

2008-2009 UPDATE COURSE

SECTION ONE

MATERIAL FACTS

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LEARNING OBJECTIVE: While this section theoretically should contain nothing new to licensees, its intent is to provide a mini “refresher” course on the definition of “material fact” and will include a summary of established law and policy as to what is and is not a material fact. While unlicensed persons may not have a duty to disclose, licensees must affirmatively disclose all material facts that they know or reasonably should have known.

Introduction

Licensees are required by statute to disclose *material facts to everyone in the transaction*, and may be subject to disciplinary action for either misrepresenting facts *or* omitting/failing to disclose a material fact. [G.S. 93A-6(a)(1).] Several hours of the real estate prelicensing education course are and have been devoted to the subject of material facts, but for many licensees, that was literally decades ago, and a few brokers still practice who were “grandfathered” in and were not required to have any fundamental education course. The Commission attempts to provide licensees with current information through articles written in the *Real Estate Bulletin* as to whether a particular issue or subject, such as synthetic stucco or polybutylene pipes, is a material fact, but it is rumored that many licensees do not look inside the *Bulletin*, reading instead only the last few pages. Recall, however, that ignorance of the law (or rules) is no defense. Not only can a licensee be disciplined for misrepresenting information or failing to disclose material facts, but more than sixty percent of claims settled by errors and omission insurance carriers pertain to negligence, misrepresentation, and omission/failure to disclose.

The following is an excerpt from Chapter 8 of the *North Carolina Real Estate Manual, 2008-2009 Edition*, published by the North Carolina Real Estate Commission, discussing the factors the Commission considers in determining whether certain information constitutes a “material fact.”

Understanding the Concept of “Material Fact”

One of the most difficult concepts for many real estate agents to grasp is that of “material fact.” The primary problem comes in trying to define the term; any definition necessarily will be somewhat vague because the concept is intended to have a broad application, thereby defying specific definition. This is complicated by the fact that a given fact may be considered “material” and require disclosure in one context, but not in another. In its broadest sense, a “material fact” may be said to be *any fact that is important or relevant to the issue at hand*. Because such a broad definition is not very helpful to real estate agents, the Real Estate Commission has provided some guidelines regarding what facts the Commission generally will consider to be “material” in most real estate transactions. These guidelines are discussed below.

Material Facts That Must Be Disclosed to Both PRINCIPALS And THIRD PERSONS

When applying North Carolina General Statute §93A-6(a)(1), the Commission will consider “material facts” in a real estate transaction to include at least the following types or categories of facts, regardless of whom an agent represents in the transaction. Note, however, that these guidelines are completely consistent with the requirements of agency law with regard to information that an agent must disclose to his or her principal. *No matter who an agent represents in a transaction, the types of facts described below are material facts that must be disclosed to **all parties** with whom the agent deals if the agent is aware of such facts or should reasonably be aware of such facts.*

- **Facts about the property itself.** Any significant property defect or abnormality. *Examples:* A structural defect, a malfunctioning system, a leaking roof, or a drainage or flooding problem.
- **Facts that relate directly to the property.** These are typically external factors that affect the use, desirability or value of a property. *Examples:* A pending zoning change, the existence of restrictive covenants, plans to widen an adjacent street, or plans to build a shopping center on an adjacent property.
- **Facts that relate directly to the ability of a principal to complete the transaction.** Any fact that might adversely affect the ability of a principal party to the transaction (seller or buyer) to consummate the transaction. *Examples:* A buyer's inability to qualify for a loan and to close on a home purchase without first selling his or her currently-owned home; a seller's inability to convey clear title due to the commencement of a foreclosure proceeding (posting of a notice of sale) against the seller. [Note, however, that the fact that a seller is behind in making mortgage payments is not a material fact until the foreclosure process has officially been started by posting a notice of foreclosure sale.]
- **Facts that are known to be of special importance to a party.** There are many facts relating in some way to a property which normally would not inherently be considered as “material,” but because they are known to be of special interest or importance to a party, they become a material fact that the agent must discover and disclose. *Example:* The fact that a residential property may not be used for a home business due to zoning or restrictive covenants normally would not be a material fact that an agent must specifically discover and disclose. However, if an agent working with a buyer knows that the buyer wants to operate a particular home business from his or her home, then the issue of whether the house being considered can be used for that purpose becomes a material fact which the agent must investigate and, if the proposed home business is found to be prohibited, the agent must disclose this fact to the buyer prior to the buyer making an offer on the house....

The materials in Chapter 8 of the *North Carolina Real Estate Manual* continue with a discussion of “material facts” which must be disclosed only to a licensee’s *principal*, but not to third parties. The definition of what constitutes a “material fact” is broader when it relates to an agent’s duties to his/her principal. The *Manual* explains:

...This is the case because under agency law *an agent is obligated to disclose to his or her principal any information that may affect the principal's rights and interests or influence the principal's decision in the transaction.* The Real Estate Commission adheres to this broader definition when applying the License Law to situations where a principal-agent relationship exists.

Types of material facts which must be disclosed only to a principal (but not third parties) include:

- 1) the other party’s (non-principal’s) willingness to agree to a price or terms other than those stated;
- 2) a third party’s motivation for engaging in the transaction; and
- 3) any other information which might affect the principal’s rights and interests or influence the principal’s decision in the transaction.

HOWEVER, the discussion in this Section will focus on the discovery and disclosure of material facts which must be communicated to *everyone* in a transaction and it will *not* delve into the additional duties and obligations arising from the broader definition applied to the principal-agent relationship.

An ancient *Bulletin* article entitled “Courts Rule on Issue of Misrepresentation” (Vol. 11, No. 2, Summer 1980) summarized several legal cases from around the country where brokers were held civilly liable for passing along information which turned out to be false. One case was a North Carolina case where a builder was adjudged liable to his purchaser for failing to disclose that the house had been built on “disturbed soil,” i.e., a hole filled with debris and then covered with clay. The Court held that: “Since this defect in the lot and the house ... was not apparent to plaintiffs (the purchasers) and not within the reach of their diligent attention and observation, defendant (builder) was under a duty to disclose this information to Plaintiffs.” In summarizing the thrust of all the cases discussed in the article, Commission staff wrote as follows:

...The principles, simply stated, are (1) that a real estate agent who intentionally or unintentionally gives a purchaser incorrect or incomplete information may be held liable for such statements even though the source of the incorrect information was the seller or another broker, and even though the purchaser could have verified the information himself; (2) that a seller and his agent have an affirmative duty to disclose to prospective purchasers any latent (hidden) defects connected with the property (for example, faulty septic tank, leaky basement, etc.) about which they are aware or should reasonable be aware; and (3) that although a real estate agent owes his primary loyalty to his principal (usually the seller), the agent must treat all parties in the transaction fairly.

Thus, agents may be liable for: • any statement or assertion that is not true and • failure to disclose when there is a duty to disclose.

Misrepresentation

A misrepresentation is *an assertion of alleged fact which ultimately is false*. A **negligent misrepresentation** is also called an unintentional misrepresentation, as it is one made without actual knowledge of its falsity. With a **willful** or intentional **misrepresentation**, the individual either has actual knowledge of the falsity or acts without regard to the truth or accuracy of the matter being stated.

Omission

While one might misrepresent a material fact, more often than not, the violation is **willful or negligent omission** of material fact, that is, *failure to disclose when there is a duty to disclose*. Understand as well that the duty of licensees to disclose arises under both the common law of agency, as well as under License Law, but neither of these binds principals nor individuals who do not have a real estate license.

Residential Property Disclosure Statement

As most licensees know, most sellers of residential property are required by statute to give the buyer a disclosure form, known as the *Residential Property Disclosure Statement*, (preferably *before* the buyer makes an offer) BUT the seller has the option of answering each inquiry “yes,” “no,” or “no representation.” Thus, while it is a mandatory disclosure form, it does not actually mandate any disclosure because of the “no representation” option. However if a seller chooses to answer the various items “yes” or “no,” s/he must do so honestly, as each person will be held accountable for the truth and accuracy of the statements or representations s/he makes to others.

