



# Property Disclosures

WHAT YOU NEED  
TO KNOW



SALES ASSOCIATE  
GUIDE



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# **Property Disclosures: What You Need to Know**



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# Introduction

The purpose of this guide is to educate real estate brokers\* about the importance of providing to prospective purchasers complete and accurate descriptions of the properties they may be marketing, the features and conditions of such properties, and the liability to which brokers may be exposed for failing to do so. Understanding their legal duties in this regard will assist brokers in reducing their exposure to liability and enhance the quality of their service to the public.

Many claims brought against real estate brokers involve allegations of misrepresentation, negligence or fraud. Real estate brokers can avoid or reduce such claims by becoming familiar with the legal basis of such liability claims. Because real estate purchasers are usually not experts in evaluating the physical condition of real property, they rely heavily on the expertise of brokers for information about the property and its condition. Frequently, purchasers bring claims against brokers after closing upon discovery of defects such as:

- *Termite infestation*
- *Cracked or collapsing foundations*
- *Roof or wall leakage*
- *Sewage system problems*
- *Inaccuracies in the size of the home or lot*

Consequently, brokers must be extremely careful about the extent and accuracy of the information they provide to purchasers.

The duties real estate brokers owe to purchasers and the liability resulting from a breach of those duties are

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\*References to real estate brokers in this guide apply to salespeople as well.

established, almost exclusively, by state rather than federal law. Thus, this guide discusses the applicable legal principles in a general fashion. The legal principles and requirements applicable in any particular set of circumstances must be determined on a state-by-state basis.



# Seller Property Condition Disclosure

The law of misrepresentation of most states obligates real estate brokers to disclose known material defects in a property to all potential purchasers. This is true whether the broker is working with a purchaser as a client or as a customer.

For this reason, and because a home is the largest single investment that most people make during a lifetime, it is important that all relevant information regarding the home's condition be provided to prospective purchasers.

A majority of states have adopted laws requiring residential property sellers to provide to buyers a statement of property condition disclosures by the seller. In some other states without such laws, the state or local associations of REALTORS® may encourage the use of seller property condition disclosure forms on a voluntary basis and may even have developed a form to be used for that purpose.

Many brokers now routinely use such property condition disclosure forms to convey information from the seller to the buyer about the physical structure and condition of the property and its features. The seller is generally in a better position than the real estate broker to know of and provide information about the condition of the property. Such forms are completed by the seller and represented to contain **the seller's** knowledge of the property's condition. Effective use of these forms results in fewer surprises to purchasers after the closing, and less liability for both the real estate broker and the seller.

Property condition disclosure forms provide written documentation of information about the seller's knowledge of the condition of the property. While the use of such forms does not alleviate the responsibility

of a broker to disclose all known material property defects to potential purchasers, it does shift some of the risk of failure to disclose from the broker to the seller. In addition, the creation of a paper trail evidencing disclosures made to a prospective purchaser will often be invaluable in the timely and effective resolutions of disputes related to the condition of the property at time of sale. The representations by the seller about certain features of the property may also prompt the buyer to seek more information.

Property condition disclosures, whether required by state law or done voluntarily, benefit each of the parties involved in a real estate transaction. A survey of purchasers concerning the use of disclosure forms indicates that they closely review the information contained in the forms and find them to be very useful. Purchasers also acknowledge that the forms help them make a faster and more informed purchase decision. In particular, purchasers unfamiliar with the part of the country where they are purchasing property may find information in a disclosure form useful in making them aware of various idiosyncrasies which may affect property in that geographical area. Purchasers provided with a property condition disclosure form may be generally more satisfied with their purchase because they encounter fewer surprises about the property, and are therefore also less likely to initiate litigation related to the transaction.

Sellers also benefit from property condition disclosure forms because the property's condition and their representations about it are clearly documented, limiting potential future liability. In addition, completing such a form may also help a seller identify last-minute home improvements to be made in order to make the property sell more quickly and to generate the highest price possible.

Use of disclosure forms also assists real estate professionals by establishing documentation regarding property condition disclosures made in a transaction, and by reinforcing **the seller's** responsibility to make full disclosure. A purchaser also gains a better understanding that the most significant representations of the condition of a property are within the knowledge of the seller rather than the real estate salesperson. The disclosure form will also facilitate the salesperson's presentation to the purchaser of information about the property and the value of obtaining a property inspection to supplement any circumstances inadequately addressed by the disclosure statement. A third-party, trained professional evaluation of the condition of the property for the purchaser may further reduce the potential liability of the seller and the salesperson in the transaction.

These disclosures by the seller may further result in a decrease in the number of lawsuits being filed against real estate salespeople for misrepresentation, and lawsuits that do get filed should be resolved more quickly, again reducing the legal expense to the real estate salesperson. Ultimately, this may mean lower errors and omissions insurance costs.

## **Using Disclosure Forms**

In states with legislation requiring the use of disclosure forms, a salesperson's actions must comply with the requirements of the applicable state law. Where no such legislation exists, but the use of a disclosure form is encouraged by the local or state association on a voluntary basis, the association's guidelines for use of the forms should be observed. Even when use of such a form is done on a purely voluntary basis, the following principles and practices should be employed to achieve maximum effectiveness.

In general, property condition disclosure forms are completed by the seller prior to or at the time the seller enters into the listing agreement. The completed

form is then made available to prospective purchasers during the showing of the property, ensuring that prospective purchasers read the form prior to making an offer. If a form is used on a voluntary basis, it should include the seller's authorization of the broker to provide a copy of the form to any person or entity in connection with any anticipated or actual sale of the property. The form is made available to prospective purchasers and should be left in a visible location in the home for review during showings. Once an offer is made, it is prudent for the prospective purchaser to sign an acknowledgment at the bottom of the form, indicating the purchaser's receipt of the information.

