

MEMORANDUM

Date: April 22, 2021

To: Alaska Real Estate Commission

From: Kassandra Taggart, Chair, Property Management Committee

RE: Best Practice – Security Deposits, Dues Deposits, Pre-Paid Rents, and Reserves

The Property Management Committee is requesting the Alaska Real Estate Commission to review and approve the Best Practice – Security Deposits, Dues Deposits, Pre-Paid Rents, and Reserves listed below. Once approved, the Property Management Committee is requesting submitting this best practice document to the ListServ and add this to the Best Practices list on the AREC – Property Management section of the public website.

This best practice document is regarding generally accepted practices in the property management industry around the topic of handling of Security Deposits, Dues Deposits, Pre-Paid Rents, and Reserves for any or all parties involved in property management contracts.

It was determined that many accounting professionals that process paperwork and brokerages have a variety of different ways of processing these funds that can cause confusion on what is typically expected in the transaction when working together in the industry. As a result, it is recommended to document some generally accepted practices to strengthen the defined duties and relationships between licensees and the public.

BEST PRACTICE

Date: April 22,2021

Adopted: June 16, 2021; All in favor

Title: Best Practice – Security Deposits, Dues Deposits, Pre-Paid Rents, and Reserves

To: Alaska Real Estate License Practicing Property Management for Commercial, Residential, or Association Management, and Alaska Real Estate Trainers

From: Alaska Real Estate Commission & Property Management Committee

Regulation Reference:

12 AAC 64.117 – Broker's Written Policy

12 AAC 64.125 – Supervision

12 AAC 64.220 – Record of Trust Account Transactions

12 AAC 64.220(b) To ensure landlord and tenant and/or association and homeowner funds are tracked through a related but separated transaction code and transaction ledger.

12 AAC 64.220(d) A broker shall establish a ledger for every transaction, including those transactions for which the deposit is held in the trust account of a cooperating broker, title company, or another third party.

12 AAC 64.240. Brokers Commission

12 AAC 64.250. Prohibited Trust Account Activity

12 AAC 64.570. Property Management of Real Property

12 AAC 64.570(E) Written documentation to refund a security deposit or deduct money from a security deposit.

12 AA 64.560 Compliance with Uniform Residential Landlord and Tenant Act

Statue Reference:

Sec. 08.88.90 – Exceptions

Sec. 08.88.331 – Making a transaction

Sec. 08.88.341 - Listings or management contracts

Sec. 08.88.351 - Accounts; Records of transaction

Sec. 08.88.361 - When commission is earned

Sec. 08.88.655 - Compensation

Sec. 08.88.405 – Preparation of documents

Sec. 08.88.685. Policies, guidelines, and requirements

Sec. 08.88.615(3) - Duties owed by licensee in all licensee relationships - presentation

Purpose: To provide guidance to assist any and all parties in property management transactions regarding what is generally accepted practices for handling of these funds.

Disclosure: All parties in a property management transaction should familiarize themselves with the latest Alaska Real Estate Commission Statutes and Regulations prior to taking on any action affecting your or another person's rights or understanding of these best practices document. This publication is not the law.

1. Broker Policy Handbook:

- a. In addition to 12 AAC 64.220, Brokers should define a detailed process that is acceptable for the brokerage on holding and distributing security deposits, dues deposits, pre-paid rents, reserves, and any ebb and flows of funds.
- b. It is recommended to do frequent audits of bank accounts facilitated by the brokerage or third-party consisting of security deposits, dues deposits, pre-paid rents, and reserves to ensure trust account balances are accurate.
- c. Review accounting practices in accordance with 12 AAC 64.220(b) to ensure landlord, tenant and/or association, and homeowner funds are tracked through a related but separated transaction code and transaction ledger.
 - i. *Example: Landlord and tenant can have a transaction code relating to a property, but the transaction ledger for a landlord is separate than the transaction ledger of a tenant, so the funds are not commingled.*
- d. It is highly encouraged to do frequent monthly audits of transaction ledgers for clients, landlords, associations, homeowners, tenants, and the brokerage to ensure funds for specific transaction codes and transaction ledgers are accurate and in the appropriate ledger to avoid commingling of funds between the various transaction ledgers.