Further, both sellers and licensees should understand that while a seller may not be compelled to disclose certain defects or issues about his/her property to others, the licensee *will* be required to disclose all *material facts* to all prospective buyers, regardless of how the seller chooses to respond. A frequent **example** is a listing where the seller completes the Residential Property Disclosure Statement with the assistance of the agent and the property is placed on the market. As a result of a home inspection done by a buyer under contract, seller learns that he has some electrical and structural issues with the house, but seller is not inclined to make any repairs. The parties agree to terminate the contract and the house is placed back on the market. If the seller originally answered any of the relevant questions “no,” then he must amend the Residential Property Disclosure Statement to avoid charges of misrepresentation and fraud, but he need not check “yes;” rather, the seller may check “no representation.” *The licensee, on the other hand, now has knowledge of material facts which s/he must affirmatively disclose to all prospective buyers, and should so advise his/her seller-client.*

The Residential Property Disclosure Statement has expanded from six questions when it was conceived in January 1996, to more than 20 questions at present. It was amended most recently in two respects as of January 1, 2008. (Reprinted at end of this Section 1.) The first

revision added a clause to #16 regarding the failure to obtain proper permits for additions or other structural changes, and the second added new Question #21 as to whether the streets adjoining the property are privately maintained. The most current form should be used in all pending and future transactions. {**Editor's Note:** the most current version of the Residential Property Disclosure Statement may be found on the Commission's website under "Forms." It has been amended several times since this Update Section appeared in July 2008.}

Failure to Provide Statement

The statement should be provided to a prospective buyer prior to the buyer making an offer. A seller or listing agent who fails to provide a completed statement to a buyer prior to an offer being extended, allows the buyer the possibility of rescinding any resulting contract within *either three days of contract formation or three days from receipt of the statement, whichever occurs first*. Listing agents have a duty to inform property owners of their rights and obligations regarding the completion and distribution of this mandatory form under the law.

Example: Buyer does not receive the Residential Property Disclosure Statement prior to making an offer and checks the appropriate box in Paragraph 15. Buyer makes an offer on the 4th day of the month and the parties spend a few days negotiating the terms of the agreement. The parties finally reach an agreement on the 9th, as of which date both parties have signed and dated the agreement and notice of acceptance has been communicated from the listing agent to the buyer agent. The listing agent faxes a copy of the Residential Property Disclosure Statement to the buyer agent on the 11th. *Buyer only has until the 12th to give written notice to the listing agent that he is rescinding the contract based solely on the failure to provide buyer with the disclosure statement prior to making an offer*, regardless of whether the disclosure statement reveals any defects.

If the buyer fails to give written notice of termination by the 12th, then he loses the right to withdraw/terminate based solely on the failure to provide the statement. If the seller does not provide the buyer with a copy of the statement until the 14th, the buyer has no right to terminate/withdraw from the contract based on the failure to provide the statement, as it has been more than three calendar days since contract formation. Remember – three calendar days from receiving the statement *or* contract formation, *whichever occurs first*.

Exempt Transactions

State law (NC General Statutes Chapter 47E) requires that *the Residential Property Disclosure Statement be given in all transfers of residential one-to-four unit dwellings by sale, exchange, installment land sales contract or option to purchase, subject to a few very narrow exceptions*. **G.S. 47E-2** states as follows:

The following transfers are exempt from the provisions of this Chapter:

(1) Transfers pursuant to court order, including transfers ordered by a court in administration of an estate, transfers pursuant to a writ of execution, transfers by

foreclosure sale, transfers by a trustee in bankruptcy, transfers by eminent domain, and transfers resulting from a decree for specific performance.

(2) Transfers to a beneficiary from the grantor or his successor in interest in a deed of trust, or to a mortgagee from the mortgagor or his successor in interest in a mortgage, if the indebtedness is in default; transfers by a trustee under a deed of trust or a mortgagee under a mortgage, if the indebtedness is in default; transfers by a trustee under a deed of trust or a mortgagee under a mortgage pursuant to a foreclosure sale, or transfers by a beneficiary under a deed of trust, who has acquired the real property at a sale conducted pursuant to a foreclosure sale under a deed of trust.

(3) Transfers by a fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship, or trust.

(4) Transfers from one or more co-owners solely to one or more other co-owners.

(5) Transfers made solely to a spouse or a person or persons in the lineal line of consanguinity of one or more transferors.

(6) Transfers between spouses resulting from a decree of divorce or a distribution pursuant to Chapter 50 of the General Statutes or comparable provision of another state.

(7) Transfers made by virtue of the record owner's failure to pay any federal, State, or local taxes.

(8) Transfers to or from the State or any political subdivision of the State.

(9) Transfers involving the first sale of a dwelling never inhabited.

(10) Lease with option to purchase contracts where the lessee occupies or intends to occupy the dwelling.

(11) Transfers between parties when both parties agree not to complete a residential property disclosure statement.

NOTE: the fact that the property is investment property and has not been owner-occupied does *not* excuse the owner from the obligation to provide the Residential Property Disclosure Statement to any interested prospective buyers. When in doubt as to whether the Statement must be given in any particular transaction, sellers either should seek legal advice or err on the side of providing the Statement, thereby eliminating the buyer's ability to cancel any resulting contract.

Licensee's Duty to Disclose Material Facts When Licensee is Party/Principal

When brokers are selling property in which they have an ownership interest, they too must provide the Residential Property Disclosure Statement to all prospective buyers, unless they fall into one of the foregoing exceptions; e.g., first sale of a dwelling never inhabited [47E-2(9)], or a transfer to the broker-owner's children [47E-2(5)], or a transfer to the broker's former spouse pursuant to the division of property upon divorce ("equitable distribution") [47E-2(6)]. While the broker-owner theoretically may check "no representation" as may any other property owner, *the broker still will be held to the higher standard of **always disclosing material facts** even when selling, leasing, buying or exchanging property as a principal/party, even in transactions which may be exempt from the statute.* (See G.S. 93A-6(b)(3) which states that a licensee may be subject to disciplinary action for violating any of the fifteen provisions set forth in 93A-6(a) "... when selling, leasing, or buying his or her own property.")

Licensees who check "no representation" on the Residential Property Disclosure Statement and then orally disclose any material facts pertaining to the property, leave themselves without any proof that they actually made the required disclosures. Thus, the more prudent practice would be to either disclose the material facts on the Statement itself, or provide the prospective buyer with a separate written statement disclosing required material facts and ask the buyer to sign acknowledging receipt of the separate disclosure statement. Licensees also should be aware that *they are expected and required to disclose all material facts affecting the property or the broker's ability to complete the transaction even if those matters are not mentioned in the Residential Property Disclosure Statement, or the transaction is one to which the Statement does not apply because it is exempt or is a lease transaction.*

Licensee's Duty to Discover and Disclose Material Facts

While *caveat emptor* (let the buyer beware) may be alive and well in North Carolina as to most property owners, *licensees, particularly those acting as agents of the property owner (i.e., listing agents or leasing agents/property managers), have an independent duty to discover and disclose material facts.* Listing agents, as agents of the property owners and the persons making the initial representations in advertising the property, including information submitted to cooperative listing services, bear the primary responsibility for assuring that their statements concerning the property are accurate. However, all licensees will be responsible for all representations/assertions they make, and will also be accountable for failure to disclose those matters which are deemed "material facts." A prudent listing agent will inform the property owner early in the relationship of his/her duties as a licensee and the obligation to disclose material facts to avoid problems later when the property owner wants his/her agent to keep something which otherwise is a material fact "secret."

It rarely is a successful defense for an agent of the property owner to argue that s/he merely relied on what his/her property owner told him/her. *A licensee who undertakes to make statements to the public about a property is expected to have personally visited and inspected the property and will be held accountable for his/her representations/statements regardless. A buyer/tenant agent may rely on the property owner agent's assertions where it is reasonable to do so, but is not absolved from discovery obligations where there are "red flags," i.e., factors*

which might indicate that a representation may not be true, warranting further investigation, or where there are issues of particular interest or importance to his/her buyer/tenant client.

