

2019-2020 General Update Course

Section Two MATERIAL FACTS



1. Tom, a seller, has decided to list his property. Tom has noticed that the water heater has begun to leak. He completed the *Residential Property and Owners' Association Disclosure Statement and Mineral and Oil and Gas Rights Mandatory Disclosure Statement* before he listed the property. On the *Residential Property and Property Owners' Association Disclosure Statement* he marked "No Representation" on question 8, which stated, "Is there any problem, malfunction or defect with the dwellings plumbing system (water heater)."

- a) Must Tom disclose the leaking water heater to potential buyers? Yes/No
- b) Has Tom complied with the Residential Property Disclosure Act? Yes/No
- c) What if Tom has a real estate license? _____

2. Bill, a broker, is inspecting a house during a listing presentation. He notices that there are several stains in the cabinet under the kitchen sink. Bill asks the owner if the sink leaks. The owner tells Bill that the sink leaks on occasion but not enough to really worry about. However, the owner also states that he has had the sink repaired multiple times in the past.

Bill lists the property. On the *Residential Property and Property Owners' Association Disclosure Statement*, the seller marks "No Representation" for all items. Bill does not include any information about the leak in the listing information.

Jeff, a broker from another firm, and his buyer-client, view the property. While viewing the house, the buyer's agent notices the stains under the kitchen cabinet and immediately closes the door. The buyer's agent does not point out the stain to his potential buyer, nor does he ask Bill about it.

- a) Would this be an example of Misrepresentation or Omission?
 - b) Which broker is at fault? Bill (listing agent) / Jeff (buyer's agent) / Both
 - c) What are the responsibilities of the listing and buyer's agent?
-

LEARNING OBJECTIVES

After completing this section, you should be able to:

- evaluate a fact to determine if a material fact exists;
- explain the categories of material fact;
- explain the duties of a listing agent;
- explain the duties of a buyer's agent; and
- differentiate between misrepresentation and omission.

TERMINOLOGY

Material Fact: Any fact that could affect a reasonable person's decision to buy, sell, or lease is considered a material fact and must be disclosed by a broker to the parties in the transaction and any interested third parties regardless of the broker's agency role within the transaction.

N.C.G.S. §93A-6(a)(1) indicates that licensees are subject to disciplinary action if they make any willful or negligent misrepresentation, or omission and/or failure in disclosing material facts to all parties in a transaction.

CATEGORIES OF MATERIAL FACTS

Facts about the property itself

This category comprises significant property defects or abnormalities such as:

- structural defect(s),
- malfunctioning system(s),
- leaking roof, or
- drainage or flooding problem(s).

Facts that relate directly to the property

This category includes external factors that affect the use, desirability, or value of a property such as:

- a pending zoning change,
- existence of restrictive covenants,
- plans to widen a street, or
- plans to build a shopping center adjacent to a property.

Facts directly affecting the principal's ability to complete the transaction

This category includes any fact that might adversely affect the ability of a principal (seller or buyer) to consummate the transaction such as:

- buyer's inability to qualify for a loan,
- inability to close on a home without selling a currently owned home, or
- seller's inability to convey clear title due to the commencement of a foreclosure sale or judgment lien on the property.

Facts that are known to be of special importance to a party

This category includes facts of special interest or importance to a party such as:

- specific zoning restrictions,
- the refusal to purchase a home within a neighborhood governed by an HOA,
- the refusal to purchase a home within the city limits, or
- the refusal to purchase a home that has been previously occupied by a pet.

Additional Facts That Must Be Disclosed to an Agent's Principal

Under agency law, an agent must disclose to the principal any information that may affect the principal's rights and interests or influence the decision of the principal in the transaction. Relevant information that a broker-agent must share only with his/her principal includes:

- the other party's willingness to agree to price or terms different from those previously stated,
- the other party's motivation for engaging in the transaction, or
- any other information that might affect the principal's rights and interests or influence the principal's decision in a transaction.