- i. *Example: Review the tenant transaction codes, transaction ledger, and the funds for the tenant within a separate ledger from funds of the landlord to ensure the ledger is accurate and not commingled.*
 - ii. *Example: Review the transaction codes and transaction ledger for a homeowner. Ensure that the funds for the homeowner are in a separate ledger from funds of the association.*
 - e. Encourage a policy and review process for the reporting and reconciling of trust accounts, transaction ledgers, and other appropriate accounts that involve security deposits, dues deposits, pre-paid rents, and reserves.
 - f. Encourage a clarification on when and how the parties intend to deliver deposits, reserves, and rents from the brokerage to a third-party or client(s).
 - i. *If the situation was a property for sale; when and to whom will deposits, reserves, and pre-paid rents be allowed to transfer. A brokerage could enforce that only a title company could receive these funds for processing for the sale.*
 - ii. *If the situation was a property transferring to another management company or client, when and to whom will deposits, rents, and reserves be allowed to transfer.*
 - g. It is recommended that a tenant's security deposit is held in the brokerage trust account for ease of processing, accounting of the funds, and reconciliation. According to 12 AAC 64.220(d), if funds are held in a landlord's trust account or other account outside of the brokerage, a broker shall establish a ledger for every transaction.
 - h. Third-Party ledgers should have a review process in place to ensure it is accounted for and fully transparent to all parties in the transaction, along with routine reconciliations for accuracy and compliance with 12 AAC 64.220.
 - i. *Examples of Third-Party ledgers: Landlord's trust accounts holding tenant's security deposits. Association holding dues deposits. Title company holding security deposits during the sale of a property.*
 - i. Encourage a brokerage to consider how, when, and to whom to release funds such as security deposits, dues deposits, reserves, pre-paid rents, and/or rents to be remitted/transferred once the services of the management contract ends.
 - j. Brokerage should consider a policy on having a detailed and clear transaction ledger for security deposits and security deposit transmittal.
 - i. *The security deposit ledger and transmittal, separate charges are to be fully itemized with details rather than a lump sum for all costs.*
 - k. Brokerage should consider utilizing ULTA – Alaska Uniform Landlord Tenant Act within their policy and procedures regarding residential lease agreements to ensure proper care of security deposits and pre-paid rents. See ULTA Sec. 34.03.070 and 12 AAC 64.560 as a reference.

2. Processing of Funds

- a. It is a general practice to have dues deposits, reserves, and daily activities acknowledged and separated within the financial documents and/or accounts; however, the association board and/or covenants may have additional guidelines over this matter.
 - i. *Example: A report, like a balance sheet, should acknowledge how much of the total funds are dues deposits, reserves, or daily activities.*
- b. In an association, each homeowner has a transaction code with its own transaction ledger to account for the dues deposits set aside for each homeowner.
- c. If the lease agreement contract states a certain dollar amount for a security deposit, then this exact amount should be held in the trust or appropriate account while also being accounted for within the financials. If the lease agreement contract and transaction ledger are not in alignment, the contract should be adjusted to reflect an appropriate amendment to the lease agreement.
 - i. *Example: The security deposit on the lease agreement contract states \$1,000 but the tenant only paid \$500, the tenant transaction ledger would only reflect \$500. An amendment to the lease agreement is then signed to have both lease contract and transaction ledger in alignment of each other stating the deposit is now \$500.*
- d. Commissions owed will be charged and paid directly from the transaction ledger that belongs to the appropriate client paying for services and be in compliance with 12 AAC 64.240 and 12 AAC 64.250.
 - i. *Example: A licensee assisted in a leasing contract. The licensee should invoice the paying client to render payment for services through the brokerage rather than deducting commissions from deposits, rents, or pre-paid rents held in a separate transaction ledger in a trust account.*
- e. Pre-paid rents should remain in the transaction ledger and be released/transferred once services or charges are rendered.
 - i. *Example: Tenant pays rent for a future month causing the funds to be considered pre-paid. These funds will remain in this transaction code/ledger and transferred to the landlord when it becomes due.*
- f. A tenant's security deposit will remain in the tenant's transaction code/ledger and be released once services/charges are due and can be payable by the security deposit or transferred to a third-party due to an event.
 - i. *Example: A landlord has a bill from a third-party for services that a landlord is obligated to pay. Once paid, the landlord has the option to back bill the charges to the tenant transaction ledger for reimbursement. The tenant can pay this invoice or depending on the lease agreement and/or amendments, the security deposit can render as payment for this charge.*

3. Definitions

- a. Customer/Client – Included but not limited to the following; a landlord, tenant, entity, vendor, homeowner, government, HOA association/board