After completion by the seller, listing agents should review the form and note any inconsistencies between the information provided and that revealed by their observations of the property made in connection with viewing it for purposes of preparing to list and market it. The listing salesperson should then consult with the seller to determine the reason for any such inconsistency noted. Agents receiving a copy of the form in the capacity of a cooperating broker (subagent or buyer's salesperson) should discuss the inconsistency with the listing broker and seek additional information or clarification. If a true inconsistency is identified and reveals a material defect that was not properly disclosed on the form, the form should be amended promptly. The defect should also be disclosed to potential purchasers who may have received the incorrect version of the form if they remain interested in the property.

Any other later discovered inaccuracies in the disclosure form should also be quickly corrected and interested prospective purchasers advised of the corrected information. In any event, buyers, sellers and salespeople must recognize that a disclosure form is not a warranty. A disclosure form provides useful information in the sale of a property, but it does not guarantee that the condition of the property is free from any latent, unknown defects.

# Steps to Limit Broker Liability

Provided below are recommended techniques brokers can use to place them in the best position to defend misrepresentation claims or, better yet, avoid such claims entirely. Although no list of practices and procedures can absolutely guarantee that a broker will never be subject to a claim or held liable for misrepresentation, a broker can take certain precautions to prevent common problems and thus limit potential liability.

## Document Statements and Events

Routine documentation (handwritten notes will suffice) of the following are extremely important in limiting your risk of liability for misrepresentation:

- *Conversations with potential purchasers of a home (including dates and names of people involved)*
- *Telephone conversations with sellers and potential purchasers about certain facts of a sale*

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***For Example:*** When you receive an email, voicemail or other inquiry related to a property, create a written record of your receipt and reply to the message, including the date, time and a brief description of your response. Save those records in the property's file for future reference.

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- *Research that you have performed on certain features of the property or aspects of a sale*
- *Notes involving specific statements made to the buyer or seller*

Documenting various statements or events and retaining that documentation in a file can provide valuable evidence if a claim is made, especially if the dispute involves whether an event did or did not occur or a statement was or was not made. In some cases it

is useful for the broker to summarize such statements or events in a letter to the buyer. Presenting this documentation when negotiating a claim may limit or bar exposure to liability, or even persuade a disgruntled purchaser to refrain from initiating litigation against the broker.

Alternatively, the absence of documentation may result in a weak defense by making it difficult to reconstruct and convincingly prove conversations and defend statements allegedly made or not made several months or years earlier.

Also, be sure the seller completes a seller disclosure form, where required by law or if your firm has adopted a policy of using such a form on a voluntary basis. Such information should then be provided to all serious prospective purchasers.

### **Watch Out for “Red Flags”**

Even where a broker does not actually know about a defect, some courts will conclude that the presence of an observable “red flag” of a possible defect creates a duty to investigate further. Such an investigation, in turn, triggers the duty to put the buyer on notice of any defects which are discovered.

Being alert for red flags is particularly important in connection with avoiding claims for misrepresentation of or failing to disclose environmental problems. Such problems might include:

- *Lead-based paint*
- *Asbestos-containing insulation*
- *Radon gas*
- *Underground storage tanks*
- *Soil contamination*

- *Waste disposal sites on or near the property*
- *Mold*

Brokers should become familiar with the red flags which suggest the presence of one or more of these conditions so that, when necessary, a prospective purchaser may seek professional advice about the extent of the hazard, its implications, and how it may be remedied. See the table in *Appendix A*, which describes various environmental problems and the signs that indicate the possible presence of such problems.

Brokers may wish to conduct a reasonably competent visual inspection of the home and make written notes of any defects that inspection reveals. This is important particularly in states which expressly impose a duty to examine property for defects and reveal what is discovered and in other states as a preventive and “good practice” measure. The broker is not, however, required to discover defects that would ordinarily be discovered only by a professional inspector.

During the inspection, look for red flags or indicators that suggest that a feature of the property may be amiss or that there may be a defect. Seek information from the seller explaining any red flags you note, and if possible, try to verify the source of the seller’s answer. If the seller is unable to provide satisfactory clarification or information, you may wish to investigate further. Always document all findings. After the inspection and any discussions with the seller, disclose any adverse findings to potential purchasers.

The REALTORS® Code of Ethics obligates REALTORS® to discover defects only within the scope of their real estate license.

## **Answer Specific Questions Carefully**

Answer specific questions with specific answers. When a purchaser inquires about a specific feature of the property, respond only if you have actual knowledge of the correct answer. Qualify your answer by identifying the source and limits of the information presented. Far too often brokers will respond to a specific question without actual knowledge of the facts or whether their answer is right or wrong. The result is often a claim of negligent misrepresentation. If you do not know the answer, obtain and provide whatever information may be available and encourage the purchaser to seek a professional, when appropriate. **Never** hazard a guess.

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***For Example:*** If a purchaser inquires about the specific type of insulation used throughout the house or the electrical capacity of the house and the broker does not know the answer, the broker should offer to investigate and get back to the purchaser or recommend that the purchaser consult with a professional. Revealing that you don't know the answer to a question is preferable to offering a "guess" or an answer of which you are unsure.

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## **Encourage the Use of Other Professionals**

Although in some states brokers may be required to conduct an inspection of the property and to disclose defects which they may find, brokers are not required, and should not act as if they possess, the expertise of other professionals. When necessary, brokers should not hesitate to refer purchasers to other professionals, e.g., home inspectors, plumbers, electricians, etc.



