

The Due Diligence Obligation of the Real Estate Buyer

The purchase of real estate is always a major investment. For home buyers, it may be a single biggest investment decision they ever make. Buyers should take the time and trouble to make sure that they understand the qualities of the property and the risks of the purchase.

When a buyer discovers that a seller has concealed a defect, and brings a suit for damages, one way that the seller will defend that suit is by asserting that the buyer had enough information to realize that further investigation was required or that a potential problem existed at the property. While a seller has the obligation to disclose facts about the property, the buyer has the obligation to observe and consider facts which are reasonably within his or her ability to ascertain.

Standard form real estate purchase contracts provide a number of opportunities for a buyer to obtain information and practice due diligence in evaluating that information and the impact it has on the desirability of the property. This information ranges from a title report confirming ownership and encumbrances on the property to physical inspection reports by qualified professionals.

A pest control inspection is always a good idea in the older buildings we have in the Bay Area. But it is limited to only structural pest issues. It should be supplemented with an inspection by a qualified general inspector who looks at the building structure and systems to advise a buyer of observable problems. A suspect roof should be inspected by a roofer, and other special trades should be consulted as indicated by the particular property. Any work done without permit should be the subject of particularly careful scrutiny.

The buyer should study any disclosure provided by the seller and inquire further to be sure that he or she understands the significance of the items disclosed. Disclosed physical conditions should be reviewed with the buyer's inspectors if possible.

The report of any inspector should be reviewed carefully and discussed with the inspector, preferably at the property while it is being inspected. We recommend that a buyer not rely on a report that was prepared for the seller. If a report recommends

further inspection, that recommendation should not be taken lightly. Beware too, of

what may be in areas noted as “inaccessible.” Try to take further steps to investigate these areas as well as possible.

The law requires that additional disclosure and information be given to the buyer regarding toxic material, natural hazards and other matters. The buyer should treat each disclosure seriously, even though it appears to be on a form which may seem to be routine. The law requires these disclosures because the matters they cover can be very important. For example, the presence of lead or asbestos may have substantial future consequences for a buyer, and the location of a property in a seismic hazard zone is a potentially serious matter.

Income property poses additional issues. Not only must the buyer review tenant leases, but the history of tenancies becomes important because of the requirements imposed by rent control laws. If rent has been increased by the seller in excess of what is allowed, or if part of the rent is a temporary capital improvement amortization increase, the rent can be rolled back after the new buyer takes title, reducing building income. Tenant questionnaires or estoppel documents should be obtained from all occupants to verify the rent history and deposit, the use rights claimed by the tenant, and whether the tenant has special rights under local rent laws.

Condominiums and Tenancy in Common interests pose additional complexity which must be reviewed and evaluated. The buyer will not be purchasing a property which he or she will be free to use as they choose. The common ownership aspect of these types of interests and the rules and regulations established by their governing documents can impose substantial limitations, and can create unanticipated risks as well. The governance of the property is important, as is the budget and the prospect of future assessments.

Buyers are typically presented with a huge quantity of information, boiler plate disclosures, and documents to “review and approve.” It is almost impossible for many home buyers to absorb and comprehend so much information in the time allowed. Generally, the only advice they get is from their real estate agent.

Most real estate agents are diligent and ethical. But they are not qualified to give legal advice, and they avoid doing so. Most buyers should get legal advice. In most states, real estate purchasers routinely obtain the review and advice of a real estate attorney, who is paid by the hour for evaluation and advice solely in the best interest of the client.

A buyer’s agent only earns a commission if the buyer purchases the property. If the agent gives the buyer advice which might result in the buyer deciding not to purchase, the agent may lose tens of thousands of dollars. As a result, there is a temptation for some agents to downplay the risks or problems in a particular purchase.

Many clients have been faced with unpleasant surprises or become involved in expensive litigation following close of escrow. In many cases, the problem would have

been avoided if the buyer had the benefit of evaluation and advice by qualified inspectors and a qualified attorney early in the transaction. The cost is quite small compared to the value and importance of a successful real estate transaction.

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