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

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NOTE: The first two sections below ("Here's the good news" and "Here's the bad news") also appear in Parts 1 and 2 of this 3-Part series. We repeat those sections here just to make sure we don't lose anybody at the starting gate and in case you forgot the content of those two sections since you read Parts 1 and/or 2. If you prefer to skip those two sections, the new content begins after those sections with **"Advice for agents:"**.

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

- **Advice for agents:** Here are some suggestions to help you avoid being brought into a nondisclosure claim by the buyer or seller:

- You're a fiduciary. Regardless of whether you represent the buyer or the seller, always be mindful that, under California law, you have a fiduciary duty of the utmost good faith and undivided loyalty to your client. In addition to learning and disclosing all material information that you know or could reasonably obtain, that duty also requires you to advise and counsel your client regarding the transaction. What that duty looks like depends upon the facts of the transaction, the knowledge and experience of your client, the questions asked by your client, the nature of the property, and the terms of the sale. You must put yourself in the position of your client and consider the type of information required for the client to make a well-informed decision. (This language comes directly from the instruction that would be given to the jury (CACI 4107) if you were sued by your client.)

  For example, if a Home Inspection Report indicates some differential settlement of the property and recommends that a structural or geotechnical engineer be hired to investigate the stability of the underlying soils or the adequacy of the foundation, and if your buyer client asks for your advice as to what to do, your fiduciary duty to counsel and advise your client probably requires at a minimum that you advise your client as to their options (including hiring a qualified professional to get them additional information), and the costs, risks, and benefits associated with each, so that the buyer can then make an informed decision as to what to do. A court might find, however, that your duty goes beyond that, and that you should advise your client that proceeding with the purchase *without* the additional expert input is a bad idea and against your advice. Conversely, a court could find that it would be a breach of your fiduciary duty if you told your client that they should ignore the recommendations for further inspection and that they should instead close on the deal because they might otherwise lose the property.

  Here's another example: As mentioned above, it's become more and more common for buyers to waive all contingencies with their offers. Depending upon the sophistication and real estate experience of your buyer client, however, a court could find that you have a fiduciary duty to counsel your client as to the risks associated with doing so, so that the client is making an informed decision as to how to proceed. And for your own protection it would be a good idea to follow up with a confirming email. (Yes, there is boilerplate language in Paragraph 8.H. of the December 2021 revision of the California Association of Realtors (CAR) form Purchase Agreement (Paragraph 14.C. of the prior version of that form) that says: If Buyer removes or waives any contingencies without an adequate understanding of the Property's condition or Buyer's ability to purchase, Buyer is acting against the advice of Agent." That statement could be

helpful to your defense if you're sued. However, a court could find that that statement alone, contained in 15 pages of fine print in the Purchase Agreement form without any place for the buyer to separately initial it, doesn't satisfy your fiduciary obligation to advise and counsel your client as to *why* waiving all contingencies with the offer is against your advice.)

- Your fiduciary duty can get complicated. Your fiduciary duty can get complicated, though, if you're acting as a dual agent (in which event you have a fiduciary duty to both the buyer and the seller), or if agents representing the buyer and seller are associated with the same broker (in which event, under California law, both agents have a fiduciary duty to both the buyer and the seller). Because there are a myriad of situations in which it can be next to impossible to satisfy your fiduciary obligations to both the buyer and the seller at the same time, it's best to avoid dual agency if possible. And although you can't always avoid having the buyer and seller represented by agents from the same broker (especially if it's a large brokerage with multiple agents), in the event you find yourself in that situation you should always be mindful of your fiduciary duty to both parties.

- You have a duty to inspect and disclose. Regardless of who you represent, you have a legal duty to make a reasonable, good faith, visual inspection of all visible and accessible areas of the property, and to disclose to the buyer everything you observe that might materially affect the property's value or desirability. This is typically done in your Agent's Visual Inspection Disclosure (AVID). Take this obligation seriously and give yourself enough time to make your inspection. The same rule applies to you as to your client: If in doubt, disclose. That said, you aren't a professional home inspector, and you should report *only* what you have observed, without any comments as to its cause, and without any recommendations as to how to address it (other than perhaps to recommend that it be investigated by an appropriate professional). And although there are many things that a home inspector must observe and report on (such as whether the various systems in the house are properly functioning) that are beyond what you can or should be reporting, the reverse is also true. There are certain conditions, both on and off the property, that a home inspector isn't expected to observe and report, but which could materially affect the value or desirability of the property that you *should* report. These could include neighborhood noises, privacy issues, unusual odors, high voltage lines, an across-the-street neighbor operating an auto repair business out of his garage, and traffic or parking concerns.