A broker's expertise is in marketing property. When brokers attempt to give advice outside this area of expertise, they expose themselves to liability since they will be expected to have the expertise and abide by the professional standards of the specialist whose role they assume.

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***For Example:*** If a broker plainly sees cracks in the walls or flooding in the basement, he should disclose that fact to the purchaser. The broker should then recommend that the buyer consult with a professional inspector to assess the extent of the problem and the cost to correct it, rather than offer his own assessment.

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### **Handle “Stigma” Issues as May be Necessary Under the Circumstances**

Each stigma problem has its own unique facts and circumstances. Make sure you understand what the law may require or permit you to do, and where there is no explicit statutory or regulatory guidance, carefully consider what action may be reasonable and prudent under the circumstances.

### **Avoid Predicting the Future**

A common source of claims against real estate brokers are statements that create expectations by the buyer about future events or circumstances, such as the value or the future condition of the home. When those expectations are not realized, claims and lawsuits often quickly ensue. Brokers should take special precautions not to predict the future. Examples of dangerous statements that can create liability are:

- *“This house is sure to appreciate.”*
- *“You won’t have to worry about this basement flooding.”*
- *“This well will never run dry.”*
- *“A roof like this never leaks.”*

When making representations about value or about structural, mechanical or other features of the home, speak in the present or past tense. In this way you convey factual information and allow the buyer to draw his own conclusions about the future. Examples of proper representations are:

- *“Property values in this neighborhood have risen twenty percent in the last three years.”*
- *“The seller tells me that the basement has not leaked as long as they have lived here.”*
- *“This furnace is five years old, and the seller had it inspected last fall.”*
- *“A new well was dug last spring. You can review the plumbing contractor’s specification form.”*

In each of these examples, the broker conveyed positive information about the property. But, he did so in a factual manner that did not assure the buyer of future events.

## **Office Policies**

It is a good practice for the brokerage firm to adopt written policies and practices which those who are associated with the firm are expected to follow. Such policies would cover:

- *The use of mandatory or voluntary seller disclosure forms*
- *Documentation practices*
- *Conducting inspections and the use of checklists in doing so*
- *Identification of publications and other “official” sources of information, such as government publications or reports, that provide information about various property problems (especially environmental issues) and that can be provided to purchasers*

- *Whether such informational publications will be given routinely to all purchasers, or provided only upon request*
- *Referrals to other professionals*
- *Handling various stigmas*
- *Information about matters of particular concern in the geographic area*



# Foundations of Misrepresentation Liability

## *Caveat Emptor*

Although this section deals with the legal basis of misrepresentation liability, we begin with *caveat emptor* (“buyer beware”) which is, in fact, a defense to such liability. Historically, and in the few jurisdictions where it still applies in real estate transactions, this doctrine requires that a seller of property and his salesperson speak truthfully if they speak at all and prohibits only intentionally misleading *affirmative* statements or acts by a seller or his salesperson. Under *caveat emptor*, the broker has no obligation to provide any information about the property, including information regarding known defects in the property. The broker incurs no liability, therefore, for failing to disclose defects, known or unknown, to the purchaser.

Only a small minority of states continue to apply *caveat emptor*, although in some cases with significant qualifications. Examples of such qualifications are that the seller or salesperson did not know of the defect, that the defect did not pose a health or safety risk, or that the defect was easily detectable by the purchaser. Thus, even where the doctrine of *caveat emptor* arguably is still viable, its harsh impact on purchasers is reduced substantially where such qualifications apply. Real estate brokers should learn the extent to which *caveat emptor* may apply in their state, and unless it does in an unqualified fashion, they should recognize that they will generally have a duty to disclose to purchasers known defects in a property.

Even where *caveat emptor* does apply, the REALTORS® Code of Ethics and good professional practice requires disclosure of known defects.

## **Liability is Based on False Statements of Material Fact, Not Opinions**

The legal theories that are the basis of liability include fraud, negligent misrepresentation, negligence, innocent misrepresentation, and statutory liability. In each case, however, only statements (or, in some cases, omissions) of **material fact** can result in liability under the law of misrepresentation. Thus, a threshold issue in any case is whether the alleged misrepresentation involved facts which are material to the transaction or whether it involved facts which are not material or even simply an opinion about the property.

Statements of opinion are not properly the basis for a suit by the purchaser, since ordinarily the purchaser is not permitted to claim he reasonably relied on a broker's opinion statements in deciding to purchase the property. Opinion statements can, however, be actionable if they relate to factual matters stated as fact without qualification and particularly when made by someone in a superior position to know the truth.

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***For Example:*** A broker's "opinions" about factually verifiable matters such as real estate boundaries or zoning may be treated as statements of fact unless clearly and unequivocally identified as opinion. Brokers should never offer unverified "opinions" on factual matters. Instead, verify the accuracy of the information before stating it. And, in any event, when stating an opinion about some matter which is not factually verifiable, be certain you clearly and unequivocally identify them as your opinion.

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A misrepresentation of fact must also be material. A fact is material if a reasonable buyer would consider it in making a decision whether to purchase the property or how much to offer to pay for it.

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***For Example:*** Even erroneous representations which would not alter the judgment or actions of reasonable buyers, such as making a small error in stating the size of a property (e.g., stating that a home is 2010 square feet rather than 2005), do not provide a basis for liability.

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## **Fraud**

Fraud is conduct that is intentionally deceptive. Fraud can be “active,” where a broker affirmatively offers a statement which he knows to be false and that is intended to mislead the buyers. Fraud can also be “passive,” i.e., where a broker deceives a buyer by failing to reveal a material defect in the property that he knows to exist and would likely change the buyer’s actions in purchasing the property if he was made aware of it.