Listing Agent's Duty to Discover and Disclose

In a *Real Estate Bulletin* article from more than two decades ago (which may be found on the Commission's website), the Commission cited a California appellate court decision as accurately reflecting the Commission's position regarding *negligent omission of material fact*. In *Easton v. Strassburger*, 152 C.A. 3d 90 (1984), the buyers of a single family home learned within months after closing that there had been two landslides on the property within the three years immediately preceding the sale, and that the sellers had taken corrective action to prevent further subsidence, but failed to disclose this either to their listing agent or to the buyers. The value of the property was virtually destroyed due to another landslide shortly after purchase. The buyers sued the sellers, the listing company and the listing agent. While the listing company and agent argued that they had no knowledge of the previous landslides nor the sellers' corrective actions, the jury nonetheless held them liable under a negligence theory. One of the instructions to the jury had been:

“A real estate broker is a licensed person or entity who holds himself out to the public as having particular skills and knowledge in the real estate field. He is under a duty to disclose facts materially affecting the value or desirability of the property that are known to him or *which through reasonable diligence should be known to him.*” (Italics added.)

The jury found that the listing agent had inspected the property several times during the listing period and that there was evidence that the agents “were aware of certain red flags” which should have indicated soil problems which they chose to ignore and failed to inquire or investigate further. In affirming the trial court's instructions to the jury as to an agent's duty to discover, the appellate court opined:

If a broker were required to disclose only known defects, but not also those that are reasonably discoverable, he would be shielded by his ignorance of that which he holds himself out to know. The rule thus narrowly construed would have results inimical to the policy upon which it is based. Such a construction would not only reward the unskilled broker for his incompetence, but might provide the unscrupulous broker the unilateral ability to protect himself at the expense of the inexperienced and unwary who rely upon him.

One question left unanswered by this case was what, if any, duty to discover did the *selling agent* have, as for whatever reason, the buyers had not named the selling agent as a defendant in the lawsuit. The conjecture was that if the “red flags” were reasonably obvious, at least to any broker, who did a careful walk-through of both the structure and the property itself, then the selling agent may well have had a duty at least to advise the buyers to hire a professional to investigate further before proceeding to close.

Similarly, a *Bulletin* article from 1992 cautioned licensees against accepting their property owners' assertion that there were hardwood floors throughout the structure under the wall-to-wall carpet. The article noted that licensees have a duty to confirm this information themselves by either looking under the carpet at the floor vents, or looking inside a closet which may not be fully carpeted, or prying underneath a carpet in a corner of each room. If for whatever reasons the licensee can not personally verify the accuracy of the statement, then s/he may wish to be cautious of the assertions s/he makes in his/her advertising. The general MLS disclaimer that the information presented is thought to be correct, but should be verified by buyer does not absolve the licensee of responsibility for his/her statements. The more accurate representation might be "Per seller - hardwoods under carpet."

Licensees who seek additional instruction and examples regarding their duty to discover and issues of misrepresentation and omission should consult Chapter 8 of the *North Carolina Real Estate Manual* as well as the License Law and Rule Comments found both in Appendix C of the *Manual* and in the Commission's publication *North Carolina Real Estate License Law and Commission Rules*, available for only \$3.00, either of which publications may be ordered from the Commission's website.

Selected Material Fact Issues

I. Facts about the Property Itself

Manufactured Homes versus Manufactured Buildings

Manufactured homes are frequently referred to as *mobile homes*. They typically are sold as personal property from the manufacturer and ownership is evidenced by a title issued by the Department of Motor Vehicles. They are built to federal standards only. If the mobile home is permanently affixed to real property and the hitch and wheels removed and an affidavit filed with the Department of Motor Vehicles certifying the foregoing, then the manufactured home is transmuted from personal property to real property.

Manufactured buildings on the other hand are frequently referred to as "*modular homes*." While they too are constructed off-site and must comply with certain federal standards, once transported to the lot, they must be assembled/built by a licensed general contractor in accordance with State and local building code standards, or by someone who has posted a \$5000 bond to assure Code compliance and who has obtained a building permit. Once properly installed on the property, a modular home becomes part of the real property.

Licensees are expected to know the difference between manufactured homes, manufactured buildings, and stick-built structures and to make the appropriate disclosures to the world at large. This includes not only prospective buyers, but lenders and appraisers, as well. All manufactured homes and buildings will have a serial number and label permanently affixed verifying compliance with the applicable federal or state codes. Licensees should look for this compliance label and serial number. The HUD tags may be found on the outside bottom left

corner of each section of a mobile home, as well as stamped into the metal underneath the kitchen sink cabinet or inside the frame of the master closet. On modular homes, the serial number may be found on or in the utility box.

Licenseses are *not required to have a separate motor vehicle license to sell a mobile home when it is "... incident to the sale of land upon which the mobile home is located ..."*, whether the mobile home is still personal property or whether it has become real property. [See G.S. 20-286(11)(b)(6).] However, it can make a *huge difference* in negotiating the contract to purchase as to whether the manufactured home is still personal property or has become real property. If it is considered real property, then the Offer may describe/reference just the real property which automatically will include the manufactured home. However, so long as it remains personal property, then its description should be included in the Personal Property paragraph of the standard Offer form, as it is *not* automatically included with a transfer of the real property.

If it is being conveyed as personal property, then its value should be separately identified, as some lenders may not include the value of the personal property in computing the eligible loan amount. (Note, however, that both the FHA and VA offer lenders loan insurance and loan guaranty programs for personal property home loans, although the vast majority of new manufactured (mobile) homes are placed on permanent foundations affixed to real property and are financed as real estate.) When in doubt, a licensee should include sufficient information in the personal property section of the standard Offer to describe the unit on the property. If it has become part of the real property, no harm done, but if it is still personal property, then the parties' intent to convey both the real property and mobile home for the total stated price is accurately reflected in the contract. Licensees may contact the Department of Motor Vehicles to see if the requisite Affidavit has been filed converting a mobile home from personal to real property, and might also check the tax records to determine whether the mobile home is still being taxed as personal property or is included in the tax value of the real estate on which it is situated.

Lastly, whenever licensees are aware that a buyer intends to move either a manufactured home or building onto the land s/he is purchasing, *the licensee **minimally** should recommend that the buyer seek legal advice as to whether such a structure is permitted under the applicable restrictive covenants and any zoning codes.*

Polybutylene Pipes

Is the mere presence of polybutylene piping in a structure a material fact? Polybutylene piping is made from a plastic resin and was commonly used for a couple of decades in lieu of copper piping for water supply. The plastic tubing connected at various junctures into joints or "fittings." These fittings were of two types, either "insert" or "non-insert." Complaints arose from consumers about leaky pipes, especially where pipes met an "insert" type fitting. Notwithstanding a Tennessee class action lawsuit which resulted in a fairly substantial settlement between the manufacturer and claimants, the Commission's study of this issue more than a decade ago revealed that:

- not all, or even most, polybutylene piping with insert fittings commonly fail;
- if a defect exists in the piping or fittings, it typically is not readily discernible; and
- no neighboring State has determined that the mere presence of polybutylene piping is a material fact.

Thus, for the foregoing reasons, the Commission concluded that *the mere presence of polybutylene piping in a structure is NOT a material fact*. **However, it becomes a material fact that must be disclosed when the licensee knows or should have known that there was a probable defect in the polybutylene piping.** A licensee might know because s/he inquires and the owner honestly reports any water issues, or because the licensee sees evidence of water damage on walls, ceilings or floors. A licensee may have reason to know or suspect a problem where s/he is aware that there is a history of pipe failure in the subject property or is aware that piping in some of the adjacent condos or town homes in the community have failed.

The Commission recommends that listing agents affirmatively inquire as to the type of piping in a property and whether there have been any problems with it in the past. If in a town home or condominium community, the agent should ask his/her owner whether s/he is aware of any problems with other units. If the answer to either is “yes,” then the agent should disclose this information to any prospective buyer and recommend that they have an inspection.

