

## 22 Basic Contract Provisions and Disclosures in a Residential Real Estate Transaction

A residential real estate sale transaction usually begins at the time a broker obtains an agency contract in the form of a listing from the property owner. If a buyer is found, the transaction proceeds through several closings:

**Closing the sale.** Buyer and seller agree as to terms. The deposit receipt form/contract is fully executed. This is the result of sales effort and negotiation.

**Legal closing.** Title insurance or title evidence has been furnished and escrow has the funds necessary to cash out the seller's equity, less expenses. All instruments necessary to transfer title are executed and recorded. Transfer of title and transfer of money are thought of as simultaneous acts.

**Financial closing.** Financial closing is closely related to legal closing but with more emphasis upon the settlement function or mechanics: i.e., the actual disbursement of funds by checks and a written accounting to all parties. In a complicated transaction involving new financing, there may be not only buyer and seller, but several old lenders and a new lender to be taken into consideration. To show that instructions of the escrow have been fully performed, the escrow holder will prepare settlement statements for the principals.

### A BASIC TRANSACTION

An owner (the seller) of a single family residence (the property) in California wishes to sell the property.

The seller enters into an Exclusive Authorization And Right To Sell Agreement (the listing) with a California real estate broker (the listing broker).

Prior to entering into the listing, the broker gives the seller an agency disclosure form. This requirement is discussed later in this chapter and, more completely, in Chapter 10.

The listing provides that it will be placed into a multiple listing service and the listing broker can cooperate/share the commission if another broker (the selling broker) finds a buyer for the property.

The selling broker finds a buyer purportedly ready, willing and able to purchase the property. An offer (preceded by an agency disclosure form) is made, negotiated, and accepted so that a meeting of the minds is reflected in a real estate purchase contract and receipt for deposit (the contract). The contract includes confirmation of the agency relationships.

The transaction, grounded in the sale closing negotiated by the listing and selling brokers, proceeds to legal and financial closing.

This chapter examines the provisions of a listing agreement and a contract involved in such a transaction and the required disclosures.

## A BASIC LISTING

The Exclusive Authorization and Right to Sell is a listing for sale of one or more specifically described parcels of real property. (This is one of several different types of listing agreements.) The phrase “right to sell” means “right to find a buyer.” It does *not* authorize the broker to sign transaction documents for the seller. Prior to signing the listing agreement, the seller should be given the agency disclosure form. See Chapter 10.

### Term

An exclusive listing must have a definite term. The term of the listing ends at midnight on a specified day. If the listing is intended to be for a certain number of weeks or months, the termination date should be determined with care to avoid misunderstanding.

### Description of the Property

The description of the property should be as exact as possible to satisfy the statute of frauds. Accuracy of description avoids any doubt of enforcement of the listing on that ground.

### Terms of Sale

The minimum requirement for setting forth the terms of sale, where cash is acceptable to the seller, is to express the price in cash.

Complications may arise when the seller demands assumption of the existing loan or loans, or indicates a willingness to pay part of the assumption fees or new set-up charges if the buyer assumes the existing loan or refinances with the existing lender. Such terms of sale should be spelled out in detail.

If the sale may be financed by a VA or FHA loan, the listing will include details of the seller’s conditions with respect to the payment of points.

Where a first loan can be assumed and the seller is willing to carry secondary financing, the specific terms of the proposed secondary financing will be set forth.

### The Broker’s Authority

A listing authorizes the broker to:

- place a “for sale” sign on the property;
- place the property in a multiple listing service;
- cooperate with subagents or buyer’s agents; and
- accept on the seller’s behalf a prospective buyer’s good faith deposit toward the purchase price.

### The Broker’s Duty

In return for the exclusive rights granted by the owner, the broker agrees to use due diligence in attempting to find a suitable buyer and negotiate a sale. Thus, the listing is a bilateral contract.

The listing states that the right of the broker is “irrevocable.” Basically, this means that it cannot be revoked by either party without the other’s consent. However, if there is a breach of contract (e.g., failure of the broker to use due diligence), the contract may be subject to rescission.

### Broker's Compensation

The compensation clause in an exclusive right to sell listing will be specific and unequivocal. It will state simply that the broker is entitled to the compensation, expressed either as a percentage of the purchase price or a dollar amount, if the property is sold by the broker, by another broker, or by the seller during the term of the listing or any extension of it. It also obligates the seller to pay the compensation if, without the consent of the broker, the owner withdraws the property from sale or in some other way makes it unmarketable during the term of the listing or any extension thereof.

A listing's "safety clause" will designate a period of time after expiration of the listing during which the broker's compensation is protected if the owner personally sells to someone who physically entered and was shown the property or who wrote an offer on the property. For this clause to be effective, the broker must, either before or within the time specified in the agreement, notify the owner in writing of the names of the prospective buyers with whom the broker has negotiated during the listing term.

### Negotiability of Commission

In the sale of residential property of not more than four units, including a mobilehome, Business and Professions Code Section 10147.5 requires that the listing (or whatever document initially establishes the broker's right to a commission, or increases the amount or rate of the commission) contain, in not less than 10-point boldface type, the following provision before the compensation clause:

**Notice: The amount or rate of real estate commissions is not fixed by law. They are set by each broker individually and may be negotiable between the seller and broker.**

A broker cannot use a listing form in which the amount or rate of compensation is preprinted or otherwise inserted prior to negotiation with the seller.

### Personal Property

The listing will specify the items of personal property included in the purchase price. For example:

Sales price to include all screens, blinds, curtain rods, drapes, patio furniture, swimming pool equipment and supplies, outdoor potted plants, and outdoor statuary.

### Multiple Listing Service (MLLES) and Internet

A paragraph may provide that the listing will be submitted to a designated MLLES where information about the property will be disseminated to members, who may also solicit potential buyers for the property. The MLLES and broker often are also have a service to advertise the property on the internet.

### Deposit

This clause authorizes the agent to accept a certain deposit to be applied toward the purchase price.