### ***Intentional Misrepresentation or Active Fraud***

Active fraud arises when the broker acts in an intentionally deceptive fashion such as stating that a defective or undesirable condition does not exist when in fact he knows it does or that a desirable condition is present when he knows it is not.

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***For Example:*** In one case a broker informed a purchaser that the entire property was zoned for business even though he was actually aware that a portion of property was zoned residential. The court held that the buyer was entitled to rely on the broker’s representation regarding zoning. The broker was held liable to the purchaser in the amount of \$16,600, which was the difference between the actual value of the property and the value of the property had it been zoned entirely for business as represented.

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Liability for active fraud does not consist only of making statements that are known to be false. Brokers have been held liable for statements made with “culpable ignorance” of their accuracy. A broker is “culpably ignorant” if he makes an affirmative statement without knowing whether it is true or false or without any knowledge of a factual basis for his statement, also known as “reckless disregard” for its accuracy.

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***For Example:*** A broker risks liability if he makes a misrepresentation regarding the condition of a home’s foundation without knowledge of, or making any attempt to determine, whether the foundation is, in fact, sound.

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Other actions deemed fraudulent include:

- *Incomplete statements or representations intended to conceal from the purchaser the existence, nature or extent of a defect*
- *Actions or statements intended to discourage the purchaser from inspecting the property himself and discover defects*
- *Misrepresentations first made innocently, i.e., without knowledge of their inaccuracy, but which are not corrected when the broker later learns that the original statement was incorrect*

To avoid liability for an active fraud, brokers must refrain from making representations which they know are false or made with culpable ignorance, i.e., those representations which they have no reason to believe are true. In addition, brokers must not make statements which are misleading, or which tend to hide the truth. In short, be truthful both as to what you know and what you don’t know, and correct any misstatements you make immediately upon learning of your error.



### ***Passive Fraud—Failure to Disclose Known Defects***

Numerous courts from a vast majority of states have concluded that a broker and a seller have a duty to disclose material defects of which they are aware, especially if a buyer would be unlikely to discover the defects himself.

Brokers can avoid liability for “passive fraud” by disclosing to potential purchasers all material defects of which they have knowledge. At least one state has expressly extended this to apply to conditions which the broker knows to exist off the property if they may adversely affect the property or its purchasers/occupants. The broker should carefully question the seller regarding the condition of the home and disclose in writing to the buyer all defects identified by the seller.

Sellers should be advised that these written disclosures are necessary to insulate them, as well as the broker, from liability. Any seller property condition disclosure statements required by law must also be completed and provided to the purchaser. The accuracy of the written information should be acknowledged by the seller. Interested purchasers should be provided the information and asked to acknowledge receipt in writing.

## **Negligent Misrepresentation**

### ***Duty to Use Care When Speaking***

The concept of negligent misrepresentation was developed by courts to serve as a basis of liability where the conduct at issue is *unintentionally* wrongful, i.e., a misrepresentation made because of a mistake rather than an intention to deceive. Thus, unlike fraud, a broker can be held liable for negligent misrepresentation without having actual knowledge that his statement of material fact was false. The broker’s liability for negligent misrepresentation

stems from his *lack of care* in ascertaining or confirming the accuracy of information he provides the purchaser or in conveying that information, rather than a purposeful deceptive intent, as in the case of both active and passive fraud.

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***For Example:*** In one case a broker, relying on statements made by the seller, honestly believed and advised the purchaser that the home was connected to a sewer system. The broker failed to notice certain indications that this was not correct, including the absence of pumps to push the sewage in the basement up to sewer level and the location of the sewage drain exit from the basement in the opposite direction of the public sewer. The court held that a careful, experienced broker would have recognized that these factors indicated the property was not connected to the sewer. The broker was held liable to the purchaser for the \$8,600 difference between the value of the property as it existed and the value of the property had it been connected to the sewage system as represented.

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Representations by the broker that readily apparent facts or ordinary care in observation would reveal to be false may also result in liability for the broker. On the other hand, brokers are generally not held liable for incorrect representations that are based on apparently reliable information and otherwise careful conduct by the broker in obtaining and communicating the information. If the broker has a reasonable basis for believing that a statement made to the purchaser is true and has obtained and communicated that information in a careful way, courts have usually not held a broker liable if his statements turn out to be untrue.

The following statements have resulted in liability for a broker/salesperson under a theory of negligent misrepresentation:

- *“The basement is dry; there are no problems with flooding or leakage.”* (The broker overlooked the statement on the MLS sheet indicating that the basement had leakage problems.)
- *“The house is termite-free.”* (The broker relied upon a ten-year old termite test. The broker was negligent for making that statement without a more recent test.)

Brokers will successfully avoid or withstand claims of negligent misrepresentation if they act reasonably and with due care. Brokers must take care not to make any representations unless they have acted carefully, have a reasonable basis for making the statements, and have no actual knowledge that the statements may not be true.

### ***Reliance on Statements Made by the Seller***

A question that often arises in negligent misrepresentation cases is the extent to which the broker may be liable for incorrect statements made by the seller about the property and relayed to the buyer by the broker.

Because of this, a broker should carefully compare his observations of the property with the seller’s statements and with any property condition disclosure statement completed by the sellers.

In general, a broker may rely on statements made by the seller **unless the broker has observed or otherwise knows of facts or conditions on the property which give him reason to believe the seller’s statements are untrue.**

When information provided by the seller appears inconsistent with the broker’s own observations of the condition and features of the home or information which otherwise comes to the broker’s attention, the broker must investigate and resolve the inconsistency before relaying the seller-provided information to prospective purchasers.