  And use your common sense when deciding whether something on the property is, or isn't, reasonably accessible to you for inspection. For example, although you have no duty to crawl through a crawlspace hatch

and go under the house into a low crawlspace, you might have an obligation to look under the house if there is a full-size access door and plenty of headroom under the house once you go through that door. If you don't, and it turns out that there was an obvious large crack in the foundation that would have readily been seen had you gone into the area, a court could find that you breached your duty to make a reasonably diligent inspection.

- Make sure your marketing information is accurate. If you are representing a seller, it should go without saying that everything you say about the property in the MLS, your website, or in any other web-based or written marketing materials, must be 100% accurate. Buyers are going to be relying on that information and since you are acting as your client's agent, misstatements in your marketing information could come back to bite both you *and* your seller client in the rear end. For example, if you are listing a property as income property with 3 occupied, separate units on the same lot with income from each, before listing the property you should first confirm with the local jurisdiction that all 3 units are legally rentable, whether as a legal Accessory Dwelling Unit or otherwise. If you don't, and a buyer relies on your marketing statements but it turns out that one of the units is not legally rentable, you and your seller client could be on the receiving end of a lawsuit.

- Always follow up quickly. At the risk of stating the obvious, you should always follow up timely as you're guiding your client through the transaction. Aside from the fact that being a good professional requires timely follow-up, your client's rights might be impacted by missed deadlines. For example, if you receive a supplemental disclosure from the seller's agent after you are already in escrow and initial disclosures already have been made, under Paragraph 14.B.(3) of both the December 2021 revision of the CAR form purchase agreement and the prior version of that form, the buyer then has 5 days (excluding weekends or legal holidays) to either remove the applicable contingency or cancel the agreement. If you don't timely forward the supplemental disclosure to your client, the 5 days could expire and your client could lose their right to cancel the contract. (NOTE: Although it could be argued that a waiver of all contingencies with the offer means that the buyer has also waived their right to cancel the contract based on a supplemental disclosure, a court could find otherwise – *especially* if the offer, with the contingency waiver, was made with reliance upon a disclosure package that had been given to the buyer before the offer was made.)

- Don't give legal advice. Finally, and again at the risk of stating the obvious, you should always stay within the scope of your expertise – and licensing – and never give legal advice to your client, whether your client is the buyer

or seller. It's true that the December 2021 revision of the CAR form purchase agreement advises buyers to consult with an "appropriate professional" on such things as the manner of taking title (Paragraph 13.D.), and goes on to provide that agents and brokers "[s]hall not be responsible for providing legal…advice…" or "for providing other advice or information that exceeds the knowledge, education and experience required to perform real estate licensed activity," and that buyers and sellers "agree to seek legal…and other desired assistance from appropriate professionals" (Paragraph 18.B.) And both the December 2021 revisions of the CAR form Real Estate Transfer Disclosure Statement (RETDS) and Seller Property Questionnaire (SPQ) contain disclaimers to the effect that brokers are qualified to advise on real estate transactions, but if buyers or sellers desire legal advice they should consult with an attorney. However, those disclaimers may not be of much help to you if you give legal advice, and a dispute arises.

What constitutes legal advice isn't always clear. Some things should be obvious (e.g., preparing a complicated Addendum exercising a renter's option to purchase, using a third party's funds, with title to be taken by the third party and the renter being required to vacate after an agreed-upon period of time). Other things may not be so clear. (E.g., does advising a seller as to what language to use in completing the RETDS and SPQ constitute legal advice?) Where there is a grey area (and there are many), our advice is to err on the side of caution and be very careful about crossing the line between real estate advice and legal advice.

One final note on this subject for those brokers and agents who also have law degrees: While legal training can be helpful in helping buyers or sellers navigate through a real estate transaction, we strongly recommend that, in addition to staying away from giving legal advice, you also make it clear to your clients (preferably in a writing that is separate from the boilerplate disclaimers in the CAR forms mentioned above) that, although you have a law degree, you are acting solely in your capacity as a realtor, and not as their attorney. This is especially important if you do not have legal errors and omissions insurance (which most realtors do not). Because there is a risk that your real estate errors and omissions carrier might decline coverage for a claim that you acted outside the course of covered real estate activities, you could end up having no insurance coverage to respond to a claim arising out of legal advice that you gave to your buyer or seller client.

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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