### Other Provisions

**Home protection plan.** Informs seller of the availability of such coverage.

**Keybox.** Authorizes the agent to place a key repository on the listed property.

**Sign.** Authorizes placement of broker's "for sale" sign on the property.

**Equal housing opportunity clause.** This clause is *prima facie* evidence of nondiscriminatory intent. The proof of compliance is, of course, that the parties act in the spirit of the declaration.

**Arbitration.** This provision, if initialed by the broker individually, or by the broker's authorized associate licensee, and all sellers, constitutes an agreement to refer all disputes or claims "in law or equity" arising out of the listing or any resulting transaction to binding arbitration.

**Attorney's fees.** In the event of any legal action to resolve a dispute, this clause provides that the prevailing party will be paid reasonable attorney's fees.

**Additional terms.** Additional provisions could include: date for possession; rent if possession is delivered on a date other than closing day; repairs to be made by owner; and termite work. Also, if the seller has a prospect which the seller personally located, the seller may wish to exclude a sale to that person from seller's obligation to pay a commission.

**Change of price or terms.** A change of price or terms of a listing should never be made on the face of the original contract, but rather on a price change or extension form.

**Owner's signature.** All owners must sign the listing. If the property is owned by a partnership or a corporation, the proper officials must sign.

**Agent's signature.** When the listing is signed by an authorized licensee member of the broker's staff or by the broker himself, it becomes a (bilateral) contract. Broker (or broker's agent) must give the seller a copy of the agreement.

### Single Agency

Single agency brokerage firms have become more common since the Agency Relationship Disclosure law was enacted. Special listing forms exist.

A Buyer-Broker agreement such as the "Buyer Representation Agreement" or the "Exclusive Authorization to Locate Property" will contain many clauses similar to those in a seller-broker exclusive listing. Cooperation between brokers representing sellers only and buyers only should be conducted with full disclosure of the nature and terms of the cooperation and understanding of the compensation split, if any. In order to avoid disputes with the buyer, the broker should be particularly careful in describing the property the broker is engaged to locate and when the commission will be deemed earned. Changes in the buyer's specifications should be made in writing and a complete "paper trail" maintained throughout the transaction.

### PURCHASE CONTRACT AND RECEIPT FOR DEPOSIT

This section discusses provisions which comprise a comprehensive Residential Real Estate Purchase Contract and Receipt for Deposit. When completed with the terms and other information relative to the buyer's attempt to purchase the property, it is an offer. When the seller [or seller or buyer after counter offer(s)] communicates unqualified acceptance, it is a contract. In this discussion, we refer to the document as the deposit receipt, offer, or contract.

### **Date and Place of Buyer's Offer**

This is the date and place the deposit receipt is signed by the (prospective) buyer. This is *not* the date used to measure temporal compliance with any of the performance provisions of the contract. Those time constraints flow from the date a contract is formed by receipt of communication of acceptance.

### **The Full and Correct Name of the Buyer**

This will include the buyer's marital status (single person, husband and wife, unmarried, widow or widower). If the buyer is a corporation, include the state where the corporation is chartered. If buyer is a general partnership, include the names of the partners. If buyer is a limited partnership, include the name of the general partner. If the buyer is a real estate licensee, disclose that fact. It is not necessary to include the manner in which buyer will take title. That will be taken care of in escrow.

### **Description of the Property**

The property description must be adequate for a court to identify it: street address, map book, page and parcel, or other legal description.

### **Purchase Price and Terms**

The offer must state unmistakably the total purchase price offered and the terms to which the buyer is willing to commit (e.g., all cash, new loan, or loan assumption). The total purchase price will *not* include the buyer's closing costs and any costs associated with obtaining financing.

### **Financing**

The contract will contain a financing contingency unless the buyer is paying all cash or specified there is no loan contingency. That is, the loan(s) necessary for closing will be described and buyer will agree to act diligently to obtain the financing. There will be a time limitation for this to occur. If, in spite of buyer's diligent attempt, the stated financing is not obtained within the allotted time, the buyer must either cancel the contract or remove the financing contingency and proceed with the transaction.

### **Deposit**

The offer will detail the form (cash, personal or cashier's check, promissory note, or money order), amount and disposition of buyer's deposit. Disposition means deposit of the funds into escrow or into the broker's trust account in a bank or other recognized depository in this state not later than three business days after receipt of the funds by the broker or by the broker's salesperson. If a check is used, the offer may require that the check be held after acceptance of the offer.

### **Time Constraints**

The offer will require delivery of acceptance by a date certain. If this does not occur, the offer is revoked and the deposit must be returned.

The contract will require that buyer and seller deliver instructions to the escrow holder within a certain number of days after acceptance of the offer.

The contract will require that escrow close within a certain number of days after acceptance of the offer.

The contract will state that time is of the essence of the agreement and the time for performance can be extended or otherwise modified only by a writing signed by both buyer and seller.

### **Title and Vesting**

The contract will state that title will vest as directed by the buyer in instructions to the escrow holder. As there can be significant legal and tax implications, a real estate licensee should urge a buyer to seek competent advice regarding the manner of taking title.

The contract will typically require transfer by grant deed, with mineral, oil and water rights if currently owned by the seller.

The contract will state that title must be free of financing liens except as provided in the contract and will be subject to all other encumbrances, easements, covenants, conditions, and restrictions, etc. shown in the preliminary title report. Title will also be subject to any other exceptions disclosed to, or discovered by, the buyer prior to closing unless the buyer disapproves in writing of a particular exception.

The contract will designate which party must pay for a preliminary title report and a policy of title insurance.

### **Prorations**

Typically, the contract will require that certain expenses of ownership be paid current as of the date of close of escrow, to become the buyer's responsibility thereafter. These include:

- real property taxes (including supplemental taxes) and assessments;
- if applicable, homeowners' association assessments;
- premiums on insurance assumed by buyer; and
- payments on bonds assumed by buyer.

If the property is a rental, the rent will be prorated so that any prepaid rent for time on and after the date of close of escrow will be credited to the buyer.

### **Transfer Taxes/Fees**

The contract will fix responsibility for the county transfer tax, the city transfer tax (if any) and any homeowners' association transfer fee.

