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Risks Associated with the Sale of Investor Properties

A recent development in this market is the purchase and resale of properties by investors. Over the last several years, investors have been purchasing properties at foreclosure sales or pursuant to short sales, improving those properties, and reselling them for a profit. While this is a very positive development for the market in that these investors are maximizing profits, there are risks associated with these resales.

Investors, who sell properties, are required under the Civil Code to prepare a Transfer Disclosure Statement (“TDS”). Unfortunately, many of the investors have little personal knowledge of the condition of the property. Some investors have never seen the property and many have seen them only once or twice. Most have never lived in the property and lack any knowledge about the condition.

When a seller completes a TDS, the questions start with, “Are you aware of...” For example, an investor is asked, “Are you aware of any flooding or drainage issues at the property?” An investor will likely answer “No” because they are unaware of any such issues at the property. However, a buyer receiving that TDS, perceives that the seller is making a representation that there are no drainage issues at the property. This is a misunderstanding on the part of the buyer. If there are future drainage problems at the property, the buyer may sue the investor for making a misrepresentation, even though the investor’s representation was based on personal knowledge.

To compound the disconnect between the buyer and the seller in investor sales, the properties are generally cosmetically attractive. Many investors paint, update flooring, install new appliances, cabinetry and other items to make these properties more aesthetically pleasing. Unfortunately, many times these are “surface upgrades” and create an appearance that the property has been remodeled or completely redone. This further entices the buyers into believing that the property is in good condition.

Recently, in a number of non-disclosure/misrepresentation lawsuits arising out of investor sales, we are finding that investors have not obtained permits for the improvements made at the property. Because the contactors or handymen are undertaking these improvements, the investors may not know that they were done without permits.

We have also observed that many investors are hiring handymen to undertake repairs instead of licensed contractors. Sellers should disclose, if an unlicensed person undertook the work, assuming the value of the combined labor and materials costs are more than the Contractors’ Board’s limit.

It is suggested that investors note on the TDS that they are an investor and qualify what knowledge the investor has of the property. For example, if the investor has never seen the property, the investor should disclose that fact. If the investor has purchased the property at a foreclosure sale, it is suggested that this fact be disclosed as it will put the buyer on notice of the limited knowledge of the investor. It is also suggested that investors describe the work that was done at the property, any improvements that were undertaken at the property and identify the contractor, if a contractor was involved provide the contractor’s contact information.

It is also suggested that buyers undertake all appropriate inspections of the property. If there are any red flags associated with these properties, it is suggested that further inspections be undertaken based on those red flags. For example, if there is an indication of prior drainage or flooding, buyers should have a soils inspection.

Buyers should check with the local building department to determine whether permits were obtained for all of the work performed.

Investor sales are a large part of our current market. However, these sales should be handled safely.

This article is meant to provide suggestions. It does not set a standard of care for the real estate industry.

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