Square Footage

Licensees should understand that the Commission does not require them to report the square footage of a structure. However, *if a licensee chooses or is compelled to disclose for whatever reasons the square footage of a building, then any representation s/he makes must be accurate*. The Commission has long maintained that relying on tax records, or blueprints, or old appraisals or previous sales of the property is not appropriate. Relying on such unverified information may result in negligent misrepresentation. *A licensee is expected to personally measure the structure or hire someone, such as an appraiser or experienced broker upon whom the licensee may reasonably rely, to measure the structure utilizing either the Commission’s square footage guidelines or similar approved uniform standards.* A prudent listing agent will retain a copy of the diagram and square footage calculations in the transaction file.

The fact that some advertising mediums now allow licensees to express square footage as a range does not obviate the need to accurately determine the square footage. Typically, a selling agent may rely on the listing agent’s representations as to square footage, unless there is something which would cause an ordinary reasonable broker to suspect an error. Note that the general disclaimer appearing in some advertisements that “Information herein deemed reliable but not guaranteed.” does not insulate a broker from liability for his/her representations. Nor will the statement “To be verified” operate to shift responsibility for the accuracy of any representations made by the listing agent from the listing agent to a selling agent. (See also “Unpermitted Additions/Improvements” later in this Section 1 as to the reporting of square footage for improvements for which proper permits were not obtained.)

What degree of accuracy is required? The Commission's *Residential Square Footage Guidelines* state:

...While an agent is expected to use reasonable skill, care and diligence when calculating square footage, it should be noted that the Commission does not expect absolute perfection. Because all properties are unique and no guidelines can anticipate every possibility, minor discrepancies in deriving square footage are not considered by the Commission to constitute negligence on the part of the agent. Minor variations in tape readings and small differences in rounding off or conversion from inches to decimals, when multiplied over distances, will cause reasonable discrepancies between two competent measurements of the same dwelling. In addition to differences due to minor variations in measurement and calculation, discrepancies between measurements may also be attributable to reasonable differences in interpretation. For instance, two agents might reasonably differ about whether an addition to a dwelling is sufficiently finished under these *Guidelines* to be included within the measured living area. Differences which are based upon an agent's thoughtful judgment reasonably founded on these or other similar guidelines will not be considered by the Commission to constitute error on the agent's part. Deviations in calculated square footage of less than five percent will seldom be cause for concern.

However, a discussion of an agent's responsibility as to the accuracy of reported square footage which appeared in the 2001-2002 *Real Estate Update* course materials (Section 3), after quoting the above text from the *Guidelines*, further noted:

... it should be mentioned that *there is no fixed margin of acceptable deviation. Whether a particular discrepancy is considered problematic depends on the circumstances of the particular case, including the size of the dwelling and complexity of its design.* It is possible that a discrepancy greater than five percent might be acceptable for some dwellings, especially those that are quite large and also have unusual and complex design features. On the other hand, a discrepancy of more than five percent might be considered problematic for a very small house (e.g., one with 1,000 square feet) that has a simple rectangular box design with no features to complicate the measurement. ... [T]he Commission will apply a common sense "reasonableness" standard when considering complaints involving errors in reported square footage.

Exterior Siding Issues

Synthetic Stucco

For the past decade the Commission has held that *it is a material fact that a house is currently or was previously clad in synthetic stucco, particularly the synthetic stucco known as "exterior insulating and finishing system" or "EIFS,"* because the problems with this form of siding were so pervasive, at least in the southeastern United States with its moisture and

humidity. While the synthetic stucco looks attractive, the problem is that moisture can seep behind the styrofoam exterior and then not escape, soaking into the wall sheathing to which it is attached, rotting the wood and attracting termites, unbeknownst to the owner/occupant as the exterior still looks fine. After a couple of class action lawsuits, the manufacturer removed most of the EIFS from the market, although there are other synthetics out there which were designed to overcome the defects of EIFS. These include DEFS or EFS, i.e., Direct-applied Exterior Finish Systems, which use cement board panels, rather than styrofoam, and “drainable EIFS” which incorporates drainage channels behind the styrofoam to allow excess moisture to escape out the bottom of the panel.

The problems encountered with synthetic stuccoes do not arise with traditional stucco, which is made from concrete, water, sand, lime, and fibers and is porous. While it will absorb moisture, it also dries easily, releasing the water without any damage to the structure. Traditional stucco is heavier, denser and harder than synthetic stucco. ***Licensees must be able to distinguish between traditional stucco, which is not a material fact and need not be disclosed, and synthetic stucco, which generally is a material fact and must be disclosed.*** When dealing with synthetic stucco of any sort, a licensee should recommend that the purchaser have a qualified inspector inspect the property. Even where a seller has removed synthetic stucco and replaced it with other siding, the fact that the property previously was clad with synthetic stucco should still be disclosed and sellers may choose to make available to prospective purchasers documents pertaining to those repairs/renovations.

Hardboard

What about manufactured hardboard siding, such as Masonite or Wafer board? (“Wafer board” is layers of hardwood strands laid at right angles for strength and bonded together under high pressure.) The Commission considered whether hardboard siding (as opposed to fiber cement siding) should be considered a material fact and reviewed several class action lawsuits by consumers against manufacturers of hardboard siding. While the complaints were similar, i.e., moisture intrusion leading to cracking, warping and delamination of the pressed wood/fiber siding, it appeared that a major factor in these cases was the *method of installation*, rather than an inherent defect in the product itself. Properly installed, hardboard provided adequate protection from the elements. Improper installation led to water intrusion with resulting rot and structural damage which typically was not covered by the manufacturer’s warranty as it was not a manufacturing defect.

The Commission decided that, unlike synthetic stucco, the mere presence of hardboard siding was NOT in and of itself a material fact, nor should licensees be expected to distinguish between the various hardboard products on the market or which were the subject of lawsuits. However, licensees are still liable for their representations, and if they state that a property has a particular type of siding on it, they should be correct. When in doubt, the safer assertion is that the siding is hardboard, or aluminum, or vinyl, or fiber-cement, or other generic type of material, rather than attempt to more specifically identify the siding.

Pressure Treated Lumber

Some types of pressure-treated lumber were phased out of use for many residential purposes after December 2003 due to an agreement between the Environmental Protection Agency and the pressure-treated lumber industry. The concern emanated from the presence of chromated copper arsenate (CCA), an arsenic-based pesticide with which much of the wood was treated. This treated wood had multiple uses, such as decks, picnic tables, kids' play structures, gazebos, fences, boardwalks, etc. Studies had found that regular contact with CCA-treated lumber resulted in high arsenic exposure, particularly for children. Thus, even though the EPA did not conclude that CCA-treated wood posed "...any unreasonable risk to the public or the environment..." nor was there "any reason to remove or replace existing structures ...or to disturb surrounding soils," the EPA believed that "...any reduction in the levels of potential exposure to arsenic is desirable."

However, given the fact that the government did not find that CCA-treated wood posed any unreasonable risk to the public nor was there any need to replace existing structures, *the Commission declined to categorize CCA-treated wood as a material fact. Thus, disclosure is not required at this time.* Nonetheless, following the EPA's recommendations as to reducing potential exposure might be wise. These include:

- washing hands thoroughly after contact with treated wood, especially prior to eating or drinking;
- cleaning up all sawdust and debris after construction;
- regularly coat pressure-treated wood with an oil-based semi-transparent stain;
- do not burn treated wood and do not use it as mulch, especially in vegetable gardens;
- do not place food in direct contact with CCA-treated wood.

Radon Gas

Radon is a colorless, odorless, radioactive gas which occurs naturally from the decomposition of uranium and is found in varying amounts in virtually all soils. It poses little to no health risk when allowed to dissipate in open air, but it can present a significant health risk over time if it becomes trapped and accumulates in buildings. Clearly, *if a licensee knows that dangerous levels of radon are present in any structure which will be occupied regularly by people, then the licensee must disclose that to all prospective buyers or tenants.* The EPA's "acceptable standard" for radon is any level less than 4.0 pico curies per liter of air.