State Law and Disclosure of Certain Facts

Certain facts that may seem material may be excused by state and fair housing laws such as:

- disclosing the death or serious illness of a previous property occupant,
- disclosing a convicted sex offender occupying, having occupied, or residing near a property, or
- disclosing a current or former occupants' AIDS/HIV status.

IS IT A MATERIAL FACT?



Brokers are often presented with a multitude of “facts” regarding a property or the parties in the transaction. Can you match the material fact with the appropriate category?

Material Fact Examples

- ___ 1. Smoke-free home
- ___ 2. Pet-free home
- ___ 3. Electrical system is malfunctioning
- ___ 4. Seller is behind on mortgage payments
- ___ 5. Seller is in a foreclosure proceeding
- ___ 6. Zoning laws will affect the property in 2 months
- ___ 7. Roof has leaked in the past on two separate occasions
- ___ 8. No HOA governs the residential community

Categories of Material Facts

- A. Facts about the property itself
- B. Facts that relate directly to the property
- C. Facts directly affecting the principal’s ability to complete the transaction
- D. Facts that are known to be of special importance to a party
- E. Not a material fact

If a material fact exists, brokers must disclose the material fact to all parties within the transaction. Brokers should analyze the following questions to help determine the existence of a material fact.

- Is a broker involved in the transaction?
- What should the broker do to prepare for listing the property?
- What is a “red flag?”
- Are any “red flags” present?
- What is the broker’s responsibility?
- What if the broker acts irresponsibly?



Is a broker involved in the transaction?

Yes. If a broker is involved in the transaction, N.C.G.S. §93A-6(a)(1) states:

- The broker must not misrepresent or omit (or fail to disclose) any material facts about the property
- A broker must disclose material facts to all parties in the transaction

The duty of disclosure of material facts is mandatory under License Law and Rule.

No. Seller, buyers, lessors, or lessees do not have a duty to discover and disclose material facts unless they hold a North Carolina Real Estate License.



What should the broker do to prepare for listing the property?

The broker should prepare for the transaction by completing the following:

- state the duty to discover and disclose material facts under License Law and Rules to their clients and/or consumers,
- research property-specific information,
- interview the owner(s) regarding property-specific information, and
- evaluate and conduct a preliminary inspection of the property to determine if any “red flags” exist before making any statements.



What is a “red flag?”

A “red flag” is the presence of any fact or issue that should make a reasonably prudent broker working with a buyer or seller suspect that the information provided by another party may be incorrect.

The broker has a duty to investigate any issue or fact that could mean a potential problem with the property.



Are any “red flags” present?

Yes. If “red flags” are present, a broker must conduct more research and use due diligence to determine the severity of the issue and the effect that these “red flags” will have on their client’s decision to buy the property.

Examples of “red flags” are:

- stains on the ceiling, floors, or in the cabinets;
- discoloration of flooring;
- absence of septic permits;
- unpermitted spaces;
- leaks;
- cracked foundational issues; or
- miscalculations of square footage.

If a red flag exists the broker can complete additional research by:

- asking the owner about known issues with the property,
- asking the owner to receive and review service records for repairs conducted on the property,
- researching the existence of septic permits and building permits with the local municipality, or
- advising the owner to hire a contractor to estimate and/or repair issues

No. As a best practice, the broker should advise their client(s) to hire a property inspector to thoroughly evaluate the property for issues.



What is the broker’s responsibility?

The broker’s responsibility is to research whether a material fact exists and disclose the presence of a material fact or potential material fact to their client so they can possess the adequate knowledge to:

- make an intelligent decision regarding acquiring the property,
- negotiate repair services, or
- decide to terminate the contract.

Additionally, the broker’s responsibility includes the following:

- researching the issue to determine if it was repaired and the likelihood of the fact existing in the future,
- asking about repair timelines and prior records of completion,
- determining the seller’s willingness to repair the defect, and
- disclosing the defect to all parties in the transaction.

The disclosure of material facts are mandatory and must be disclosed freely to all parties in a transaction. The broker cannot decide to refrain from disclosing the material fact to any party because they believe that the material fact was common knowledge.



What if the broker acts irresponsibly?

