maryland General Assembly
 2012 Session

FISCAL AND POLICY NOTE

Senate Bill 738 (Senator Jennings)
 Education, Health, and Environmental Affairs

State Real Estate Commission - Regulation of Business Brokers

This bill requires all persons conducting “business brokerage services” to be licensed by the State Real Estate Commission within the Department of Labor, Licensing, and Regulation (DLLR) before conducting business in the State, and subjects licensed business brokers to regulation by the commission. The bill also establishes a Business Brokerage Fund to pay claims for actual loss against licensed business brokers and their unlicensed employees. The bill contains a related reporting requirement.

Fiscal Summary

State Effect: Special fund expenditures by the State Real Estate Commission increase by \$153,600 in FY 2013 for costs associated with regulating business brokers. Increase in special fund and nonbudgeted revenues for the commission starting in FY 2014 from licensing fees and assessments for business brokers. The bill’s reporting requirement can be handled with existing budgeted resources.

(in dollars)	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
SF Revenue	\$0	\$130,700	\$139,100	\$145,200	\$151,700
NonBud Rev.	\$0	\$250,000	-	-	-
SF Expenditure	\$153,600	\$130,700	\$139,100	\$145,200	\$151,700
NonBud Exp.	\$0	-	-	-	-
Net Effect	(\$153,600)	\$250,000	\$0	\$0	\$0

Note: () = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Meaningful for business brokers.

Analysis

Bill Summary:

Business Brokerage Services

A person must be licensed by the commission as a business broker before providing business brokerage services in the State, which include (1) for consideration, selling, buying, or exchanging any small business for another person; (2) for consideration, assisting another person to locate or obtain for purchase any small business; (3) engaging regularly in a business of dealing in business brokerage transactions; (4) engaging in a business the primary purpose of which is promoting the sale of small businesses; or (5) for consideration, serving as a consultant regarding any activity defined as providing business brokerage services.

A business broker is entitled to hold and use trust money for a purpose that relates to a business brokerage transaction involving a small business in the State, subject to specified conditions and disciplinary actions that also apply to real estate brokers.

In general, a business broker is required to meet the same requirements as a real estate broker for branch location and certification, signage, notification, advertisement, agency, client relationship, representation, lawyer solicitation and compensation, conviction reporting, and team service. Nonresident business brokers who are not licensed in the State may provide business brokerage services under specified conditions.

A business broker may not charge a commission for the provision of business brokerage services that exceeds 10% of the sale price of the business.

Licensing Requirements

To qualify for a business broker license, in addition to specified character and age requirements, an applicant must have completed successfully a basic course in business brokerage approved by the commission that is 60 clock-hours or less and meets specified conditions for content. The person also must pass an examination provided by the commission. The commission may establish other requirements to ensure specified professional competency in persons licensed as business brokers. An applicant must also pay a one-time fee of \$20 into the Business Brokerage Fund. Business broker licenses are renewed biennially, subject to specified notification and continuing education requirements. The commission may also implement reciprocal licensing of business brokers, subject to specified requirements.

Business Brokerage Fund

The commission must establish a Business Brokerage Fund, which must maintain a balance of at least \$250,000. The Treasurer may invest the fund's assets in similar fashion as the State Retirement and Pension System. As noted above, the bill requires that licensed business brokers be assessed a one-time fee of \$20 to capitalize the fund; as noted below, Legislative Services believes this fee to be insufficient. The commission must assess all licensed business brokers as necessary to maintain the mandated fund balance. Investment earnings are credited to the fund, and may be used for the original purpose of the fund. The commission may adopt regulations to administer the fund.

Specified persons may recover compensation from the fund for an actual loss, not to exceed \$25,000. The claim must (1) be based on an act or omission that occurs in the provision of business brokerage services by a licensed business broker or an unlicensed employee of a licensed business broker; (2) involve a transaction that relates to a business located in the State; and (3) be based on an act or omission in which money or property is obtained by a person through specified means and that constitutes fraud or misrepresentation. In general, a claim must be submitted within three years of the loss or damage. All contracts between licensed business brokers and employers must include a written notice informing the employer about their protections by the fund.