### **Occupancy and Possession**

The contract will include a paragraph in which the buyer designates whether he/she will occupy the property as a principal residence. The contract will further require delivery of possession (keys, etc.) on a date certain, usually the date escrow closes. If the seller is to remain in possession after close of escrow or if the buyer is to take possession prior to close of escrow, such possession should be by appropriate written agreement.

### **Buyer's Inspection of the Property**

Acceptance of the property's condition is a contract provision, subject to inspections to be conducted at buyer's expense. The buyer must communicate approval of the property's condition or request the seller make repairs or take other actions. The buyer and seller then have a certain period of time to negotiate buyer's requests. If the seller is willing to correct the items, the transaction proceeds. If the seller is unable or unwilling to correct the items, the buyer must either proceed with the transaction or cancel the contract.

### **Condition of the Property**

The Property is usually sold in its condition on the date of acceptance of the contract. The buyer still has the right to inspect the property and request that the seller make repairs. The seller remains obligated to disclose known material defects, however.

### **Smoke Detector(s)**

The contract may reiterate state laws that require that dwelling units be equipped with smoke detectors approved by the State Fire Marshall. In an existing dwelling, there must be a battery operated smoke detector outside each sleeping area. As of August 14, 1992, new construction (or an addition, alteration or repair that exceeds \$1,000 and requires a permit or includes addition of a sleeping room) must include smoke detectors in each bedroom and at a point centrally located *outside* the bedroom(s). In new construction, the smoke detector(s) must be hard-wired, with battery back-up. The seller must give the buyer written certification of smoke detector compliance, as required by Health and Safety Code Section 13113.8. This may be done in the contract or in a separate writing. Certain transactions are exempt from this requirement, as set forth in Health and Safety Code Section 13113.8(d). These exemptions are nearly identical to those set forth below relative to the provision of a Transfer Disclosure Statement.

### **Water Heater Bracing**

The contract may set forth the seller's duty to see that each water heater is braced, anchored or strapped, in accordance with the California Plumbing Code, to resist falling or horizontal displacement during an earthquake. As indicated in Health and Safety Code Section 19211, the seller must give the buyer written certification of compliance in the contract, the Homeowner's Guide to Earthquake Safety (discussed below), in the Transfer Disclosure Statement, or in some other transaction document.

### **Retrofit**

The contract should assign responsibility for any retrofitting required, upon sale, by the local government. This could include installation of low flow shower heads and gallon restricted flush toilets.

### **Governmental Compliance**

The contract may include the seller's representation that he/she has no knowledge of any notice of violation of any building, zoning, fire, or health laws, regulations or ordinances. If the seller has such knowledge, disclosure must be made. Further, the contract may include the seller's covenant to notify the buyer if the seller receives a notice of violation.

### **Fixtures**

Subject to specific exclusions made part of the contract, the buyer is entitled to all fixtures. Fixtures are items attached permanently (e.g., by cement, plaster, bolts, screws, or nails) to what is permanent (walls, etc.). Examples are electrical, lighting, plumbing and heating fixtures, fireplace inserts, solar systems, built-in appliances, window coverings, TV antennas, air conditioners, and in-ground landscaping.

### **Personal Property**

The buyer is entitled to only that personal property listed in the contract. This could include any large outside potted plants, as these are ordinarily not fixtures.

### **Home Warranty Plans**

The contract may remind seller and buyer of the availability of home warranty plans. If a plan is to be purchased, the contract will detail the duration, maximum cost, provider, and responsibility for payment.

### **Septic/Sewer/Well Systems**

As applicable, the contract should specify responsibility for inspection and any needed repair of the septic system and testing of the well for potability and production. If local law requires connection to a sewer system, the contract must assign this responsibility. Of course, these items must be completed prior to close of escrow.

### **Pest Control**

The contract will specify whether or not a pest control inspection is to be performed and, if so, at whose expense and may specify who must pay for any work required so that a registered structural pest control company can issue a written certification that the property is free of evidence of active infestation in the accessible areas. Lenders may require issuance of a certification prior to funding. If the contract provides that some of the required work will be completed at seller's expense after close of escrow, that provision may also require that the seller deposit funds into escrow, to be disbursed when the buyer has received a written certification.

A copy of the structural pest control inspection report (and other pest control documents required by Civil Code Section 1099) must be delivered to the buyer as soon as practical before transfer of title, provided the report is a condition affecting the transfer or financing of the property. If more than one licensee is acting as an agent in the transaction, the selling agent must deliver the documents, unless the seller has given written instructions to another licensee acting as agent in the transaction to make the delivery. The responsible broker shall maintain a record of action taken to effect compliance. (Commissioner's Regulation 2905)

### **Rental Property**

If applicable, an addendum to the contract should state that the buyer takes the property subject to the rights of existing tenants. The contract can help ensure that the rental situation undergoes a smooth transition by requiring that:

- the seller, within a stated period of time, give the buyer copies of the rental agreement/lease, the current income and expense statement, and any notices sent to the tenants;
- the seller cannot make any changes to the rental agreement/lease without the buyer's consent;
- the seller must give the buyer written statements from the tenants confirming the salient aspects of the tenancy and that no defaults exist; and
- the seller must transfer to the buyer, through escrow, any unused tenant deposits.

### **Repairs and Final Inspection**

The contract may provide that all required repairs will be performed in a skillful manner with materials of comparable quality to the original and, unless otherwise agreed in writing, be completed prior to close of escrow. The buyer can be given the right to inspect the property prior to close of escrow to confirm both the repairs and that the property is otherwise in the same condition as when the contract was formed.

### **Sale of Buyer's Property**

If applicable, the contract will provide that buyer is not obligated to complete the transaction unless buyer closes escrow on the sale of his/her property, as described. The contract may then afford the seller two options:

- to continue to offer the property for sale and to accept another offer. If this happens, the contract will provide that the buyer must, in writing and within a stated period of time, remove this contingency and the loan contingency of there is one. If the buyer does not do this, the transaction is terminated.
- to continue to market the property for back-up offers only.