## Negligence

Negligence is the broker's failure to use reasonable care to discover material defects in real property. This additional duty to discover defects is not imposed in all states and, in fact, has been expressly recognized in only a few and explicitly rejected in several others. Any defects which are discovered in the process must, of course, be disclosed.

Negligence liability is based on an additional duty beyond the obligation to refrain from fraud or negligent misrepresentation by accurately disclosing all known defects of the property to the buyer. This duty consists of the obligation to discover, as well as disclose, material defects in the property. Courts have described this duty as requiring the broker to conduct a reasonably competent and diligent inspection of property and to disclose to the buyer defects or other material facts discovered by the inspection. Where such negligence principles apply, a broker may be liable, even when he has not made any erroneous representations to the buyer, if he fails to make a reasonable inspection of the property which would have revealed defects which were later discovered by the purchaser.

To avoid liability on the basis of negligence, a broker should conduct at least a visual examination of the property. That examination should focus on those property conditions, features and potential defects which brokers in that market area are ordinarily expected and trained to recognize and understand. It is important to recognize that the inspection should not and need not extend to defects or conditions that are reasonably discoverable only by professional inspectors. Liability for negligence does not extend to the broker's failure to discover latent defects beyond his expertise to do so. Any defects revealed by the broker's examination must, of course, be specifically disclosed to the purchaser.

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***For Example:*** A broker risks liability under a theory of negligence if he fails to discover and disclose readily apparent indications of defects such as:

- (1) The home rests on unstable soil, where readily apparent netting has been placed on the ground to hold insufficiently compacted soil in place;
  - (2) The home is infested with termites where visual inspection reveals weakened or grooved wood;
  - (3) The basement or roof has a leakage problem where water marks on the floor or ceiling or cracked plaster and loose tile are noticeable;
  - (4) The foundation is visibly weak, as indicated by substantial shifting or noticeable cracks in the foundation that are open to view.
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Brokers may avoid claims of negligence if they carefully inspect property and disclose to prospective buyers, preferably in writing, any defects or indications of defects discovered. Sellers should also be told the results of the inspection to permit them to make any repairs that might cure (rather than conceal) any discovered defects and, thus, enhance the home's market value.

### **Innocent Misrepresentation or Strict Liability**

Only two jurisdictions (District of Columbia and Wisconsin) still place an onerous and unfair burden upon real estate brokers by holding them liable for any material misrepresentations made concerning the property, even where their actions are reasonable and diligent in attempting to determine the accuracy of the misrepresentation. In these jurisdictions, the broker becomes a guarantor of the accuracy of all statements he makes regarding the condition of the property.

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*For Example:* In one case a broker was held liable for advising the buyer that the water supply was adequate when in fact it was not, even though he had no reasonable way of knowing that his statement was false and had acted reasonably and competently in obtaining and conveying that information.

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## **Consumer Protection or Licensing Act Liability**

Many states have also adopted statutes or regulations expressly prohibiting consumer fraud, intentional or negligent misrepresentation, or unfair and deceptive trade practices. Such statutes often specifically include real estate services or have been held to apply in actions brought by real estate purchasers against brokers. In other cases, there is an express statutory or regulatory prohibition of misrepresentation in the real estate licensing act or regulations.

Statutes such as this often reduce the burden of proof of a plaintiff and occasionally permit the recovery of two or three times the plaintiff's actual damages, as well as the plaintiff's attorneys fees. Brokers should determine if such a statute exists in their state, if it applies to real estate transactions, what penalties may be imposed for violations, and what, if any, steps can be taken to minimize the possibility of a violation.

## Disclosure of Non-Physical Defects/Stigmatized Property

A special case of the broader issue of property disclosure and liability for misrepresentation of property is presented by so-called “stigmatized property.” Brokers involved in the sale of properties with unusual, non-physical features or histories are frequently required to make difficult decisions about what they must, should, or need not disclose to prospective purchasers.

The NATIONAL ASSOCIATION OF REALTORS® defines stigmatized property as “a property that has been psychologically impacted by an event which occurred or was suspected to have occurred on the property, such event being one that has no physical impact of any kind.” Thus, such properties are those whose desirability may be affected by events which occurred on or near the property, but which are not manifested by any physical features or characteristics of the property. The stigma produced by such events, real or imagined, is thus usually an intangible one, residing in the minds of potential purchasers.

The most common events associated with stigmatized property are murders, suicides and other criminal activity that may have occurred on or near the property. Stigmatized property may also include property in which a current or former occupant is infected with the Human Immunodeficiency Virus (HIV) or diagnosed with Acquired Immune Deficiency Syndrome (AIDS). The troublesome task for brokers marketing properties affected by such circumstances is to determine whether the facts creating the stigma require disclosure to potential purchasers and, if so, what must be disclosed.

## AIDS Disclosure

AIDS is a fatal disease that affects the body's ability to fight infection. AIDS is caused by a retrovirus commonly known as HIV. AIDS can be transmitted by sexual contact, through inoculation with HIV-infected blood or through pregnancy from the infected mother to her child. Both the Center for Disease Control and the Surgeon General of the United States stress that the virus is not transmitted by "casual" daily contact. The *Report of the Surgeon General of the United States on AIDS* states that you cannot get AIDS from toilets, doorknobs, telephones, office machinery or household furniture.

This last point has considerable significance for real estate, since it means that subsequent occupants of a residence previously occupied by one suffering from HIV infection or AIDS are not at risk to contract the disease from simply living in the house. A potential purchaser who is concerned with health risks from purchasing a property where a prior occupant had AIDS has fears that are unfounded.

Moreover, the Fair Housing Amendments Act of 1988 established the handicapped as a protected class. It is illegal to discriminate against people with handicaps just as it is illegal to discriminate on the basis of race, color, religion, sex, national origin or familial status. The definition of handicapped includes persons diagnosed with AIDS.