Claims against the fund must be in writing, under oath, and include specified information pertaining to the loss. The commission must review the claim and responses and may conduct an investigation. If there is a hearing and the commission finds that the claimant has a valid claim, subject to specified conditions, the commission may order payment by the fund to the claimant. After a payment by the fund, a *licensee* who the commission finds responsible for the claim must reimburse the fund for the amount paid plus interest at an annual rate of at least 10%. If the licensee does not reimburse the fund, under specified conditions, the commission or the State Central Collection Unit is entitled to a judgment for the amount not reimbursed. The reimbursement amount and any accrued interest are a lien in favor of the State on any real property of the licensee, subject to specified conditions.

If the commission orders a payment from the fund based on an act or omission for which a licensee is responsible, the commission must immediately suspend the license of the licensee. The commission may not reinstate the license until the person repays the fund and applies for reinstatement.

State Real Estate Commission

Licensed business broker is added to the list of eligible professions for the commission's five industry members. A person must be a licensed business broker for at least one year

immediately before appointment. For the duration of their employment, the executive director and members of the commission are prohibited from holding an active business broker license and from directly or indirectly receiving or becoming entitled to receive any fee, perquisite, or compensation related to business brokerage transactions.

The commission must conduct an investigation that relates to any complaint alleging that an unauthorized person has provided business brokerage services. The commission's annual report must include the number of licensed business brokers.

The bill also exempts the Real Estate Guaranty Fund's interest earnings from the requirement that interest earnings be paid into the general fund of the State.

Current Law/Background:

Business Brokers

Business brokers generally function in the same manner as a real estate broker, only with regard to the sale and purchase of small businesses instead of real estate. The exact number of business brokers is unknown at this time; however, multiple sources estimate between 3,000 and 4,000 nationally, or about one business broker for every 1,600 small businesses. As of 2009, Maryland had 93,191 businesses of less than 20 employees and an additional 10,546 businesses with between 20 and 99 employees. This equates to approximately 100,000 small businesses as defined in State law. Applying the national average of 1 business broker for every 1,600 small businesses yields approximately 60 business brokers in the State. The combined number of small businesses in Pennsylvania, Delaware, Maryland, West Virginia, Virginia, and the District of Columbia is approximately 500,000. Applying the same ratio of business brokers to small businesses yields 315 business brokers in the State and surrounding area.

State Real Estate Commission

The commission grants licenses to qualified real estate brokers, associate brokers, and salespersons. The downturn in the residential real estate market resulted in a decrease in the number of licensees over the past several years; the decrease was especially marked among new salesperson licensees. There were 41,465 licensees in June 2011, which is a significant reduction from the 54,460 individuals licensed with the commission in June 2008.

Chapter 399 of 2005 established the commission as a special fund agency; all revenue collected by the commission is deposited in the State Real Estate Commission Fund to cover the actual documented direct and indirect costs of the commission. The continued decrease in the number of licensees resulted in expenditures exceeding revenues in

fiscal 2009. However, subsequent fee increases approved by the commission resulted in a significant increase in commission revenue for fiscal 2010. In fiscal 2010, both the commission's operating surplus and year-end fund balance were significantly higher than in fiscal 2009. The commission's operating surplus fell in fiscal 2011 from its 2010 peak as total revenue declined to \$2.8 million, while expenditures increased to \$2.6 million. **Exhibit 1** displays the commission's revenues, expenditures, and fund balances between fiscal 2007 and 2011.

Exhibit 1
Commission Revenues, Expenditures, and Fund Balances
Fiscal 2007-2011

	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>
Total Revenues	\$2,130,650	\$2,022,188	\$2,128,098	\$3,142,251	\$2,796,056
Total Expenditures	\$1,861,920	\$1,909,797	\$2,196,257	\$2,304,893	\$2,623,727
Fund Balance	\$268,730	\$381,121	\$312,962	\$1,150,320	\$1,322,649

Source: Department of Labor, Licensing, and Regulation

State Treasurer's Investments

The State Treasurer's Office is the procurement control agency for all banking, financial services, and insurance services contracted by State agencies. The Treasurer's Office is responsible for investing unexpended or surplus funds over which it has custody in low-risk investment instruments. It may only invest in government-backed debt (such as Treasury bills), collateralized repurchase agreements, highly rated commercial paper, and money market funds. The State Retirement and Pension System invests in a broad array of asset classes, including real estate and private equity, which the Treasurer does not. Despite statutory authorization to invest assets of the Real Estate Guaranty Fund in similar fashion to investments for the State Retirement and Pension Fund, the Treasurer's Office advises that it invests those funds as it does all other State funds.