### **Property Destruction or Damage**

The contract may assign the risk of loss due to destruction or damage to the property which is not the fault of either buyer or seller. If the contract does not, then damage or destruction prior to close of escrow is the seller's problem. An exception to this would be damage or destruction occurring after buyer takes possession but before escrow closes (i.e., buyer moved in as a tenant).

### **Multiple Listing Service**

The contract may give the brokers authorization to report the terms of the transaction to any MLS, to be published and distributed to other parties on terms approved by the MLS.

### **Equal Housing Opportunity**

The contract may inform the parties that the property is sold in compliance with federal, state and local anti-discrimination laws. It is illegal to discriminate on the basis of race, color, religion, sex, handicap, familial status, or national origin.

### **Mediation/Arbitration of Disputes**

The parties may agree to mediate all disputes and claims before resorting to arbitration or court action. A mediator is impartial and may facilitate resolution of a dispute but cannot impose a settlement. However, mediation can result in a binding settlement document signed by seller and buyer. For mediation which is not successful, the contract may afford the option of proceeding to arbitration. An arbitration, conducted in accordance with the rules of either the American Arbitration Association (AAA) or Judicial Arbitration and Mediation Services, Inc. (JAMS), results in a binding decision.

### **Liquidated Damages**

If separately signed or initialed by both seller and buyer, the liquidated damages paragraph is activated and provides that if the seller proves that the buyer breached the contract:

1. The seller is released from the obligation to sell the property to the buyer.
2. The amount of the liquidated damages is limited to the buyer's deposit, to a maximum of 3% of the purchase price.

The liquidated damages provision must be printed in at least 10-point bold type or in contrasting red print in at least 8-point bold type.

If the deposit was increased after the initial offer/acceptance, the buyer and seller must, if the amount of the increase is to be subject to liquidated damages, sign a separate liquidated damages agreement covering the increased deposit.

### **Attorney's Fees**

The contract may provide that the prevailing party in any action, proceeding or arbitration between buyer and seller is entitled to reasonable attorney's fees and costs. This provision may include an exclusion if the prevailing party commenced the action, proceeding or arbitration without first attempting mediation.

### **Offer and Acceptance - Contract**

In order to form a binding contract, the seller must accept the buyer's offer, without modification, and communicate that acceptance to the buyer before a specified expiration date.

If the seller finds unacceptable some element(s) of the offer, the seller may make a counteroffer, giving the buyer a certain time to accept. These negotiations will culminate in either a stalemate or a contract. If a contract is reached, the result will be either breach or transfer of the property.

The acceptance clause may include the seller's agreement to compensate the listing and selling broker's:

- on recordation of the deed;
- upon seller's default; or
- upon buyer's default (a stated portion of any damages seller recovers from buyer, after first deducting title and escrow expenses and any costs of collection).

## **DISCLOSURES**

The following are important disclosure requirements which attach primarily to the sale of residential real property of one-to-four units.

### **Real Estate Transfer Disclosure Statement**

Many facts about a residential property affect its value and desirability. These include:

- age, condition, and any defects or malfunctions of the structural components and/or plumbing, electrical, heating, or other mechanical systems;
- easements, common driveways, or fences;
- room additions, structural alterations, repairs, replacements, or other changes, especially those made without required building permits;
- flood, drainage, settling or soil problems on or near the property;
- zoning violations, such as nonconforming uses or insufficient setbacks;
- homeowners' association obligations and deed restrictions or "common area" problems;
- citations against the property or lawsuits against the owner or affecting the property;
- neighborhood noise or nuisance problems; and
- location of the property within a known earthquake zone.

California Civil Code Section 1102.3 requires that a seller of real property consisting of one-to-four residential dwelling units deliver to prospective buyers a specified written disclosure statement concerning the condition of the property. The disclosure covers matters within the personal knowledge of the seller and the agent, and matters based on a reasonably diligent inspection of the property. This requirement extends to any

transfer by sale, exchange, installment land sale contract, lease with an option to purchase, any other option to purchase, or ground lease coupled with improvements. The following transfers are exempt:

- transfers required to be preceded by delivery to the prospective transferee of a subdivision public report or where a public report is not required because the offering of subdivided land satisfies all the criteria in Business and Professions Code Section 11010.4;
- transfer pursuant to a court order;
- transfer to a mortgagee by a mortgagor who is in default; transfer by a foreclosure sale, or pursuant to a power of sale, after such default;
- transfer by a fiduciary in the administration of a decedent's estate, guardianship, conservatorship or certain transfers from a trust;
- transfer from one co-owner to another;
- transfer to a spouse or to a person or persons in the lineal line of consanguinity;
- transfer between spouses resulting from a judgment of dissolution of marriage or of legal separation or from a property settlement agreement incidental to such a judgment;
- transfer by the State Controller of unclaimed property;
- transfer resulting from failure to pay taxes; and
- transfer to or from any governmental entity.

The required disclosure must be delivered to the prospective buyer as soon as practicable before transfer of title, or before the execution of the contract in the case of a lease option, sales contract, or ground lease coupled with improvements. If any disclosure or amended disclosure is delivered after execution of the offer by the buyer, the buyer has three days after delivery in person or five days after delivery by deposit in the United States mail to terminate the offer or agreement to purchase by delivering a written notice of termination to the seller or to the seller's agent.

The obligation to prepare and deliver disclosures is imposed upon the seller and the seller's agent and any agent acting in cooperation with such agent. If more than one real estate agent is involved in the transaction, (unless otherwise instructed by the seller) the agent obtaining the offer is required to deliver the disclosures to the prospective buyer. If the disclosure is based on a report or opinion of an expert, such as a contractor or structural pest control operator, the seller and the agent may be protected from liability for any error as to the item covered by the report or opinion.

The required disclosures are set forth in Civil Code Section 1102.6.

### **Local Option Disclosure Statement**

Civil Code Section 1102.6a permits any city or county to require an additional disclosure statement focusing on some local condition which may materially affect a buyer's use and enjoyment of residential property. The statute uses the example of adjacent land zoned for timber production and perhaps subject to harvest.

