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Real Estate And Construction Highlights

***A Newsletter For Real Estate
and Construction Professionals***

THOITS, LOVE, HERSHBERGER & MCLEAN
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Transfer Disclosure Obligations in Residential Real Estate Sales

THIS ISSUE

What are the rights and liabilities created by California's transfer disclosure obligations?

BACKGROUND

California law requires a seller to disclose to a buyer all material facts of which the seller is aware bearing on the value or desirability of the property in most residential real property transactions. The transfer disclosure statement, or TDS, is one of the most frequently litigated documents in real property transfers, and with good reason. Lawsuits may be based on later-discovered conditions of the property, including conditions of the land itself, the building on the land, the title or even the surrounding neighborhood. Frequently, lawsuits are based on none of these, but rather on an after-acquired uneasiness about the transaction itself. Transfer disclosure statements are the first place plaintiff's attorneys can look to try to undo what is later perceived to be not such a good deal. And because sellers often want to minimize these

disclosures so as to maximize the price of their home, many opportunities present themselves for a savvy plaintiff's attorney.

IN BRIEF

Seller Disclosures

All agents have seen them, many times over. But for most clients, the TDS is a vast array of confusing statements and inquiries. Without proper guidance, most clients stand little chance of knowing how to respond to the numerous sections of the document. Sellers may have questions such as "how long ago is long-enough ago to not list something?" or, even more to the point, "do we really have to be *that* inclusive in the disclosure?" The short answer is, if you have to ask about it, then you probably should disclose it. The longer answer is that if the condition is likely to be "material" to the average buyer, and it is known by the seller, then the condition should be disclosed. From the perspective of a plaintiff's attorney attempting to invalidate a sale after the fact, or seeking damages for repair to the property, "materiality" may be very different from what it was to a seller attempting to minimize the impact of the TDS. And, of course, any communication from the seller to the agent saying words to the effect of "don't disclose the condition we discussed" is ultimately discoverable by the attorney representing the disgruntled buyers.

Transfer disclosure statements are rife with opportunities for misleading statements. Almost any kind of value judgment about the property is subject to later cross-examination. Such statements as, "there is a slight squeak in the master bedroom floor" or, "bricks in walkway are slightly loose," merely lend themselves to later examination. What seems "slight" at the time of the sale may be "major" when the buyer wants to rescind the deal later. Also, what may appear to be full disclosure at the time of sale, may well look like an attempt at misdirection when examined under the harsh light of litigation. For instance, if those "slightly loose" bricks were loose because the seller had been routinely filling in the earth under them because of a known land subsidence issue, then the seller failed in his obligation to provide a full disclosure.

In one case, a seller knew that the retaining wall in the back yard was failing and would have to be replaced. The wall was covered with ivy, and it was impossible to tell without removing the ivy that the wall was unsound. In the section of the TDS asking about Foundations, Basement, Crawl Space and Soils/Retaining Walls, the seller merely listed “cracks in walkway.” It later became apparent that the seller knew of the condition of the retaining wall at the time of the sale, having discussed it with the neighbor at length only 12 months prior to the sale. The neighbor, upon learning from the buyer that she was shocked to find that the retaining wall needed to be replaced, showed her several construction proposals that had been prepared by a contractor and delivered to the neighbor *and* to the seller. The transaction was rescinded based on the active concealment by the seller.

Of course, every disclosure is a value judgment to some extent. Is it reasonable to disclose that a roof leaked 7 or 8 years earlier, but that it was repaired and no leaking had been noted since then? Maybe not. But would this kind of disclosure be likely to affect the sales price of the home?

Agent Disclosures

Agents representing both the buyer and the seller have a statutory obligation to perform a diligent visual inspection of the home and report those conditions that they observe. In the statutory form provided for this report, there is a box saying: “Agent notes no items for disclosure.” Of course, any agent who checks that box is essentially admitting that he has not done a competent visual inspection, since every home has something to report – with the home itself, in the yard, in the neighborhood, or, if all else fails, “agent notes that the home has a very strong smell of new paint throughout.”

What does a competent inspection require? Different standards apply depending on the kind of home being purchased and the customs for the area. But some notable items come up frequently -- for example: there is the smell of mildew in the basement; agent noted neighbor dogs barking during open house; grass and fungus are growing through vents on exterior of home, and

may warrant examination by an expert; and, my personal favorite, copied verbatim, “during agents’ open house, woman identifying herself as neighbor wanted to ensure that she could continue using the backyard to grow vegetables after property was sold.”

Right of Rescission

There is a common misperception that all real estate sales contracts have an automatic 3-day right of rescission. No statute or case law in California creates that right, however. But the delivery of the TDS may create a right of rescission if it is delivered to the buyer *after* the buyer submits an offer. In that event, there *is* a statutory 3-day window to rescind a purchase offer, even if it has already been accepted by the sellers, and even if the sellers have relied upon it to their detriment. If the TDS is delivered to the buyer after the offer is made, and the buyer exercises the rescission rights in writing within the 3-day window, then the buyer is entitled to recover the entire deposit from escrow. The buyer does not need to give a specific reason for rescission – even “cold feet” is good enough.

Subsequent Inaccuracies

If information disclosed later becomes inaccurate as a result of any act, occurrence or agreement, the inaccuracy is not subject to the disclosure laws. This requires, however, that the seller and agent made a diligent effort to obtain the information before making the disclosure. For example, after a TDS is delivered to a potential buyer, the school board approves construction of a new school across the street. This new approval is not subject to the disclosure laws. But it is highly likely to be the subject of litigation after the sale closes, and, in this example, was probably known or knowable by the seller at the time of the delivery of the TDS. Again, when in doubt, disclose.

“As Is” Sales

The delivery of a TDS cannot be waived in an “As Is” sale. That is true even in those cases where it is the clear intent of the parties that the building

will later be torn down and entirely replaced. Furthermore, an As Is addendum does not mean merely “buyer beware.” A seller must still make a full, honest, and diligent disclosure of known conditions of the property. An As Is addendum merely eliminates the obligation of the seller to make certain repairs, such as structural pest control repairs or ensuring functionality of certain components of the property. All too often, however, sellers perceive the As Is addendum as relieving them of the obligation to disclose known conditions of the property. Frequently, once litigation has begun, a seller points to the As Is addendum as if it were a waiver of liability for all claims known and unknown. But in reality, the As Is addendum has very limited application in subsequent litigation.

CONCLUSION

California statutes say that no real property transaction will be invalidated merely by the breach of a transfer disclosure obligation. And the statutes further state that the remedy for a failure to properly disclose a condition is the cost of repair of that condition. But frequently, the transfer disclosure statements are used to demonstrate active concealment of a known condition at the time of sale. In the event the value of the property has dropped significantly after the sale, a buyer may attempt to use the inaccurate statement to rescind the deal, claiming that if he had known of the condition of the property, he would never have entered into the deal. Proper and full disclosure is essential to ensure that transactions are not later subject to rescission based on concealment.

NEXT ISSUE: Landslides, debris flows, and hillside failures: who is liable?

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