WHAT EVERY CALIFORNIA BUYER, SELLER, AND AGENT *MUST* KNOW TO AVOID NONDISCLOSURE CLAIMS IN A HOT RESIDENTIAL REAL ESTATE MARKET (PART 1 IN A 3-PART SERIES)

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Here's the good news:

To say that the residential real estate market in California has been hot is like saying the Grand Canyon is a nice little hole in the ground. With high demand and low inventory, this seller's market has resulted in double digit year-over-year appreciation. It has also resulted in multiple over-asking-price offers, and typical days-on-market of less than 2 weeks. If you're a seller, these are really good times.

Here's the bad news:

Unfortunately, we have also seen a significant uptick in nondisclosure claims. We believe there's a direct relationship between the current market and the increase in these claims. Here's a fact pattern that we've now seen on many occasions: Homebuyers, eager to get into the market, have been outbid on several other properties. The buyers then decide they're not going to let the next property get away. They've received a seller's disclosure package on what they hope will be their dream home, and the package comes with a short fuse for offers to be received and for escrow to close. The buyers then make an over-asking price offer with a short close. And, relying entirely on the disclosure package (sometimes without fully understanding it or even reviewing it in detail, and sometimes without even seeing the property in person), they waive all contingencies with their offer. The offer is accepted, and the buyers put a 3% initial deposit into escrow.

That's when things start to fall apart. During escrow, the buyers discover something that wasn't disclosed, and they ask to cancel the contract and get their deposit back but the seller refuses. Or, escrow closes and something is then discovered, and the buyers want the seller to give them some money back or undo the deal, and the seller refuses. The buyer then gets a lawyer on board, a claim is made against the seller and the agents, and from that point forward things start to get really expensive, really quickly.

Could all of this be avoided? *Yes.* From our experience representing buyers, sellers, and agents in these types of claims, here's our advice for buyers as to how to avoid this scenario from happening to you:

- **Advice for buyers:** Don't let your eagerness to jump into the real estate market get in the way of your good common sense. The rules of thumb for you are: 1) Do what you can to minimize risk; and 2) Do everything you can to know, and understand, what you're getting into so that you minimize the potential for surprises. Here are some ways in which you can accomplish these goals:
  - <u>Never make an offer on a property sight unseen</u>. You should always assume that your offer will be accepted as presented, and once it is, you

are now in a binding contract. If you've never seen the property, and if you've waived all contingencies (more on this below), you're basically "buying a pig in a poke" as the saying goes. Even though a lot of information can be obtained about a property on the internet, that's no substitute for actually seeing it in person.

- Although you might believe that the only way your offer will be accepted is for you to waive all contingencies, it's never a good idea to do so. Contingencies are there for a reason. The inspection contingency is there to give you an opportunity to do your own due diligence on the property, using your own eyes, and your own inspectors if you want, so that you aren't completely relying on the seller's disclosures and the seller's inspection reports. The financing contingency is there so that, if for some reason the loan you're counting on doesn't come through (and there are many reasons why that could happen), you will have a way out of the deal and getting your deposit back. These contingencies are there to give you a way out of the deal if that should become necessary, and waiving either of them can expose you to enormous risk.

- Make sure you read – and completely understand – the seller's entire disclosure package. Under Paragraphs 11.A(1) and 3.N(1) of the December 2021 revision of the California Association of Realtors (CAR) form (and Paragraph 14.A. of the prior version of that form) the seller is required to give the buyer all required disclosures within 7 days of acceptance of the offer. However, many sellers in today's hot market are actually providing the disclosures to potential buyers electronically with the MLS listing so that buyers can review them before making an offer. If you receive the disclosure package before making your offer, it's critical that you read and understand it *before* you make your offer so that you know what you're getting yourself into and can evaluate your risks - *especially* if you're going to waive contingencies with your offer (which we don't recommend; see above). If a seller has failed to disclose something that should have been disclosed and you relied on the disclosure package in making your offer, you may be able to argue that the contract should be cancelled or the price should be reduced even if you've waived your inspection contingency, on the basis that you would not have entered into the agreement if the true facts had been disclosed. The argument can be made, however, *only* if you actually had read and relied upon the disclosure package before making your offer.

  The disclosure package will typically include, among other things, the seller's Transfer Disclosure Statement (TDS) and Seller Property Questionnaire (SPQ), and copies of inspection reports performed for the seller (typically including a Home Inspection Report and a Wood Destroying Pests and Organisms Report (WDO Report). If there have been structural issues with the property, there might also be one or more reports of inspections by structural engineers. If there is anything in the TDS or SPQ that you can't read (which often happens, because these are typically filled in by hand), or that you don't understand, ask your agent to get a *written* explanation from the buyer's agent. And make sure you also completely understand the items that are disclosed in the seller's WDO Report, Home Inspection Report, and other inspection reports. If you don't understand something, you should ask your agent to get a written explanation from the seller's agent.

Also – these inspection reports almost always refer to areas in the property as to which they recommend further inspection, either by them, or by a different type of expert. (For example, a WDO Report might recommend that a wall be opened and inspected for suspected termite activity that can't be confirmed without opening the wall. Or a Home Inspection Report might indicate some differential settling of the property and recommend that a structural or geotechnical engineer be hired to investigate the stability of the underlying soils or the adequacy of the foundation.) Make sure you understand these recommendations, and if you don't, ask your agent for help (such as a referral to an expert who can interpret these things for you). Your safest route would be to ask the seller for permission for you to have the further inspections performed (at your expense), but that might not happen since it will involve an expense on your part in connection with a property you might not buy, and the seller might not allow it. If that's the case, at least be aware of the risk you are taking on if you close on the property without the further inspection(s) being performed.

- <u>Strike a balance between risk and reward</u>. At the end of the day, you will have to strike a balance between knowing as much as possible about the condition of the property before buying it, against the potential for losing the property because the seller has other buyers who are willing (knowingly or otherwise) to take on a greater risk than you are. Where you strike that balance will turn upon your risk tolerance, and your financial capacity to deal with a risk that turns into a reality.

CONCLUSION

Although the volume of real estate nondisclosure claims seems to increase in a seller's market, they can also arise in a buyer's market where sellers, anxious to sell their properties, may find themselves paying a bit less attention to their disclosure obligations. Our comments apply to either situation, and while we can't guarantee that you won't encounter a problem if you follow our recommendations, we can say for certain that following them will reduce the risk of becoming involved in a nondisclosure dispute. And if you need any assistance, whether before or after a problem arises, we're here to help.

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