### **Mello-Roos Disclosure**

The Mello-Roos Community Facilities Act of 1982 authorizes the formation of community facilities districts, the issuance of bonds, and the levying of special taxes thereunder to finance designated public facilities and services. Civil Code Section 1102.6b requires that a seller of a property consisting of one-to-four dwelling units subject to the lien of a Mello-Roos community facilities district make a good faith effort to obtain from the district a disclosure notice concerning the special tax and give the notice to a prospective buyer. The same exemptions apply as for delivery of a Real Property Transfer Disclosure Statement.

### **Smoke Detector Statement of Compliance**

See discussion above under “DEPOSIT RECEIPT/CONTRACT.”

### **Disclosure Regarding Lead-Based Paint Hazards**

Many housing units in California still contain lead-based paint, which was banned for residential use in 1978. Lead-based paint can peel, chip, and deteriorate into contaminated dust, thus becoming a lead-based paint hazard. A child’s ingestion of the lead-laced chips or dust may result in learning disabilities, delayed development or behavior disorders.

The federal Real Estate Disclosure and Notification Rule (the Rule) requires that owners of “residential dwellings” built before 1978 disclose to their agents and to prospective buyers or lessees/renters the presence of lead-based paint and/or lead-based paint hazards and any known information and reports about lead-based paint and lead-based paint hazards (location and condition of the painted surfaces, etc.). The Rule defines a residential dwelling as a single-family dwelling or a single-family dwelling unit in a structure that contains more than one separate residential dwelling unit, and in which each such unit is used or occupied, or intended to be used or occupied, in whole or in part, as the residence of one or more persons.

Properties affected by the Rule are termed target housing. Target housing does *not* include pre-1978 housing which is:

- sold at a foreclosure sale (but a subsequent sale of such a property *is* covered);
- a “0-bedroom dwelling” (e.g., a loft, efficiency unit or studio);
- a dwelling unit leased for 100 or fewer days (e.g., a vacation home or short-term rental), provided the lease cannot be renewed or extended;
- housing designated for the elderly or handicapped, unless children reside there or are expected to reside there;
- leased housing for which the requirements of the Rule have been satisfied, no pertinent new information is available, and the lease is renewed or renegotiated;
- rental housing that has been inspected by a certified inspector and found to be free of lead-based paint. (The Rule allows use of state certified inspectors only until a federal certification program or a federally accredited state certification program is in place.)

Sellers (and lessors) of units in pre-1978 multifamily structures will have to provide a buyer (or lessee) with any available records or reports pertaining to lead-based paint and/or lead-based paint hazards in areas used by all the residents (stairwells, lobbies, recreation rooms, laundry rooms, etc.). If there has been an evaluation or reduction of

lead-based paint and/or lead-based paint hazards in the entire structure, the disclosure requirement extends to any available records or reports regarding the other dwelling units.

The federal Environmental Protection Agency (EPA) publishes a pamphlet titled *“Protect Your Family From Lead In Your Home.”* This pamphlet describes ways to recognize and reduce lead hazards. The Rule requires that a seller (or lessor) of target housing deliver this pamphlet to a prospective buyer (or tenant) before a contract is formed. If this is done after that time the buyer has the right to cancel the contract.

The Rule requires that a seller of target housing offer a prospective buyer ten days to inspect for lead-based paint and lead-based paint hazards. This 10-day inspection period can be increased, decreased, or waived by written agreement between buyer and seller. The Rule does not require a seller to pay for an inspection or to remove any lead-based paint/hazards, but merely gives a buyer the opportunity to have the property inspected. A list of State-certified lead inspectors and contractors is available by calling the California Department of Health Services at (800) 597-LEAD.

The Rule further requires that the seller’s (or lessor’s) lead-based paint/lead-based paint hazards disclosures, a Lead Warning Statement, and the buyer’s (or lessee’s) acknowledgment of receipt of the information, offer of inspection period (or waiver of same) and the EPA pamphlet be included in an attachment to the contract. Seller (or lessor), buyer (or tenant) and agent must sign and date the attachment. The retention period, for sellers (or lessors) and agents, of this document is three years from completion of the sale (or from commencement of the lease/rental).

A real estate agent must ensure that:

- his or her principal (seller or lessor) is aware of the disclosure requirements;
- the transaction documentation includes the required notifications and disclosures;
- the buyer or lessee/renter receives the EPA pamphlet; and,
- in the case of a sale, the buyer is offered an opportunity to have the property inspected for lead-based paint and lead-based paint hazards. In the case of a sale, “agent” does not include one who represents only the buyer and receives compensation only from the buyer.

Violation of the Rule may result in civil and/or criminal penalties.

To obtain the essential compliance information, a person may call the EPA at 1-800-424-LEAD.

**California’s environmental hazards pamphlet.** As discussed above, in California a seller (with a few exceptions) of residential real property comprising one-to-four dwelling units must give the buyer a Real Estate Transfer Disclosure Statement. The statement must include environmental hazards of which the seller is aware. The listing and selling agents must inspect the property and disclose to the buyer material facts, including environmental hazards (e.g., lead-based paint), which may affect the value or desirability of the property. Further, the seller or the seller’s agent can give the buyer (of any real property) a pamphlet titled *“Environmental Hazards: A Guide for Homeowners, Buyers, Landlords, and Tenants.”* If the buyer receives the pamphlet, neither the seller nor agent is required to say more about environmental hazards (again, assuming no awareness of such a problem).

### **Disclosures Regarding State Responsibility Areas**

The Department of Forestry and Fire Protection (the Department) has produced maps identifying rural lands classified as state responsibility areas. In a state responsibility area, the state (as opposed to a local or federal agency) has the primary financial responsibility for the prevention and extinguishing of fires. Maps of these state responsibility areas and any changes (including new maps to be produced every five years) are to be provided to assessors in the affected counties.

If a seller knows that the property is located in a state responsibility area or the property is included on a map given by the Department to the county assessor, the seller must disclose the possibility of substantial fire risk and that the land is subject to certain preventative requirements. (Public Resources Code Section 4291 lists the requirements.) Notices of the location of the maps will be posted at the offices of the county recorder, county assessor, and the county planning commission.