But how is a licensee to know? Because it is not readily observable, radon is viewed as a hidden or latent defect. A licensee is not expected to test all properties for radon. However, if a licensee has any reason to suspect that radon may be present in a hazardous level, s/he might first ask the property owner whether they have ever tested for radon. If not, the licensee might recommend to a buyer that the buyer have a radon test. *Red flags include knowledge that other*

buildings in the area have unusually high radon levels. Alternatively, the licensee might be made aware of unacceptable levels as a result of a test performed by a buyer who elects to terminate the contract based on radon levels which exceed whatever standard was set forth in the contract.

What if the seller had a radon problem in the past, but installed some radon reduction system to remediate the problem and bring the radon within acceptable EPA levels. Is the mere presence of the radon reduction system a material fact? Because it was installed to remedy an existing problem which could reoccur if the system failed to operate correctly, the presence of the system should be viewed as a material fact and disclosed to prospective purchasers. If one is purchasing property in an area with high radon levels, it might also behoove the buyer to have the water tested for radon as well.

A question which has been debated for the past decade or so is whether granite countertops pose a radon risk. A July 24, 2008 article in the New York Times acknowledged that "... health physicists and radiation experts agree that most granite countertops emit radiation and radon at extremely low levels. They say these emissions are insignificant compared with so-called background radiation that is constantly raining down from outer space or seeping up from the earth's crust, not to mention emanating from manmade sources like X-rays, luminous watches and smoke detectors." However, one might be cautious if using the "more exotic and striated varieties [of granite] from Brazil and Namibia" and have them tested first. While the EPA has seen an increase in the number of calls concerning high radiation levels from granite countertops, it has no plans to conduct any studies due to "lack of resources." The article quotes the director of the Center for Radiological Research at Columbia University as stating that the cancer risk from granite countertops is "on the order of one in a million," less than the likelihood of being struck by lightning.

Lead Paint Disclosures

The Residential Lead-Based Paint Hazard Reduction Act passed by Congress in 1992, also known as Title X, was intended to protect families from exposure to lead from paint, dust and soil. *The law requires **property owners and their agents** to disclose whether the owner or agent is aware of any lead based paint in the structure when selling or leasing most housing built prior to 1978.* Failure to disclose violates federal EPA and HUD regulations (24 CFR Part 35 and 40 CFR Part 745 respectively) and can result in fines up to \$11,000.00 *per violation*. The only pre-1978 housing which is exempt from the disclosure requirement include:

- housing for the elderly or disabled where no children under six years of age reside;
- zero-bedroom dwellings (e.g., efficiency or studio apartments);
- lead-based paint free housing, as determined by a certified lead inspector; and
- leases of less than 100 days with no renewals or extensions.

Not only must the applicable disclosure form be given, depending on whether it is a lease or sales transaction, but **the EPA booklet, *Protecting Your Family from Lead in Your Home* must also be provided.** The owner is to disclose: ■ any information about lead-based paint

hazards of which s/he is aware, ■ the basis for that determination, ■ the location of the hazards, and ■ the condition of painted surfaces.

Additionally, the *owner is to provide the buyer or tenant with copies of any lead-based paint or hazard evaluation reports*. Disclosure must occur prior to a tenant or buyer becoming obligated under any contract and in a lease situation, prior to the payment of any substantial non-refundable deposit. A seller must allow a buyer a 10 day period to conduct inspections or risk assessments for lead-based paint or hazards; however, the parties may agree in writing to lengthen or shorten this period or it may be waived entirely by the buyer.

An agent has an affirmative obligation to ensure that the owner discloses all necessary information or must personally comply with the disclosure requirements to avoid sanctions. An owner's agent will be as liable for compliance with the disclosure regulations as the owner and may be fined or incarcerated. Further, **note** that when a buyer agent is compensated by the listing agent, the buyer agent also is liable for ensuring that the mandated disclosures and brochures have been given. (Where the buyer agent is paid by the buyer, the obligation does not arise under federal regulations.) Federal regulations require the owner and agent to retain the disclosure document signed by all parties for three years. This period will be even longer for property managers, as licensees' three year record retention period does not start until the conclusion of the transaction, which would not be until either that tenant vacates or the owner terminates the management agreement.

Penalties for failure to comply include:

- fines up to \$11,000.00 per violation;
- criminal penalties for particularly egregious violators; and
- civil liability to tenants/buyers *up to three times the amount of their actual damages*, plus attorney fees, court costs, etc.

Again, these sanctions can be imposed against agents, as well as the property owners. Licensees who want more information on this topic are encouraged to consult the resources available at HUD's website, www.hud.gov/offices/lead/enforcement/disclosure.cfm. These resources include the mandatory pamphlet, *Protecting Your Family*, in Spanish, Russian, Arabic, Somali and Vietnamese, sample disclosure forms, the rule itself as well as guidelines interpreting the rule. One can also research current enforcement actions being pursued by HUD and/or the EPA.

“Meth” Houses

Another topic which has garnered much press in the past few years are properties in which the occupants manufactured methamphetamine, a highly addictive controlled substance. It is estimated that concocting just one pound of methamphetamine can generate five to seven pounds of hazardous waste, including hydrogen chloride gases, which gases, fumes and chemicals can seep into the walls, air vents, filters, carpets, draperies, appliances and other household components. The waste byproducts could have been dumped on or around the property, contaminating the soil, septic system and ground water. According to a May 2005 *Real*

Estate Bulletin article, there were only 9 meth lab “busts” in North Carolina in 2000, which had increased to 177 in 2003, 322 in 2004, and 121 in the first 3.5 months of 2005.

Once law enforcement eliminates the illegal activity, the Health Department is notified which in turn notifies the property owner that remedial action is required. The Department of Health and Human Services has established decontamination standards in hopes of assuring that properties previously used to manufacture meth are reasonably safe for human habitation. The rules require a “responsible party,” i.e., an owner, lessee, operator or other person in control of a residence or place of business previously used to manufacture methamphetamine, to:

- 1) assess the level of contamination and scope of necessary remediation *before* beginning to decontaminate;
- 2) decontaminate the property; and
- 3) document both the pre-decontamination assessment as well as the remediation.

The foregoing documentation must be retained by the local health department for three years.

What are a licensee’s responsibilities? It could well be that brokers acting as property managers or listing agents for absent owners or other licensees might be viewed as “persons in control of a residence or place of business” under the rules which require responsible parties to remediate, although the law does not specifically address this issue. ***Due to potential lingering health consequences inherent in a property formerly used to manufacture methamphetamine, a broker must disclose the fact that the property was a meth lab if the broker knows or should have known, unless remediation has been completed and can be properly documented.*** Whether a broker “should have known” will be determined on a case by case basis.

The Commission has not said that a broker must check with the local health department, local law enforcement or the SBI every time the broker takes a listing or agrees to manage a property. However, if a broker has reason to suspect that a property was used for the illegal manufacture of drugs, s/he should minimally contact the local law enforcement agency or health department to see if they have any records or information. In time it will be easier to check whether a property was used for the illegal manufacture of drugs due to a new website maintained by the Department of Justice. One may go to www.usdoj.gov/dea/seizures/ and **click on any given state to find property addresses of “...locations where law enforcement agencies reported they found chemicals or other items that indicated the presence of either clandestine drug laboratories or dumpsites.”** The website cautions that the listed information was not gathered by the Department of Justice, and that persons should contact their local health department or law enforcement agency to confirm information on any given address. The site also provides an email address where one may send notice if a property has been incorrectly listed.

II. Matters Affecting the Property

Subdivision Streets

Over the years the Commission has received numerous complaints from consumers alleging that brokers failed to accurately explain or disclose to them who is responsible for maintaining the streets which abut their properties. The subject is governed in part by G.S. 136-102.6 titled “Compliance of subdivision streets with minimum standards of the Board of Transportation required of developers.” The statute applies to any tract or parcel of land which is subdivided into two or more lots for residential purposes where the subdivision will include a new street or the changing of any existing street and requires the developer to record a map or plat of the subdivision with the Register of Deeds in the county where the land is located prior to conveying any portion of the land.