If a broker has determined that a material fact exists but fails to disclose or misrepresents the existence of such fact, he is engaging in misrepresentation and/or omission of a material fact.

- **Misrepresentation:** communication of false or incorrect information.
- **Omission:** failure to disclose material information.



Does a buyer's agents have a responsibility to inquire about material facts?

Yes. The buyer's agent has a responsibility to inquire about the presence of material facts for their client. In an effort to determine whether material facts exist, the buyer's agent should complete the following:

- research zoning codes/requirements of the property,
- determine facts of special interest or relevance to the client,
- research property-specific information,
- evaluate and inspect the property for issues, and
- inquire with the listing agent about the presence of material facts.



What questions should a buyer's agent ask?

Examples of questions a prudent buyer's agent should ask a listing agent include:

- Are there any issues like leaks, stains, or improper permitting associated with this property?
- When is the last time this property or systems on the property been serviced?
- Is this property correctly zoned for the specified usage?
- Is the seller currently in a foreclosure proceeding?

Examples of questions a prudent buyer's agent should ask a buyer include:

- What are some "facts" of special importance to you?
- Are you having difficulty acquiring financing for your purchase?
- Do you have to sell another home before you acquire this one?

A buyer's agent may rely on a listing agent's assertions regarding a property; however, the buyer's agent is still responsible for following up on any red flag issues.

CASE: Was that a fact?

Read the following case summary.

Determine what, if any, errors were made by the broker(s) and which License Laws or Commission rules were violated.

PARTIES:

The Complaining witness was the potential Buyer of a residential property. The Respondent was the listing agent.

COMPLAINT:

On March 20, 2018, the potential buyer filed a complaint with the North Carolina Real Estate Commission indicating that the Broker failed to accurately state the square footage of the property in advertisements, and disclose issues with the property truthfully.

FACTS:

On February 5, 2018, the broker of the subject property completed the *Residential Property and Owners' Association Disclosure Statement* and the *Mineral and Oil and Gas Rights Form* when she listed the property for sale. On the *RPOADS* form, she indicated that the heating and cooling sources on the property were 2 years old upstairs and 13 years old downstairs. Furthermore, the broker stated in the Multiple Listing Services that the square footage of the subject property was 3,175 by utilizing the county tax records.

In addition, the broker failed to disclose that material defects existed on the property. The buyers entered into an *Offer to Purchase and Contract* with the broker on March 2, 2018.

The buyers discovered during the due diligence period that the actual square footage of the property was 2,956. Also, the property inspection report indicated that material defects existed on the property and that the furnace was 13 years old.

Main Points - Was that a fact?

- February 5, 2018, the broker completed the *RPOADS* and *MOG* disclosure statements and indicated the inaccurate age of the heating and cooling units as 2 years old upstairs and 13 years old downstairs on the *RPOADS* statement.
- February 2018, the broker represented the property as 3,175 square feet using the county tax records.
- February 5, 2018, the broker indicated there were no issues with the property by selecting “No” on the *RPOADS* form except when she selected “No Representation” in reference to the pipes in the home.
- March 2, 2018, the potential buyer signed the *Offer to Purchase and Contract* and property disclosure statements.
- March 2018, the potential buyers had an appraisal conducted and the report determined that the square footage of the property was 2,956. The potential buyers were also alerted to the presence of material facts that were not disclosed on the *RPOADS* statement or disclosed during the contract.
- March 20, 2018, the potential buyers filed a complaint with NCREC.

Evaluation and Discussion - Was that a fact?

Errors made by the Listing Broker:

Related Law and Rule Considerations - Was that a fact?

Misrepresentation

N.C.G.S. § 93A-6(a)(1) states:

- The Commission has the power to suspend, revoke, reprimand, or censure any licensee if they make any willful or negligent misrepresentation or any willful or negligent omission of material fact.

N.C.G.S. § 93A-6(a)(3) states:

- The Commission has the power to suspend, revoke, reprimand, or censure any licensee if they pursue a course of misrepresentation or making of false promises through agents, advertising or otherwise.