With the agreement of the Director of Forestry and Fire Protection, a county may, by ordinance, assume responsibility for *all* fires, including those occurring in state responsibility areas. Absent such an ordinance, the seller of property located in a state responsibility area must disclose to the buyer that the state is *not* obligated to provide fire protection services for any building or structure unless such protection is required by a cooperative agreement with a county, city, or district.

These disclosures must be made on the Natural Hazard Zone Disclosure Statement.

### **Disclosure of Ordinance Location**

Federal and state agencies have identified certain areas once used for military training which may contain live ammunition. A seller of residential property located within one mile of such a hazard must, pursuant to Civil Code Section 1102.15, give the buyer written notice as soon as practicable before transfer of title. This obligation depends upon the seller having actual knowledge of the hazard. The exemptions which pertain to delivery of the Real Property Transfer Disclosure Statement apply also to this requirement.

### **Disclosure of Geological Hazards and Earthquake Fault Zones**

Pursuant to the Alquist-Priolo Earthquake Fault Zoning Act, the State Geologist is in the process of identifying areas of the state susceptible to “fault creep” and delineating these areas on maps prepared by the State Division of Mines and Geology.

A seller of real property situated in an earthquake fault zone, or the agent of the seller and any agent acting in cooperation with such agent, must disclose to the buyer that the property is or may be situated in an earthquake fault zone. This disclosure must be made on the Natural Hazard Zone Disclosure Statement,

In addition, the Seismic Safety Commission has developed a Homeowner’s Guide to Earthquake Safety for distribution to real estate licensees and the general public. The guide includes information on geologic and seismic hazards for all areas, explanations of related structural and nonstructural hazards, recommendations for mitigating the hazards of an earthquake, and a statement that safety or damage prevention cannot be guaranteed with respect to a major earthquake and that only precautions such as retrofitting can be undertaken to reduce the risk. The Seismic Safety Commission has also developed a Commercial Property Owner’s Guide to Earthquake Safety.

If a buyer receives a copy of the Homeowner's Guide (or, if applicable, the Commercial Property Owner's Guide), neither the seller nor the broker are required to provide additional information regarding geologic and seismic hazards. Sellers and real estate licensees must, however, disclose that the property is in an earthquake fault zone and the existence of known hazards affecting the real property being transferred.

Delivery of a booklet is required in the following transactions:

1. Transfer of any real property improved with a residential dwelling built prior to January 1, 1960 and consisting of one-to-four units any of which are of conventional light-frame construction (Homeowner's Guide); and,
2. Transfer of any masonry building with wood-frame floors or roofs built before January 1, 1975 (if residential, both guides; if commercial property, only the Commercial Guide).

In a transfer subject to item 1 above, the following aspects of the structure and any corrective measures taken, which are within the seller's actual knowledge, must be disclosed to a prospective buyer:

- absence of foundation anchor bolts;
- unbraced or inappropriately braced perimeter cripple walls;
- unbraced or inappropriately braced first-story wall or walls;
- unreinforced masonry perimeter foundation;
- unreinforced masonry dwelling walls;
- habitable room or rooms above a garage; and
- water heater not anchored, strapped, or braced.

Certain exemptions apply to the obligation to deliver the booklet when transferring either a dwelling of one-to-four units or a *reinforced* masonry building. These exemptions are essentially the same as those that apply to delivery of the Real Estate Transfer Disclosure Statement.

### Environmental Hazard Disclosures

The Real Estate Transfer Disclosure Statement includes disclosure of hazardous substances, materials, or products including, but not limited to, asbestos, formaldehyde, radon gas, lead-based paint, fuel or chemical storage tanks, and contaminated soil or water.

(Lessees or renters of real property who know or suspect that a release of a hazardous substance has occurred or may occur on or beneath the property are required to provide written notice of that condition to the property owner or lessor. Failure of the lessee or renter to provide written notice to the property owner or lessor may subject the lessee or renter to actual damages and/or civil penalties.)

The Department of Real Estate, the Department of Toxic Substances Control, and the Office of Environmental Health Hazard Assessment have developed a booklet to be used for the purpose of educating and informing consumers on environmental hazards which may be located on and affect real property. The booklet, titled *Environmental Hazards: A Guide for Homeowners, Buyers, Landlords, and Tenants* identifies common

environmental hazards, describes the risks involved with each, discusses mitigation techniques, and provides lists of publications and sources from which consumers can obtain more detailed information. Hazards discussed in the booklet are asbestos, radon, lead, and formaldehyde. The booklet also provides general information on hazardous wastes and the use and disposal of hazardous household products.

If the booklet is provided to a prospective buyer of real property, neither the seller nor a real estate agent involved in the sale has a duty to provide further information concerning such hazards, other than lead, unless the seller or licensee has actual knowledge of the existence of environmental hazards on or affecting the subject property.

### **Energy Conservation Retrofit and Thermal Insulation Disclosure**

State law prescribes a minimum energy conservation standard for all new construction without which a building permit may not be issued. Local governments also have ordinances that impose additional energy conservation measures on new and/or existing homes. Some local ordinances impose energy retrofitting as a condition of the sale of an existing home. The requirements of the various ordinances, as well as who is responsible for compliance, may vary among local jurisdictions. The existence and basic requirements of local energy ordinances should be disclosed to a prospective buyer by the seller and/or the seller's agent and any cooperating agent.

Federal law requires a "new home" seller to disclose in every sales contract the type, thickness, and R-value of the insulation which has been or will be installed in the house.

### **Special Flood Hazard Area Disclosure and Responsibilities of FEMA**

Flood Hazard Boundary Maps identify the general flood hazards within a community. They are also used in flood plain management and for flood insurance purposes. Flood Hazard Boundary Maps developed by the Federal Emergency Management Agency (FEMA) in conjunction with communities participating in the National Flood Insurance Program (NFIP) delineate areas within the 100-year flood boundary termed "special flood zone areas." Also identified are areas between 100 and 500-year levels termed "areas of moderate flood hazards" and the remaining areas above the 500-year level termed "areas of minimal risk."