State Expenditures: DLLR's estimates for the costs associated with implementing a business broker licensing program within the commission assumes approximately 1,000 licensees. As discussed above, Legislative Services does not concur with that projected number of licensees, and advises that significantly fewer staff are needed to implement the program. Further, DLLR does not anticipate any licensees until fiscal 2014 due to the lack of a grandfathering clause for current business brokers. Therefore, during fiscal 2013, the commission must develop regulations, an education program, a licensing exam, and e-licensing so that licensure can begin in fiscal 2014.

Accordingly, special fund expenditures increase by \$153,633 in fiscal 2013, which accounts for the bill's October 1, 2012 effective date. This estimate reflects the cost of hiring one half-time assistant Attorney General, and one education administrator in fiscal 2013. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses – including indirect cost allocation beginning in fiscal 2013. It is assumed that, since there is no licensing revenue in fiscal 2013, these expenditures are paid from the commission's fund balance, which is large enough to accommodate these expenditures.

Positions	1.5
Salaries and Fringe Benefits	\$78,921
E-licensing and Related Programming	30,000
Licensing Exam Development	20,000
Other Operating Expenses (including indirect costs)	<u>24,712</u>
Total FY 2013 State Expenditures	\$153,633

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

The above expenditures reflect the direct costs of regulating business brokers and the indirect costs that DLLR attributes to each regulatory program within the Division of Occupational and Professional Licensing for the use of division and departmental resources.

Direct costs include necessary expenditures for personnel, equipment and supplies, contractual services, and fixed charges. Indirect costs – such as usage of the central electronic licensing system, general services offices, and a portion of the salaries of some senior staff – are allocated to each program by a formula based on the program's usage of these services. Thus, special fund expenditures for indirect costs under the bill are anticipated to be approximately \$4,000 in fiscal 2013 and \$14,000 annually in future years.

State Revenues: As a special fund entity, the commission must set licensing fees to cover the direct and indirect costs of regulating business brokers. Accordingly, special fund revenues for the State Real Estate Commission Fund increase by \$185,226 in fiscal 2014. However, because the total number of business brokers in the State is unknown, as is the number of reciprocal license applications, actual special fund revenue, and the assessment issued to capitalize the business brokerage fund, may vary significantly from this estimate.

This estimate assumes that nonbudgeted revenues increase by \$250,000 in fiscal 2014 to capitalize the Business Brokerage Fund to the mandated level. The bill requires a one-time fee of \$20 to be paid by each business broker upon initial licensure, but it also requires the commission to assess each business broker an additional fee if the fund balance falls below \$250,000. Legislative Services advises that the one-time fee is likely to be insufficient and, thus, require an additional assessment in fiscal 2014 to reach the mandated fund balance. The future expenditures from the fund – and therefore necessary revenues to recapitalize the fund – are unknown.

Small Business Effect: Legislative Services estimates there are fewer than 75 business brokers in the State. Assuming costs associated with regulating 75 business brokers, initial biennial license fees are approximately \$3,597. In addition, the commission must assess business brokers to capitalize the Business Brokerage Fund at the mandated minimum level of \$250,000, which equates to \$3,333 per business broker. In addition, each business broker would be responsible for any costs associated with education requirements. The combined costs for *just* the initial licensing fees and fund capitalization are almost \$7,000. In the out-years, assuming a minimal number of new licenses, licensed business brokers may be assessed additional fees to maintain the minimum balance in the Business Brokerage Fund.

Additional Comments: The commission advises that, in its survey of other state real estate commissions, it found that 90% of the commissions do not regulate business brokers unless real property is involved in the sale, which would require the business broker to hold a real estate license. Further, some sales are regulated by the U.S. Securities and Exchange Commission if they only involve equity. The commission advises, and Legislative Services concurs, that more information should be obtained if possible to accurately assess how many business brokers are in the State and surrounding area, and whether the number would support the cost of their regulation. Also, in the absence of a grandfathering provision, business brokers may not practice their profession in fiscal 2013, until a licensing system is established by the commission in fiscal 2014.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): Department of Labor, Licensing, and Regulation; Judiciary (Administrative Office of the Courts); Treasurer's Office; Business Brokerage Press; American Business Brokers; Association of Professional Merger & Acquisition Advisors; U.S. Census Data; Department of Legislative Services

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