N.C.G.S. § 93A-6(a)(10) states:

- The Commission has the power to suspend, revoke, reprimand, or censure any licensee if they engage in conduct which constitutes improper, fraudulent, or dishonest dealing.

ANSWERS TO DISCUSSION QUESTIONS

For Discussion on page 27

1. Tom, a seller, has decided to list his property. Tom has noticed that the water heater has begun to leak. He completed the *Residential Property and Owners' Association Disclosure Statement and Mineral and Oil and Gas Rights Mandatory Disclosure Statement* before he listed the property. On the *Residential Property and Property Owners' Association Disclosure Statement* he marked "No Representation" on question 8, which stated, "Is there any problem, malfunction or defect with the dwellings, plumbing system (water heater)."

Does Tom have to disclose the leaking hot water heater to potential buyers?

Answer: *No. However, if a listing agent is involved, a listing agent would have to disclose the leaking water heater. Also, if the seller is licensed, he must disclose the leaking water heater.*

Has Tom complied with the Residential Property Disclosure Act?

Answer: *Yes.*

What if Tom has a real estate license?

Answer: *If Tom has a real estate license, he must comply with the law and answer all questions truthfully. Furthermore, he must disclose material facts.*

2. Bill, a broker, is inspecting a house during a listing presentation. He notices that there are several stains in the cabinet under the kitchen sink. Bill asks the owner if the sink leaks. The owner tells Bill that the sink leaks on occasion but not enough to really worry about. However, the owner also states that he has had the sink repaired multiple times in the past.

Bill lists the property. On the *Residential Property and Property Owners' Association Disclosure Statement*, the seller marks "No Representation" for all items. Bill does not include any information about the leak in the listing information.

Jeff, a broker from another firm, and his buyer-client, view the property. While viewing the house, the buyer's agent notices the stains under the kitchen cabinet and immediately closes the door. The buyer's agent does not point out the stain to his potential buyer, nor does he ask Bill about it.

Would this be an example of...?

Answer: *Omission*

Which broker is at fault?

Answer: *Both*

What are the responsibilities of the listing and buyer's agents?

Answer: *The listing agent's responsibilities are to disclose material facts and facts that they should have reasonably known to be material to all parties in the transaction. The buyer's agent has the responsibility to inquire about red flags and/or material facts that have been repaired but are likely to be an issue again on the property. Also, they must notify their buyer if a potential issue they observe could be viewed as a material fact.*

For Discussion on page 30

- D 1. Smoke-free home
- D 2. Pet-free home
- A 3. Electrical system is outdated
- E 4. Seller is behind on the mortgage
- C 5. Seller is in a foreclosure proceeding
- B 6. Zoning laws will affect the property in 2 months
- A 7. Roof has leaked in the past on two separate occasions
- D 8. No HOA governs the residential community

Note: Some “facts” may have more than one answer choice.

Case Outcome - Was that a fact? on pages 34-35

Errors identified during the Commission’s Investigation

- The broker advertised the square footage as 3,175 per county tax records
- The broker identified the property had two HVAC systems and identified the upstairs unit was 2 years old and the downstairs unit was 13 years old on the *Residential Property Owners’ Association Disclosure Form*
- The property inspection report identified the furnace was 13 years old

Law & Rule Violations identified during the Commission’s Investigation

- N.C.G.S. §93A-6(a)(1) - Making any willful or negligent misrepresentation or any willful or negligent omission of material fact
- N.C.G.S. §93A-6(a)(3) - Making false promises through agents, advertising, or otherwise
- N.C.G.S. §93A-6(a)(10) - Conduct which constitutes improper, fraudulent or dishonest dealing

Sanctions Imposed by the Commission

- Listing Broker - Suspension for a period of 3 months; Stayed if the broker submitted a course completion certificate evidencing satisfactory completion of the *Issues in Answers in NC Real Estate Practice Course* within 1 month.
- Firm - Reprimand; Dismissed if the broker submitted a course completion certificate evidencing satisfactory completion of the *Issues in Answers in NC Real Estate Practice Course* within 1 month.