A seller of property located in a special flood hazard area, or the seller's agent and any cooperating agent, must disclose that fact to the buyer and that federal law requires flood insurance as a condition of obtaining financing on most structures located in a special flood hazard area. Since the cost and extent of flood insurance coverage may vary, the buyer should contact an insurance carrier or the intended lender for further information. The disclosure must be made on the Natural Hazard Zone Disclosure Statement.

### **Local Requirements Resulting from City and County Ordinances**

Residential properties located in cities and counties throughout California are typically subject to specific local ordinances relating to occupancy, zoning and use, building code compliance, and fire, health and safety code regulations. Whether such matters must be investigated when they are not within the personal knowledge of the seller or the agent may depend on the circumstances. Civil Code Section 2079.3 provides that the listing and selling agents' duty to inspect does not include areas off the site of the property or public records or permits concerning the title or use of the property in the absence of special circumstances.

### **Foreign Investment in Real Property Tax Act**

Federal law requires that a buyer of real property must withhold and send to the Internal Revenue Service (IRS) 10% of the gross sales price if the seller of the real property is a “foreign person.” The primary grounds for exemption from this requirement are: the seller’s nonforeign affidavit and U.S. taxpayer I.D. number; a qualifying statement obtained through the IRS attesting to other arrangements resulting in collection of, or exemption from, the tax; or the sales price does not exceed \$300,000 and the buyer intends to reside in the property.

Because of the number of exemptions and other requirements relating to this law, it is recommended that the IRS be consulted for more detailed information. Sellers and buyers and the real estate agents involved who desire further advice should also consult an attorney, CPA, or other qualified tax advisor.

### **Notice and Disclosure to Buyer of State Tax Withholding on Disposition of California Real Property**

In certain California real estate sale transactions, the buyer must withhold 3 1/3% of the total sale price as state income tax and deliver the sum withheld to the State Franchise Tax Board. The escrow holder, in applicable transactions, is required by law to notify the buyer of this responsibility.

A buyer’s failure to withhold and deliver the required sum may result in the buyer being subject to penalties. Should the escrow holder fail to notify the buyer, penalties may be levied against the escrow holder.

Transactions to which the law applies are those in which:

- The seller shows an out of state address, or sale proceeds are to be disbursed to a financial intermediary of the seller;
- The sales price exceeds \$100,000; and,
- The seller does not certify that he/she is a resident of California or that the property being conveyed is his/her personal residence, as defined in Section 1034 of the Internal Revenue Code. (Note: If the seller is a corporation, the certification would be that the corporation has a permanent place of business in California.)

For further information, contact the Franchise Tax Board.

### **Furnishing Controlling Documents and a Financial Statement**

The owner (other than a subdivider) of a separate interest in a common interest development (community apartment project, condominium project, planned development, or stock cooperative) must provide a prospective buyer with the following:

- a copy of the governing documents of the development;
- should there be an age restriction not consistent with Civil Code Section 51.3, a statement that the age restriction is only enforceable to the extent permitted by law and specifying the applicable provisions of law;
- a copy of the most recent documents of the homeowners’ association, including financial statements, budgets and insurance information required under Civil Code Section 1365;

- a written statement from the association specifying the amount of the current regular and special assessments as well as any unpaid assessment, late charges, interest, and costs of collection which are or may become a lien against the property; and,
- information regarding any approved change in the assessments or fees which is not yet due and payable as of the disclosure date.

### **Notice Regarding the Advisability of Title Insurance**

In an escrow for a sale (or exchange) of real property where no title insurance is to be issued, the buyer (or both parties to an exchange) must receive and sign the following notice as a separate document in the escrow:

“IMPORTANT: IN A PURCHASE OR EXCHANGE OF REAL PROPERTY, IT MAY BE ADVISABLE TO OBTAIN TITLE INSURANCE IN CONNECTION WITH THE CLOSE OF ESCROW SINCE THERE MAY BE PRIOR RECORDED LIENS AND ENCUMBRANCES WHICH AFFECT YOUR INTEREST IN THE PROPERTY BEING ACQUIRED. A NEW POLICY OF TITLE INSURANCE SHOULD BE OBTAINED IN ORDER TO ENSURE YOUR INTEREST IN THE PROPERTY THAT YOU ARE ACQUIRING.”

This requirement is also of interest to a real estate broker conducting an escrow pursuant to the exemption set forth in Financial Code Section 17006(a)(4).

### **Visual Inspection**

The real estate agent representing a seller of residential property consisting of one to four dwelling units (or a manufactured home) and any cooperating agent each have the duty to conduct a reasonably competent and diligent visual inspection of the property and to disclose to a prospective buyer all material facts affecting value, desirability, and implicitly intended use.

The required inspection does not include areas not reasonably accessible. If the real property is a dwelling unit in a condominium, planned development, or a stock cooperative, the visual inspection need only include the unit involved and not the common area. It also does not include investigation of areas off the site of the property or public records and permits in the absence of special circumstances.

Nothing in the law relieves a buyer of the duty to exercise reasonable care to protect himself/herself, including the facts that are known to or within the reasonably diligent attention and observation of the buyer.

An agent’s certification of performing the required visual inspection is contained in the Real Estate Transfer Disclosure Statement. This requirement does not apply if the sale is made pursuant to a subdivision public report or the sale is exempt from the public report requirement pursuant to Business and Professions Code Section 11010.4, *provided* that the property has not been previously occupied.

(See also Chapter 10.)

### **Agency Relationship Disclosure**

To clarify relationships between buyers and sellers and real estate brokers, the law requires persons acting as agents in certain residential real estate transactions to make statutorily prescribed written disclosures concerning the agency roles intended. This requirement applies to transactions involving the sale or exchange of certain estates

(including leases of more than one year) in residential real property of from one-to-four dwelling units, as well as the sale or exchange of mobilehomes occurring through a real estate agent. The seller should receive the agency disclosure before signing the listing agreement.

Principals and agents may modify and change the agency relationship(s) between the parties by written consent of all of the parties to the transaction. The required agency disclosure form is set forth in Civil Code Section 2079.16.

(See also Chapter 10.)