For that reason, the Department of Housing and Urban Development (HUD) has declared it to be illegal for real estate brokers and salespeople to make *unsolicited* disclosures that a current or former occupant of a property has AIDS. In addition, HUD advised that salespeople not respond to *direct questions* by prospective purchasers as to whether a current or former occupant has AIDS, *even if* the salesperson knows that to be the case. While HUD has not provided a "correct" response, NAR recommends a response along the lines of the following:



*It is the policy of our firm not to answer inquiries of this nature one way or the other since the firm feels that this information is not material to the transaction. In addition, any type of response to such inquiries by me or other salespeople of our firm may be a violation of the federal fair housing laws. If you believe that this information is relevant to your decision to buy the property, you must pursue this investigation on your own.*

Any specific obligations related to such disclosure that are imposed by state law should also be determined and those obligations also carefully performed.

## **Megan's Law**

Another type of property “stigma” may arise from convicted sex offenders residing in proximity to a property in which a purchaser is interested. Pursuant to a federal requirement, each state has adopted a version of “Megan’s Law,” which requires persons convicted of sex offenses to register with a local law enforcement agency and provide their local address and other information. From state to state and among local jurisdictions within states, the requirements of such laws vary as to the agency with whom registration is required, the sex offenses for which registration is required, and the manner in which such information is available to the public.

Whether brokers have a duty to prospective purchasers to disclose sex offenders residing near a property of interest is a matter of state law. A few states have adopted legislation specifying the disclosure responsibilities, if any, that brokers may have with respect to registered or other sex offenders. In states that have not enacted such legislation, brokers should consider the extent to which the state’s general property disclosure obligations may require sex offender disclosure, or otherwise consider providing prospective purchasers with information derived from

the registries maintained by local law enforcement officials. Alternatively, brokers might consider providing to prospective purchasers information about how purchasers can access the registry applicable to the area in which they intend to purchase a home.

## **Disclosure of Facts Which May Create Stigmatized Property**

Although federal law provides some assistance in handling AIDS disclosures, there remains uncertainty regarding the disclosure of other facts which might raise a stigma. When a known property defect is physical, disclosure is generally mandatory. On the other hand, when factual circumstances relating to the property or its history but not involving any physical characteristics may result in a property stigma, the question of disclosure becomes more difficult. In some cases, states have prescribed by legislation or regulation the requirements for disclosure of such facts. In cases where no such express legislative direction is provided, the need to disclose such facts will generally depend on their materiality. The following guidelines are intended to help a broker when faced with information regarding a potential stigma and to determine the appropriate course of action regarding disclosure of the facts which may produce the stigma.

***STEP 1: Determine whether the information is fact or fiction.*** Investigate the validity of the information by checking sources such as newspaper accounts or reports from state or local agencies. Separate rumor from reality. If the stigma is based on rumor and not on facts which can be confirmed, there may be no obligation to disclose. If, on the other hand, the stigma turns out to be factual, e.g., there was in fact a murder on or near the property, you should proceed to the next step.

***STEP 2: Check state laws.*** A number of states have enacted laws that generally apply to AIDS, Megan's Law, homicides, or suicides and provide that the facts relating to such a potential stigma are not a material factor and need not be disclosed.

If there is law governing disclosure, it may well provide that there is no duty imposed on the broker to disclose and no liability for failure to do so. In that case, investigation into the issue ends here. If a state does not have a specific law governing disclosure of specified stigmas, there may be other laws such as privacy laws that will influence or affect the disclosure decision. State statutes vary widely, however, so it is essential that a broker be familiar with the laws of his state. If there is no law expressly governing disclosure, proceed to Step 3.

***STEP 3: Determine materiality.*** To analyze the materiality of a set of facts which may produce a stigma, one must determine whether knowledge of those facts would affect the willingness of a reasonable person in deciding whether to buy the property or the amount of money to offer or pay for the property.

Most stigmatized property cases involve stigmas that are less sensational than, for example, a multiple murder on the property. Less sensational stigmas may or may not impact the market value of the property. Whether or not the problem is a high-profile one, however, it is necessary to assess how reasonable persons would react to the information and if they are less likely to desire to purchase the property. Alternatively, one should consider how the "market" would judge such a property and whether it can be objectively concluded that the market value of the property is less because of the property's history. If this analysis results in the conclusion that the facts and stigma may have an impact on the buying decision of prospective purchasers, the facts creating the stigma are probably material and should be disclosed.

***STEP 4: Discuss disclosure with the sellers.*** A listing broker who concludes that the stigma-producing facts are material and need to be disclosed should also discuss with the sellers the basis for his conclusions and his intended course of action. The sellers need and deserve to understand the broker's analysis and why the particular facts may affect the marketing and sale of their property and, thus, must be disclosed. Often sellers can understand the problem better if they are asked to consider themselves in the position of a prospective purchaser and whether or not they would want the factual information before deciding to purchase or what to offer for the property. Discussing the matter with the sellers up front avoids objections and controversy later about why the particular facts were disclosed to prospective purchasers.

Buyer's brokers and non-agent "transaction brokers," on the other hand, do not owe fiduciary duties to the seller and need not review their decision to disclose to him. But they do need to disclose stigma-producing facts of which they have knowledge and which they have determined to be material.

Disclosures about stigmas should, in any case, be made appropriately and judiciously. It is not necessary to disclose information causing a stigma to those who simply express interest in the property. The best time to disclose may vary but should always be sufficiently prior to the contract offer being made to permit the buyer to adequately understand and take into account the facts revealed in making that offer. Present the subject as one more relevant piece of information about the property and use simple non-threatening language. Disclose only confirmed factual information, and present it as such—facts to be taken into account. Don't make value judgments about the matter, since that is the sole and exclusive prerogative of the purchaser.

