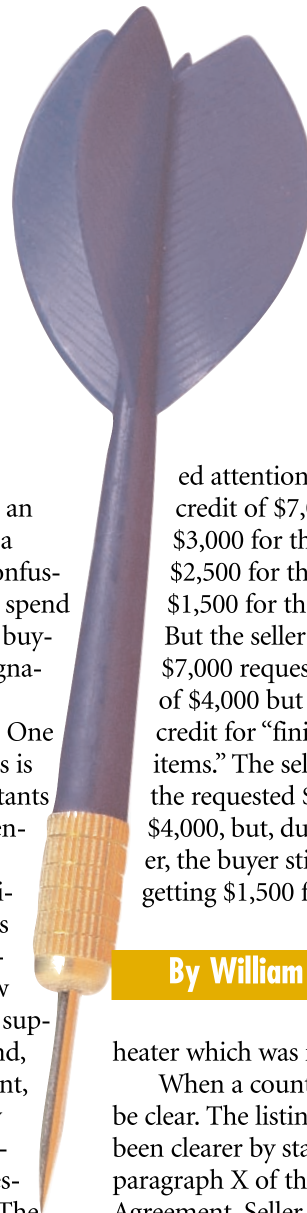
MANAGING RISK

Targeting the Top Seven Risks in Real Estate



No matter how many times your state or local real estate association has fine-tuned its standard purchase contract, no matter how many times you as a broker have reviewed it with your agents, and no matter how many times your agents have completed purchase agreements, the chances are still good that you will be in dispute over a contract several times this year.

You have to wonder why. I think it's because we tend to forget that while 90% of real estate transactions is very similar to every other real estate transaction, 10% of it is unique. It's that absolute uniqueness that creates such room for error.

In my practice consulting with brokerages in California about reducing risks, I find that seven situations repeatedly get agents and brokers into trouble. If brokers would train their agents to guard against these top seven high-risk areas, brokers would spend less time and money resolving contractual disputes.

1. Failure to properly complete the purchase agreement, disclosures and amendments. It's a simple fact that a sales offer or purchase contract—plus all disclosures and amendments—must be filled out correctly, signed in all appropriate places by all parties, and dated in all appropriated places. If a signature is missing, the contract is not technically complete and is subject to challenge. Ditto if a box isn't checked, which could then omit an important contract clause or, at a minimum, make the contract confusing. At the very least, agents will spend too much time running back to buyers and sellers to get a missed signature, initial or date.

There has to be a better way. One thing I recommend to my clients is that agents utilize personal assistants or transaction coordinators whenever possible. With their strong administrative talents, these individuals offer another pair of eyes on the document. Another technique that works is to know how many signatures and initials are supposed to be on the document and, before transmitting the document, simply stop and carefully review the document in detail for omissions. Carpenters have an expression:"Measure twice, cut once." The same applies here.

2. Fuzzy counteroffers. Sometimes even the attorneys can't sort out what was intended by the counteroffers! Here's a good example. Recently I reviewed an offer from a buyer who was anxious to take possession of his new home. The seller hadn't even finished some of the pre-sale fix-up chores, such as completing a new deck, installing a fence and gate and replacing an old hot water heater. The initial offer was intended to accept the property "as is", unfinished items and all. However, the offer itemized all the exterior and interior items that needed attention and requested a credit of $7,000 from the seller: $3,000 for the deck completion, $2,500 for the fence and gate and $1,500 for the hot water heater. But the seller countered the $7,000 request with a lump sum of $4,000 but identified that as a credit for "finishing exterior items." The seller was countering the requested $7,000 with a total of $4,000, but, due to a sloppy counter, the buyer still thought he was getting $1,500 for a new water

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heater which was not an exterior item.

When a counter is made, it must be clear. The listing agent could have been clearer by stating "Regarding paragraph X of the Purchase Agreement, Seller will credit a total of $4,000 for the deck completion, fence, gate and water heater."

3. Is that a contingency or a promise? The two words I dread seeing are "Buyer to … " or "Seller to …" in an addendum or counteroffer. For example, a contract may read "seller to provide buyer with certificate of occupancy prior to escrow." Now what is that … a contingency or a promise? If it's a contingency in favor of the seller, then the seller's inability to obtain the certificate will allow the seller to cancel the contract. If it's a promise, and the seller is unable to obtain the certificate, the seller could be found to be

in breach of the contract. Attorneys for buyers and sellers have argued it both ways.