The statute requires delineation on the map or plat as to whether the new or changed streets will be public or private, and if designated as public, “...shall be conclusively presumed to be an *offer* of dedication to the public of such street.” If designated as public, then the street must be constructed in accordance with Department of Transportation standards. The proposed map or plat can not be recorded by the Register of Deeds until it is approved by a Review Officer. As to streets designated as “public,” the Review Officer merely confirms that such streets were constructed in accordance with the minimum standards of the Board of Transportation. However, the statute expressly states that “...The certificate of approval shall not be deemed an acceptance of the dedication of the streets on the subdivision plat or map.” ***The offer of dedication to public use by the developer remains just that – an offer – and does NOT impose responsibility for maintenance of that street by the State (or municipality) until it formally accepts the offer of public dedication.***

The statute, **G.S. 136-102.6(f)** further states:

Prior to entering any agreement or any conveyance with any prospective buyer, the developer and seller shall prepare and sign, and the buyer of the subject real estate shall receive and sign an acknowledgment of receipt of a separate instrument known as the subdivision street disclosure statement ... [which statement] ...shall fully and completely disclose the status (whether public or private) of the street upon which the house or lot fronts.

If the street is designated as a public street, then the developer and seller must certify that its design has been approved by the Division of Highways and that it has been or will be constructed in accordance with Department of Transportation standards for acceptance on the highway system, but *this does not mean that the State or municipality has agreed to accept maintenance responsibilities for the street.* If the developer and seller indicate in the subdivision street disclosure statement that the streets are private, then they also must include “...in the disclosure statement an explanation of the consequences and responsibility as to maintenance of a private street, and shall fully and accurately disclose the party or parties upon whom responsibility for construction and maintenance of such street or streets shall rest” and must

further disclose that the street may not be constructed to minimum standards sufficient to allow the State to assume maintenance responsibilities.

It appears to be a common misconception among many that once a street is dedicated to public use, that future maintenance is automatically accepted by the city or state. ***This is not true.*** In the 1992 case of *Bumgarner v. Reneau*, 105 N.C. App 362, at 366-367, the Court of Appeals noted:

...A dedication of a road to the general public is a revocable offer until it is accepted on the part of the public in “some recognized legal manner” and by a proper public authority. (Cites omitted.) A “proper public authority” is a governing body having jurisdiction over the location of the dedicated property, such as a municipality, an incorporated town, a county, or any public body having the power to exercise eminent domain over the dedicated property. (Cites omitted.) Acceptance in “some recognized legal manner” includes both express and implied acceptance.... Express acceptance may take the form of, *inter alia*, a formal ratification, resolution, or order by proper officials, the adoption of an ordinance, a town council’s vote of approval, or the signing of a written instrument by proper authorities. Acceptance of an offer of dedication is implied in North Carolina when the dedicated property is used by the general public *coupled with* control of the road by public authorities for a period of twenty years or more.

Bottom line is: ***the issue of who bears responsibility for maintaining roads which provide ingress and egress to a property is a material fact.*** Just because a developer or seller expresses the intent to dedicate the streets to public use does *not* mean that maintenance of that street has been accepted by a governmental entity, and until such time as the state or municipality accepts the dedication to public use, who is responsible for repair and maintenance?? The issue should be addressed in either the protective covenants or owners’ association rules, but it may be totally overlooked. Where streets are designated as private, then responsibility for maintenance should be specified in the subdivision street disclosure statement required by G.S. 136-102.6.

Licensees should at least ask the owner who is responsible for maintaining the streets which provide access to any given property and to disclose that information to both prospective purchasers and to lenders, particularly where there is no governmental maintenance responsibility. If there are aspects of the road conditions or property location which might lead a reasonable agent to suspect lack of public maintenance, then an agent’s duty to investigate road maintenance obligations, or at least to caution others to do so, is increased. The duty to discover and disclose where there are “red flags” applies to both listing and selling agents. Do not assume that public dedication equates to governmental acceptance of maintenance and repair responsibilities. Where streets are designated as private, there should be some corollary agreement for maintenance by someone, whether the original developer or the adjacent property owners or an owners’ association as a whole. Where there is no express agreement, the affected

property owners will not be happy when ten years down the road they learn that the issue of who must pay to repair the potholes and otherwise maintain the roads is still an open question.

Zoning Issues

Permitted uses of any given property may be impacted both by governmental zoning ordinances and by any restrictive or protective covenants which are attached to and “run with” the property. While licensees generally are not expected to routinely obtain and provide copies of the applicable restrictive covenants from the Register of Deeds office, licensees *should* be aware of and disclose the existence of governmental zoning ordinances which might restrict the permitted uses of the property in many circumstances. Examples include:

- A listing agent who is marketing property in an historic district should clearly disclose that the property is in an historic overlay district, as generally there are limitations or regulations concerning exterior modifications, outbuildings, fences, and demolition or renovation of structures on the property.
- A broker working with a buyer, whether as a seller’s (sub)agent or as a buyer agent, who learns that the buyer wants to operate a small business out of their home *at a minimum* should advise the buyer that such a use may not be permitted in that residential neighborhood and recommend that the buyer first check the local zoning ordinances.
- A broker working with buyers, whether as customers or clients, learns that the buyers wish to purchase property as an investment while their child attends college in that area and that their intent is to rent it to their child and other college students. The broker should realize that there may be local ordinances which limit the number of unrelated persons who may live in the property and should alert the buyers to this fact. If the broker knows what the limit is, s/he should tell the buyers. If not, then at the least the broker should recommend that the buyers investigate and find out if there is such a limitation.

Brokers should also be aware of the character of surrounding properties. For example, a broker undertakes to list a nice oceanfront two family unit in a residential neighborhood. The house was built in 1995 and was a single-family home on pilings and is thirty feet behind the first stable vegetation on the beach. The owners tell the broker that in 1997, they enclosed the area underneath the original house and installed a bedroom, living room, bathroom and kitchen and have been renting it for the past several years, with the rental income defraying the mortgage payments. The owners complete the Residential Property Disclosure Statement, answering all questions with “no representation.”

If the broker lists this property without further investigation, s/he may be in for a rude awakening later and may be opening the door to a complaint for omission of material facts. First, is a two family unit a permitted use under the applicable zoning code in what otherwise appears to be a single-family neighborhood? Did the owners obtain all the necessary permits and certificates of occupancy when they renovated the previously open lower level into another

living unit? (Probably not.) Does the property comply with FEMA and CAMA rules and regulations? Again, probably not. FEMA rules and local flood plain ordinances usually prohibit enclosing ground-level space under buildings in the highest risk zone unless the enclosure is for storage, parking or access only. Space enclosed in violation of applicable flood hazard laws is uninsurable.

Licensees are expected to be generally familiar with regulatory requirements which govern homes and other properties in their respective markets. In some areas, such as the beach, there may be federal or state regulations in addition to typical zoning ordinances. Licensees should be cognizant of the questions to ask and where to go to find answers, such as the local city or county inspection office which typically issues building permits and enforces the local zoning ordinances.

Flood plains can occur all over the State, even in areas where it would not seem intuitive. Licensees can easily check the status of almost any property to learn whether it is in a designated flood plain (which would assist in completing Paragraph 6 in the standard Offer to Purchase form) by going either to www.fema.gov or www.NCFloodmaps.com. *If the property is in a designated flood plain, then that material fact must be disclosed to all prospective buyers as well as all lenders.* If there is a pending proposal to reclassify the property as being in a flood zone, that too should be disclosed, as well as any remaining time within which to file objections or otherwise dispute the proposed reclassification. In some instances, property owners have successfully challenged proposed reclassifications which would have placed the property in a flood zone. Licensees also should be aware of local Stormwater Infrastructure Management areas (SWIM zones) which may impose limitations on what improvements or landscaping may be installed within the zone.

Permitting Regulations

In addition to the local building inspector who issues building permits and certificates and enforces local zoning ordinances, local Health Departments may be charged with the responsibility of administering other state or local regulations affecting public health and sanitation. The most common example is a property which is not connected to a municipal or community water or sewage system and thus must have an onsite septic system.