If the sellers refuse to agree to disclose what the listing broker (or a subagent working with the listing broker) has determined to be a material factor regarding the property, the broker should strongly consider terminating the listing or other involvement in the transaction. As the agent of the seller, the broker cannot disclose information the seller has directed to remain confidential without violating the duties inherent in the agency relationship with the seller. By not disclosing the information, however, both the listing and cooperating broker risk violating the obligation to disclose to purchasers material facts that affect the value or desirability of the property and expose themselves to serious liability to buyers who may purchase the property without learning the undisclosed facts. The best and perhaps only certain way to resolve the dilemma created by the reticent seller is to resign the listing or terminate involvement in the sale of the property.

*See the Stigma Disclosure Flowchart located in Appendix B for a diagram of these steps.*



## Remedies for Failure to Disclose Known or Discoverable Defects

Courts may impose a variety of penalties on brokers who have been found liable for misrepresenting material facts.

*First*, successful plaintiffs may recover “actual” damages. Such damages may be calculated as the difference between the value of the property as is and the value of the property as represented or the costs to repair the defect in the property.

*Second*, courts may impose “punitive” damages when a broker’s misrepresentation has been particularly blatant or willful, which is most commonly limited to cases of fraud. The rationale for awarding punitive damages is to deter similar conduct by brokers in the future. The amount of punitive damages is not necessarily related to the amount of damages suffered by the purchaser, but rather on the severity of the broker’s wrongful conduct.

*Third*, courts sometimes order “rescission” of the property sale. This remedy returns the parties to their positions prior to the signing of the contract. Title to the property is returned to the seller and the purchaser is reimbursed for any amounts paid and transaction costs incurred.

*Fourth*, misrepresenting the condition of property is often prohibited by real estate license laws and may result in a broker having his real estate license suspended or revoked.

*Finally*, Article 2 of the NATIONAL ASSOCIATION OF REALTORS® Code of Ethics requires REALTORS® to avoid “exaggeration, misrepresentation or concealment of pertinent facts,” thus making disciplinary action by the REALTORS® Association a possibility.





## Conclusion

REALTORS® are legally and ethically obligated to treat purchasers of real estate honestly and fairly. “Let the buyer beware” is, almost uniformly, no longer an adequate legal or ethical defense for a broker who fails to correctly disclose material defects in the property. The current trend is to impose a duty on the broker to act reasonably and diligently to disclose, and in some cases to discover, material defects in the property. A failure to satisfy these obligations exposes the broker to a variety of damages:

- *The costs to repair the defect*
- *The difference between the value of the property with and without the defect*
- *The expenses associated with the possible rescission of the transaction, including costs incurred by the buyer in purchasing the property*
- *Punitive damages in particularly egregious circumstances*

To minimize liability for misrepresentation or a failure to disclose a material defect, real estate brokers should:

1. Advise the buyer of all material defects that are known to be present.
2. Avoid statements of fact that have not been verified with either the seller or by an independent investigation.
3. Where required by law or when deemed appropriate on a voluntary basis, have the seller complete the applicable seller property condition disclosure form, and provide a copy to interested buyers. Independently confirm any representations or other statements made by the seller about the condition of the property if there is reason to believe the seller’s statements are not correct.

4. Conduct a careful visual inspection of the property, and make only those representations that are consistent with the results of that investigation.
5. Document answers to the buyer's questions about the condition of the property by either a memorandum in the file or a letter to the buyer.
6. Be sure a buyer is aware of any qualifications or contingencies that might affect the accuracy of a statement about the property. Encourage the buyer to confirm the statement through other sources such as public records, if appropriate.
7. Become familiar with red flags of problems that are common to properties in the market. If discovered, discuss them with the seller and, if necessary, investigate them further. Be sure the buyer is made aware of any red flag, its potential significance, and the results of your investigation.
8. Encourage the use of other professionals to determine the condition of the property or to assess the significance of a red flag.
9. Review any facts which might raise a "stigma" related to the property, and carefully consider whether those facts require disclosure.

If followed, these steps should significantly reduce a real estate broker's liability for misrepresentation or failure to disclose property defects. But equally important, they will enhance your professional image with buyers and sellers and your opportunity for continued success in the real estate profession.