A better approach is to start by determining if the item is to be a contingency (or condition) or a promise (also called a covenant). If the paragraph is to be a contingency, use words to convey that: "This contract is contingent upon seller…" or "This contract is subject to seller …"

If it is to be a promise or covenant, use words of promise: "Seller shall provide buyer with …" or "Seller will provide buyer with …"

4. Powers of attorney and trustee sales. Brokers should pay close attention when a party signs a contract pursuant to a power of attorney or as a trustee of a trust. I've seen too many powers of attorney used in real estate transactions that were expired, did not contain the power to sell real estate or was not in recordable form. If the power of attorney is flawed, the contract isn't binding. I recommend that, if a party is going to execute contract documents with a power of attorney, first have that document's validity for use in the transaction approved by an attorney or the escrow officer.

Properties held in trust can also pose problems, especially when the original trustees are deceased. I reviewed a situation recently where the son and daughter claimed to be trustees of a family trust which owned their deceased parents' property. It was logical, so no one questioned it. But, in fact, an uncle was the successor trustee, and the children were merely beneficiaries under the trust. When dealing with trust property, listing agents should first ask to see a copy of the actual trust document to determine who the actual trustees are, and whether the trustees have the power under the trust to sell the property. Questions should be referred to a competent trust and estates attorney.

5. Drafting long and complicated paragraphs. Anytime you, as the broker, see a long, detailed paragraph in a contract written by the agent, take extra time to read and understand what has been written. If it is not clear, do one of two things: either send it immediately to your own legal counsel or suggest the clients have it reviewed by theirs. Agents have good intentions when they draft these paragraphs. They are genuinely trying to make things clear rather than muddy. But a contract is a legal agreement, and long, complicated contract provisions should be drafted, or at least reviewed, by those who know the practice of contract law.

For example, recently an agent handling the sale of a piece of real estate along with a business opportunity on the property (a horse boarding and training facility), tried to write a noncompete agreement, so that the seller would not be able to start a competing business nearby. He also attempted to draft a complex employee retention clause. It is wise to refer such matters to the client's attorney or at least have the entire contract subject to review and approval by the attorneys for the parties within a specified period of time.

Better yet, I recommend that brokers and managers train their agents to come to them *before* they write and present those types of contract clauses to get proper guidance.

6. Encroachment and easement issues. Often an agent will encounter a situation where a fence, retaining wall or building of one property encroaches on the other. Or there may be an alleged easement, such as a common driveway. In either event, the matter must be promptly addressed since these types of disputes can be contentious, bitter and expensive.

Often the encroachment or easement dispute will come up during a listing when a neighbor will advise the listing agent that he or she believes that there is an encroachment or easement issue that has not been resolved. The seller may dismiss these claims and not want the matter disclosed because the seller feels they lack merit. If the dispute cannot be resolved prior to placing the property on the market, the buyer needs to be fully informed. Many buyers want the issue resolved prior to close of escrow; others may be willing to live with the problem. In the latter case, buyers should get competent legal advice regarding the consequences prior to proceeding.

7. Out of area or different types of properties. Finally, agents who get involved in transactions that are outside of their normal practice areas are creating risk. A classic example is the agent who wants to represent his or her sellers on the buying side when they move up to their million-dollar dream house in the next county. Real estate practices and customs change every 20 to 30 miles. Every community has its own ordinances. Every REALTOR® association has local disclosure forms. When a favorite client moves to the country, for example, a city-bred agent will encounter a new set of property circumstances with which he or she might not be familiar: wells, septic systems, leach fields, development restrictions and more.

Also, residential agents should not get involved with commercial properties or subdividable tracts if they have not done so before. We are in a world of specialization. It's too easy to get involved and not know what you are doing. I've seen agents make egregious errors, not due to incompetence or maliciousness, but simply out of sheer ignorance. My advice? Say "No" to that coveted transaction, take a referral fee and sleep nights.

Finally, I know you've heard it before, but it's worth repeating: It's not just new licensees that need to be alerted to these high-risk areas. I've seen 15-year agents, tremendously successful, with a big book of business embroiled in just these situations. The fact is that contracts change, disclosure requirements change, and all agents—new and experienced—need ongoing training to guard against these common mistakes. ■

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