### **No Disclosure Required for Manner/Occurrence of Death; Affliction of Occupant with AIDS**

No cause of action arises against an owner or the owner's agent (or any cooperating agent) when selling, leasing, or renting real property and failing to disclose to the buyer, lessee, or renter the following:

- the manner or occurrence of an occupant's death upon the real property if the death occurred more than 3 years prior to the transferee's offer to purchase, lease, or rent the property; or
- that an occupant of the property was afflicted with, or died from, Acquired Immune Deficiency Syndrome (AIDS).

Note that the controlling statute does not change the law relating to disclosure of any other physical or mental condition or disease of an occupant or the physical condition of the property. Further, the statute will not protect the owner or agent(s) from misrepresentation if the buyer asks a direct question concerning deaths occurring on the real property.

### **Disclosure of Sale Price Information**

Within one month after the close of escrow for the transfer of title to real property (or the sale of a business opportunity) through a real estate agent(s), the agent(s) must inform the buyer and seller in writing of the selling price. In the case of an exchange, the information on the selling price is required to include a description of the property and the amount of added money consideration, if any.

If a transaction is closed through an authorized third party escrow holder, a closing statement from said escrow holder will be regarded as compliance with the requirements of this law.

### **Seller Financing Disclosure Statement**

Some sellers of residential properties participate in financing the sale of their homes by extending credit to the buyer in the form of a seller "carry-back." This is usually in the form of a promissory note secured by a deed of trust. To ensure adequate disclosure and to prevent abuses involving some of these seller-assisted financing plans, the state legislature enacted a disclosure law which applies to real estate transactions involving residential dwellings of not more than four units if the seller extends credit to the buyer through a written agreement which provides for either a finance charge or more than four payments of principal and interest (or interest only), not including the down payment.

Written disclosures required by this law are the responsibility of the *arranger of credit*. An *arranger of credit* is defined as a person who is not a party to the transaction (except as noted below), but is involved in negotiation of the credit terms and completion of the credit documents, and who is compensated for arranging the credit or for facilitating the transaction. A real estate broker may be deemed an arranger of credit. The duty to provide the disclosures also applies to an attorney or a real estate licensee who is a principal in the transaction.

Disclosures pursuant to this law are *not* required to be given to a buyer or seller who is entitled to receive (in connection with the credit being extended) a disclosure under any of the following:

- Federal Truth-in-Lending Act;
- Real Estate Settlement Procedures Act (RESPA);
- A mortgage loan disclosure statement (Business and Professions Code Section 10240) or a lender/purchaser disclosure statement (Business and Professions Code Section 10232.4); or
- Section 25110 of the Corporations Code or exemption therefrom relating to the sale of qualified securities under permit or exempt securities or transaction.

The disclosure statement required by this law must be delivered as soon as possible before the execution of any note or security document. The statement must be signed by the arranger of credit and the buyer and seller, who are each to receive a copy. Should there be more than one arranger of credit, the arranger obtaining the offer from the buyer is responsible for making the disclosure unless another person is designated in writing by the parties to the transaction.

The disclosure statement will include comprehensive information about the financing, cautions applicable to certain types of financing, and suggestions of procedures which will protect the parties during the term of the financing. The disclosures include:

- identification of the note, or credit, or security document and the property which is or will become the security;
- a copy of the note, or credit, or security document, or a description of the terms of these documents;
- the terms and conditions of each encumbrance recorded against the property which shall remain as a lien or is an anticipated lien which will be senior to the financing being arranged;
- a warning about the hazards and potential difficulty of refinancing and, should the existing financing or the financing being arranged involve a balloon payment, the amount and due date of any balloon payment and a warning that new financing may not be available;
- an explanation of the possible effects of an *increase* in the amount owed due to negative amortization as a result of any variable or adjustable-rate financing being arranged;
- if the financing being arranged involves an all-inclusive trust deed (AITD), a statement of the possible penalties, discounts, responsibilities, and rights of parties

to the transaction with respect to acceleration and/or prepayment of a prior encumbrance as the result of the creation and/or refinancing of the AITD;

- if the financing involves an AITD or a real property sales contract, a statement identifying the party to whom payments will be made and to whom such payments will be forwarded, and if the party receiving and forwarding the payments is not a neutral third party, a warning that the principals may wish to designate a neutral third party;
- a complete disclosure about the prospective buyer, including credit and employment information along with a statement that the disclosure is not a representation of the credit worthiness of the prospective buyer; or, a statement that no representation regarding the credit worthiness of the prospective buyer is being made;
- a warning regarding possible limitations on the seller's ability, in the event of foreclosure, to recover proceeds of the sale financed;
- a statement recommending loss payee clauses be added to the property insurance policy to protect the seller's interest and advising of the existence or the availability of services which will notify the seller if the property taxes are not paid;
- a statement suggesting or acknowledging that the seller should file or has filed a request for notice of delinquency and a request for notice of default in case the buyer fails to pay liens senior to the financing being arranged;
- a statement that a title insurance policy has been or will be obtained and furnished to the buyer and seller insuring their respective interests, or that the buyer and seller should each obtain title insurance coverage;
- a disclosure whether the security documents for the financing being arranged have been or will be recorded, and what might occur if the documents are not recorded; and,
- information as to whether the buyer is to receive any "cash back" from the sale, including the amount, source, and purpose of the cash refund.

The requirement of a seller financing disclosure statement also applies to transactions by real property sales contracts (as defined in Civil Code Section 2985) and to leases with option-to-purchase provisions where the facts demonstrate intent to transfer equitable title. If the extension of credit is subject to a balloon payment, a balloon payment notice is to be included on the face of the promissory note or other evidence of debt.

An arranger of credit must inform the seller that a buyer who intends to occupy the real property involved may have the right to homeownership counseling in the event of a default in the mortgage payments. The collector of the payments, whether the seller or a loan servicing agent, has the duty to inform the defaulting homeowner of the availability of such counseling. Loss of or reduced ability to make payments on a residence may entitle the homeowner to the aforementioned counseling. The duty to inform a defaulting homeowner of the availability of counseling is operative regardless of the nature of the credit transaction or the presence of an arranger of credit.

### **Water Heater Bracing**

See discussion above under "DEPOSIT RECEIPT/CONTRACT."

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