Onsite Septic Systems

State law requires that every residence and place of public assembly have an approved system for sewage disposal. Approved systems include municipal systems, community systems and onsite systems. Some properties which are not connected to municipal or community systems may not support an onsite system, which significantly curtails the use of that property. Onsite systems vary greatly in form and price, from the conventional subsurface system with tank and drainage field to the more complicated low-pressure pipe system. These systems are regulated by local Health Departments. Systems which discharge above the ground, such as spray-irrigation systems, or systems which discharge into streams or waterways are regulated by the North Carolina Department of Environment and Natural Resources. Off-site and community systems which serve more than one lot also are regulated at the state level.

Prior to consummating the purchase of vacant land, the prudent buyer will request a soil suitability test (previously known as a “perc test”), if the seller has not done so already or will not provide the results from the evaluation. A buyer’s agent should advise his/her buyer-client to have such a test performed. One need only file an application with the local Health Department explaining the proposed use of the property and a Registered Sanitarian from the Health Department will inspect the lot/tract, gather soil samples from different places on the parcel and rate the samples as either “suitable,” “provisionally suitable,” or “unsuitable” for an underground septic system. “Provisionally suitable” means that the location may be suitable if certain conditions are fulfilled.

If the sanitarian finds that there are sufficient suitable or provisionally suitable soils for an onsite system, *and* that there is enough land for a “repair area,” which must remain vacant and undisturbed in case the system malfunctions, then the Health Department will issue an improvements permit. Once issued, the permit is valid for a specified period of time, even if the standards later change, so long as the property features or its proposed use has not changed. The period of time during which the permit is valid varies from county to county. The permit will set a capacity limit for the system, typically specifying the number of bedrooms for a residence (with presumed occupancy of two per bedroom), or the maximum number of rooms or some other measure for a nonresidential structure. The permit may prohibit the use of an automatic dishwasher, or garbage disposal or other use which might overload the system. The permit also may include a map depicting the best location for the system and repair area. If the property’s water source is a well, then no component of the septic system may be within 100 feet of any well serving either the subject property or adjoining properties. **Health Departments keep public records of soil evaluations, improvement permits and certificates of completion issued.**

A seller should consider having a soil suitability test prior to listing vacant land. If the tract is suitable, marketability of the property may be enhanced by applying for and obtaining a permit, as the permit is valid for a specified period and it resolves the question before it becomes an issue. If the seller learns that the tract is not suitable for any onsite system, then the broker will be compelled to disclose that material fact to all prospective purchasers. It may also influence the seller’s decision as to whether s/he wishes to sell now, or just wait until perhaps community or municipal service becomes available. *Again, licensees will be responsible for all assertions/ representations they make and should verify what type of system, if any, serves the property before making any statements pertaining thereto.*

“Straight-piping”

Lastly, be aware that in some parts of North Carolina there are properties which still discharge their wastewater via straight-piping, which is illegal. State law requires “...any person owning or controlling a residence, place of business or place of public assembly ... shall discharge all wastewater directly to an approved wastewater system for that specific use.” Wastewater includes “grey water,” which is water used for dishes, laundry and bathing, and “black water” which is sewage. Straight-piping is where wastewater is discharged directly into the yard or into a nearby creek or stream, rather than into any approved treatment system. As

recently as 1999, it was estimated that 200,000 households in North Carolina were straight-piping their wastewater at a conservative estimate of two million gallons per day. *The existence of straight-piping is a material fact and must be disclosed by licensees to everyone, owner, buyers, tenants, and lenders, if the licensee knows or reasonably should know about it.* At one point, the Department of Environment and Natural Resources ran the Wastewater Discharge Elimination (WaDE) Program which provided financial assistance to low-income households and conducted door-to-door surveys to detect straight-pipes.

III. Matters Affecting a Party's Ability to Perform

Foreclosure

Generally, an agent's fiduciary duties of loyalty and obedience to his/her principal prohibit the agent from divulging personal information about his/her principal to any other person that is not a material fact. However, the duty to safeguard a principal's personal information evaporates if the broker learns that the principal will not be able to perform his/her obligations under the contract. Thus, *while it is **not** a material fact that an owner is one or two months behind on his/her mortgage and a listing agent is **not** at liberty to disclose his seller's financial straits to any third party, once the foreclosure action actually is commenced, typically by the filing of a Notice of Hearing with the Clerk of Court, the foreclosure proceeding becomes a material fact which must be disclosed to all prospective purchasers.*

The foreclosure is a material fact about the property itself AND casts significant doubt on the seller's ability to fulfill his contractual obligation to convey the property to the buyer. Once commenced, the foreclosure proceeding becomes an objection to marketable title which, if not removed, will prevent the seller from keeping his/her basic contractual promise to convey insurable and marketable title to the buyer. A foreclosure action is an expedited process to enforce a lender's rights under a deed of trust. Its purpose is to extinguish the seller's interest in a property and to sell the property to produce cash to pay off the secured debt, i.e., the loan. While the seller might be able to redeem the property if s/he has sufficient equity, the risk that the property may be sold out from under the buyer is too great and fairness dictates that the buyer be told.

As an aside, licensees should be aware that the Attorney General's Office and the Commissioner of Banks have established a hotline for consumers facing foreclosure. *Consumers may call the HOPE Hotline toll-free at 888-995-HOPE 24 hours a day, 7 days a week for free counseling on options to avoid foreclosure.* The hotline will connect callers with non-profit housing and credit counselors in their local community who can advise the homeowner about various options such as modifying their loan, selling or refinancing their home, or arranging a repayment plan with the lender to satisfy over time any arrearage.

"Short Sales"

A related phenomenon in the current market is what some call "short sales." In this situation, the seller knows before even listing his property that for various reasons, often market

factors, s/he can not sell the property for an amount equal to or exceeding that which s/he owes on the property. Because the sales price for the property, even at top dollar, will not satisfy the outstanding indebtedness secured by the property, the seller will not be able to convey marketable and insurable title as required by the contract without the consent of the lienholder, unless the seller has other resources from which to pay the remaining balance due on the loan. Again, because this relates directly to the principal's ability to perform, a prospective buyer is entitled to know up front in cases where the lender's consent *will* be required to convey title and that it may take several weeks, if not months, to obtain that consent, and can the buyer really wait that long? Generally, to be eligible for short sale consideration, the loan must be in default or default must be imminent due to some financial hardship the seller has experienced.

Failure to Qualify for Loan

If a selling agent learns that the buyer, after diligent, good faith attempts, can not obtain a loan on the terms stated in the contract and is unwilling to commit to a loan at a higher rate, then again, *the buyer's inability to obtain the requisite financing which would enable him/her to perform his/her contractual obligations becomes a material fact which must be disclosed to the listing agent and seller.* The selling agent may not remain silent and just wait until the scheduled closing to notify the seller. The parties should be strongly encouraged to enter into an agreement terminating their contract (whether with or without release of earnest money deposit)so the seller may proceed to relist the property without further delay.

Basically, any issue which will prevent a party from fulfilling his/her contractual obligations and which can not be remedied becomes a material fact that brokers must disclose to all other parties.

Miscellaneous Matters

Death or Serious Illness

Is the fact that someone died in the property a material fact? Does it matter if it was natural causes or suicide or murder? While many individuals might like to know this information, the General Assembly enacted legislation in 1989 stating that the death or serious illness of a former occupant is not a material fact and thus need not be disclosed. The two relevant statutes are G.S. 39-50 (for sales of property) and G.S. 42-14.2 (for leases of property). The two statutes are virtually identical and read:

In offering real property for [sale][rent or lease] it shall not be deemed a material fact that the real property was occupied previously by a person who died or had a serious illness while occupying the property...; provided, however, that no [seller] [landlord or lessor] may knowingly make a false statement regarding any such fact.

Thus, the statute excuses owners, sellers, lessors, and brokers from affirmatively disclosing that a previous occupant died or had a serious illness. Nonetheless, listing agents may wish to discuss this issue with their sellers.

Note that additional laws apply to situations where a current or previous occupant of a property suffers from **Acquired Immune Deficiency Syndrome (AIDS) or Human Immunodeficiency Virus (HIV)**. Under **federal and state fair housing laws**, a person with AIDS/HIV is considered to be legally handicapped and is protected from discrimination in housing transactions. *Consequently, if a real estate agent is asked by a prospective purchaser (or tenant) whether a current or previous occupant of property has/had AIDS/HIV, it should be treated as an impermissible question.* The broker might respond that it is a violation of fair housing laws for the agent to answer the question.