**Appendix A:  
Environmental Problems/  
Red Flags Table**

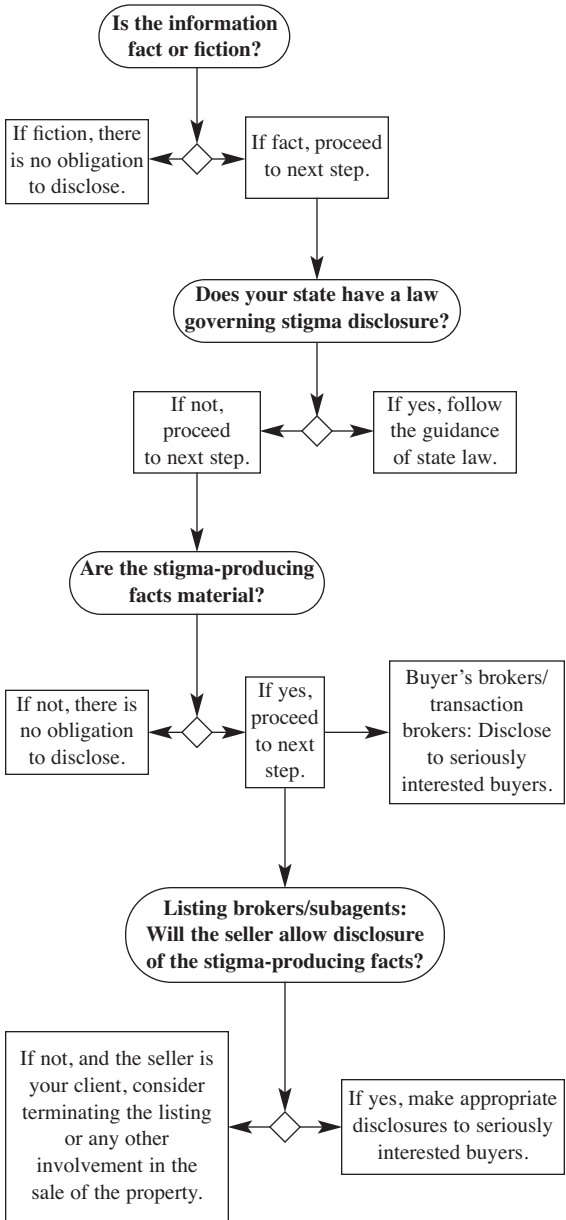
<b>Environmental Problem</b>	<b>Red Flags</b>
<b>Asbestos</b>	<p>The possible existence of asbestos-containing materials may be evident from a visual inspection. Four common types of materials often contain asbestos:</p> <ul style="list-style-type: none"> <li>• A fluffy, cotton-candy like material sprayed on ceilings or walls as a fire retardant</li> <li>• A granular, cement-like plaster that was either sprayed or troweled on walls and ceilings for fireproofing and soundproofing purposes</li> <li>• Wallboard used for insulation that has sprayed or troweled-on material behind it</li> <li>• Pipe or boiler insulation that may be felt-like or cement-like in appearance or may look like fibrous wrapping paper</li> </ul>
<b>Lead-Based Paint</b>	<p>The concern about lead poisoning in housing arises principally from the presence of lead-based paint and lead plumbing. Although the manufacture of lead-based paint was banned in 1978, it is estimated that between 30 and 40 million older homes around the country contain lead-based paint. Thus, homes constructed prior to 1978, and particularly those where there is decaying, flaking or peeling paint, raise special concerns regarding the potential presence of lead-based paint hazards. The existence of lead-based paint at a particular property can be determined only by testing the paint. Brokers and agents should be aware of, and comply with, the federal lead-based paint disclosure regulations.</p>
<b>Radon</b>	<p>Radon, in amounts which can be hazardous to human health, can be found in any home. Well-insulated and energy efficient homes tend to experience higher levels of radon gas than other homes because the radon becomes trapped inside the house and cannot escape to the open atmosphere,</p>

<b>Environmental Problem</b>	<b>Red Flags</b>
<p><b>Radon</b> <i>(continued)</i></p>	<p>where it is harmless. Radon enters into homes through minute openings in the foundation above the ground, such as cracks in the basement floor or walls, slab or openings commonly built around plumbing. It can also enter through well water. Radon contamination has been found to be a problem in certain homes and schools, but ordinarily is not a problem in the upper floors of commercial, high-rise buildings.</p> <p>Testing of a home is the only way to determine if it has elevated levels of radon. You may be able to obtain clues as to the likelihood of the presence of radon from local, state, and federal environmental and health officials, or from information about nearby homes. The absence of elevated levels in even adjacent homes, however, does not establish that elevated levels are not present in any particular home.</p>
<p><b>Mold</b></p>	<p>Small amounts of some common molds are present in most homes, but there is concern that larger amounts of mold growth or mold spores may adversely affect human health. Although there is not scientific certainty about adverse health effects of exposure to mold, some evidence suggests that it may cause respiratory and other adverse health effects for some people, and that more serious illnesses may be the result of exposure to a few particular mold species.</p> <p>Mold spores are present everywhere, but mold growth occurs where spores have access to a moisture source and organic materials such as textiles, wood, carpet, drywall, paper, leaves, or the like. Thus, an important red flag for mold concerns is uncontrolled or unremedied water damage or problems, such as roof or basement leakage, plumbing leaks, excessive indoor humidity or other sources of water.</p>

<b>Environmental Problem</b>	<b>Red Flags</b>
<b>Underground Storage Tanks</b>	<p>A physical examination of the property may provide clues to the possible presence of one or more underground tanks, since such tanks usually have an air vent that sticks out of the ground above the tank. Oil sheens in wet areas, piping or vents sticking out from the ground, or traces of concrete, metal or asphalt that may indicate former commercial use of the property may all suggest the presence of an underground tank. Particularly where such indicators are observed, the seller should be questioned concerning any knowledge he/she may have about the presence of such tanks.</p>
<b>Groundwater Contamination</b>	<p>Typical sources of groundwater contamination include:</p> <ul style="list-style-type: none"> <li>• Leaking underground storage tanks and pipelines</li> <li>• Faulty septic systems</li> <li>• Hazardous and nonhazardous landfills</li> <li>• Excessive road de-icing</li> <li>• Run-off of agricultural pesticides and fertilizers</li> <li>• Mining activity</li> </ul>
<b>Waste Disposal Sites</b>	<p>Visual inspection of the property may identify red flags of problematic dump sites that warrant further inquiry or investigation. Be vigilant for:</p> <ul style="list-style-type: none"> <li>• Depressions, mounds or soft spots that could indicate the possible presence of landfill</li> <li>• Traces of concrete, metal or asphalt that could indicate prior commercial use</li> <li>• Ravines or earth embankments that could indicate former dumping on the site</li> <li>• Discoloring of soil or stressed vegetation that may be caused by contamination</li> </ul>

## **Appendix B: Stigma Disclosure Flowchart**

# Stigma Disclosure Flowchart











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