

WHAT EVERY CALIFORNIA BUYER, SELLER, AND AGENT *MUST* KNOW TO AVOID NONDISCLOSURE CLAIMS IN A HOT RESIDENTIAL REAL ESTATE MARKET (PART 2 IN A 3-PART SERIES)

By Philip R. Diamond, Esq.*

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 sellers as to how to avoid this scenario from happening to you:

- **Advice for sellers:** Here are some suggestions to help you avoid a nondisclosure claim from the buyer:
 - Disclose, disclose, disclose. Always remember – your disclosure package is your best friend. A complete and accurate disclosure package is your best protection to minimize the risk of being on the receiving end of a nondisclosure claim, and to maximize your chance of success in defending against one. Your disclosure package will typically include, among other

things, your Real Estate Transfer Disclosure Statement (RETDS) 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 or other professionals. Remember: You are obligated to disclose any knowledge, and any written reports, that you have that may materially affect the value or desirability of the property.

- When to disclose. Under Paragraphs 11.A(1) and 3.N(1) of the December 2021 revision of the California Association of Realtors (CAR) California Residential Purchase Agreement And Joint Escrow Instructions 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 actually make the disclosures available to potential buyers electronically with the MLS listing. There are at least 2 good reasons to do this: First, giving potential buyers your disclosure package up front gives the buyer the opportunity to factor the disclosures into the offer's price, which in turn can reduce potential requests from the buyer for price reductions during escrow based on the condition of the property. Second, in a multiple-offer environment when contingency waivers can be the difference between a buyer's offer being accepted or rejected, having the full disclosure package before making an offer can make potential buyers more comfortable with waiving contingencies with their offer.

Also keep in mind that you may need to update your disclosure package at some point in the process. For example, let's assume that you've marketed the property as having rental income from a separate unit on the property that you thought was legally rentable, but during escrow the buyer's investigation reveals that the unit in fact is not a lawful Accessory Dwelling Unit. If that escrow doesn't close, you will need to update your disclosures, and your agent will need to update the MLS listing and your marketing materials, to reflect the true nature of the separate unit. Similarly, if a buyer has the property inspected and provides you with a copy of the inspection report during escrow but that escrow doesn't close, you're obliged to disclose that inspection report to later buyers.

- Err on the side of disclosure. As mentioned above, your disclosure duty goes to matters that are: 1) "material" and that affect 2) the "value" or 3) the "desirability" of the property. Some things will be obvious as to whether they are to be disclosed or not (e.g., large water stains on an upstairs ceiling

where you had previously observed water dripping into the room during a rainstorm). Other things might be more subtle. If you have any question about whether something should be disclosed, here are 3 good rules of thumb to follow: 1) When in doubt, disclose (i.e., always err on the side of over-disclosing); 2) Ask yourself what you would want to know about the property if you were the buyer; and 3) If your reason for possibly not disclosing something is that it might scare away a buyer, that almost always means it's something that must be disclosed.

- Form and substance are *both* important. Further, *how* you say something is often as important as *what* it is that you are saying. Make sure that everything you say in the RETDS and SPQ, or in any disclosure addendum, is 100% clear to the reader, so that there can be no doubt down the road that the buyer knew, or should have known, what he or she was getting themselves into, from your written disclosures. This means that, if your disclosure is handwritten, make sure it is completely legible, *and* that what you are saying is completely clear. (We often help sellers in preparing their disclosures, especially where it's a For Sale By Owner.)
- "As-Is" doesn't mean "don't disclose." Even if the purchase agreement provides that the property is being sold "As-Is," meaning that you don't have an obligation to repair any defects, you still have a legal duty to disclose all material facts you know about that might affect the value or desirability of the property.
- Inspection contingency waivers don't let you off the hook. Finally, even if your buyer has waived the inspection contingency, that doesn't relieve you from your legal duty to disclose all material facts affecting the value or desirability of the property that you know about. The buyer could still sue you for damages or to undo the deal if you don't disclose an important issue and the buyer can prove that he or she would not have entered into the deal if the disclosure had been made.

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.

**Phil Diamond is a real estate attorney, Of Counsel to Lerman Law Partners, LLP, where he handles a wide range of real estate-related litigation and transactions, including real estate nondisclosure disputes. He is also a mediator and arbitrator through his independent practice, DIAMOND DISPUTE RESOLUTION. Phil is also a licensed real estate broker, commercial landlord, and developer. You can reach him at philipdiamond@comcast.net, or (415) 492-3341.*