Presence of Registered Sex Offenders

If a broker is aware that there is a registered sex offender in the neighborhood, must s/he disclose that as a material fact? Again, the same statute which absolves owners, and by extension their agents, from disclosing death or illness of a former occupant, was amended in 1998 to state:

“...it shall *not* be deemed a material fact...that a person convicted of any crime for which registration is required by Article 27A of Chapter 14 of the General Statutes [statutes establishing North Carolina’s registration programs for sex offenders and sexually violent predators] occupies, occupied, or resides near the property; provided, however, that no [seller] [landlord or lessor] may knowingly make a false statement regarding such fact.”

Since the statute states this information is not a material fact, *an agent involved in a real estate transaction is **not required** to volunteer to a prospective buyer or tenant information that a registered sex offender occupies, has occupied, or resides near a property being offered for sale or rent.* If asked about sex offenders in a neighborhood, an agent may decline to answer, but if s/he chooses to answer, s/he must answer truthfully to the best of his or her knowledge. An agent may also respond that registration is a matter of public record which the individual can check him or herself and may provide a prospective buyer/tenant with information on how to access the county sheriff’s registry or the statewide registry via the internet at <http://sbi.jus.state.nc.us/sor>.

Gravesites on the Property

*Since owners and brokers need not disclose that someone died or was seriously ill, must a broker disclose that someone is buried on the property? Yes. **Gravesites located on the property are considered a material fact**, in part because of other statutes which may allow the decedent’s relatives to have access to the property for purposes of periodically paying their respects to the decedent. In one case, a broker who was listing a 30+ acre farm and homestead for a widow learned that her dear departed husband was buried a few hundred yards off to the side of the house, complete with headstone. The broker and widow had discussed the widow’s intentions as to her husband’s grave, and the widow had agreed that she would take his remains with her when she moved.*

The buyers became aware of the husband's grave only after the property went under contract and, upon learning that the widow had decided *not* to take her husband's remains with her, they wanted to terminate the contract. She agreed to release the buyers from the contract, but promptly went out and removed the headstone and planted grass to help hide the grave. Despite her attempts to conceal the grave, the broker was still compelled to disclose its presence on the property, as it had become a material fact once he knew the widow intended to leave the grave on the property.

Lack of Homeowner's Insurance

Is it a material fact that the current owner does not have a homeowner's hazard insurance policy? It may depend on *why* there is no insurance. Where the *property is insurable*, but the owner chooses for whatever reason not to have insurance, then *the absence of insurance is not a material fact*, so long as the seller can convey the property at closing in substantially the same condition as at the time the offer was made. If, however, the *property is uninsurable or is insurable only at exceptionally high rates, then yes, that is a material fact* which must be affirmatively disclosed to all prospective purchasers.

Buyers concerned about insurability might wish to utilize an addendum giving them the right to terminate the contract if they cannot obtain hazard insurance for the property at or below some stated standard. See, for example, the North Carolina Association of REALTORS standard form 370-T, "Insurance Availability/Affordability Addendum," which states the type of basic policy the buyer must be able to acquire at a cost within 150% of the "base rate" for that insurance according to the NC Department of Insurance records. The ultimate decision concerning insurability is made by the insurance company which is willing to issue a policy, and consumers may find a significant range in both coverage and premiums offered by different insurance companies for a property.

Unpermitted Additions/Improvements

Several issues have surfaced in the last few years over additions or improvements to properties made by the owners who failed to obtain the necessary permits, inspections or certificates. The square footage of unpermitted additions or improvements must be separately identified when making representations concerning square footage and brokers must inform prospective purchasers that there is no permit for the addition. This raises the possibility that a new owner might be required to remove the addition or incur some expense to obtain a permit or certificate after the fact. Further, homeowner's insurance may not cover damage to the property if the cause originated in the unpermitted, uninspected addition or improvement. Commission staff has previously noted in a Spring 2006 article on this subject:

... Improvements made in violation of the building code can, and usually are, ordered to be removed or brought into code compliance at the expense of the property owner. The cost of either remedy is generally substantial. This is a matter of general law which every citizen should be aware, just like the penalties for shoplifting or drunk driving, and of which a licensed professional real estate agent could hardly claim ignorance. *Representing the heated living area in a*

manner that misleads a prospective purchaser into believing that he or she is acquiring the lawful use and ownership of this space when that is not what is transpiring, constitutes several different violations of the License Law.

A listing agent undertaking to offer such a property for sale, where the owner has refused to remedy the situation before placing the property on the market, will have to fully disclose the existence of the “unpermitted” area separately from the lawfully permitted area and must do so in a manner that clearly informs any prospective purchaser that the seller expects the purchaser to bear all costs of bringing the property into compliance with the building code.

(Italics added.)

In other words, if a structure intended for human occupancy otherwise satisfies the definition of “living area” as set forth in the Commission’s *Guidelines*, i.e., heated, finished, and directly accessible from other living area, and measures 3475 square feet, but 850 of that square footage is found in an addition for which no permit was obtained, the licensee may indicate the full 3475 square feet in any advertising or multiple service listing *so long as* the broker also *clearly states* that 850 square feet of the total is in an addition or improvement for which the proper permits were not obtained.

One should also note that if a seller answers “Yes” to Question 13 on the Residential Property Disclosure Statement, i.e., “room additions or other structural changes,” but knows that the proper permits were not obtained or the addition was not constructed in compliance with building codes, then the seller must also answer “Yes” to Question 16, as to answer “No” would be a false statement for which the seller could be liable. As with all material facts, the broker must disclose the lack of proper permitting even if the seller answers “no representation” to the aforementioned questions.

Partial Destruction of a Property

The Residential Property Disclosure Statement attempts to elicit information concerning problems or defects or issues which currently exist or affect a property. To what extent must a broker disclose relatively recent repairs or corrective action taken to fix a problem? Again, it depends on the nature of the problem, its extent, and whether the repair totally solved the problem. Where the broker is reasonably certain that the repair was successful and cured the problem, then it may not need to be disclosed, such as a leaky faucet which has been fixed, or the purchase of a new water heater to replace the old one, etc.

A tougher question is presented when a property has been partially destroyed by flood, fire, tornado or other similar natural disaster and then rebuilt or repaired. If the renovations exceeded \$30,000 in cost, then the work should have been done by a licensed general contractor who should have secured all the necessary permits and certificates. If it was not, then was a proper person employed to make the repairs and were all necessary permits obtained? Other questions include:

- Did the repairs totally fix the problem, or might there still be lingering issues of smoke, or moisture, or mold?
- Might there be hidden or latent defects which still lurk?
- Was there a malfunction in some wiring or piping or other system which might reoccur?
- How long ago were the repairs – within the past eighteen months or five years ago with no further problems?

When in doubt, a broker should err on the side of disclosure and should encourage his/her seller to make available to prospective purchasers information as to who did the repairs and the nature and extent of the repairs. Providing this information may be sufficient to satisfy a buyer and eliminate the issue. If not, the buyer nonetheless is on notice and may undertake whatever investigations or inspections s/he desires. *The whole point of disclosing is to put others on notice so they may investigate if they want, but they cannot investigate matters of which they are not aware, particularly latent, rather than patent, issues.*

Conclusion

It should be clear by now that almost any issue impacting or affecting property may be a material fact which licensees are expected both to discover and to disclose to third parties. The list is potentially endless. If there is a problem with any of the systems or components listed on the Residential Property Disclosure Statement, then a licensee should disclose those problems or defects to prospective purchasers, even though the owner may have elected to check “no representation” in response to all queries. For example, if there are underground storage tanks, their presence should be revealed.

Licensees hold themselves out to the public as having specialized knowledge and skills in matters pertaining to the lease, sale, purchase and exchange of real estate beyond that possessed by most consumers, which is why they attempt to persuade consumers to hire the agent to guide them through the transaction. As such, licensees may not turn a blind eye to problems, nor may they merely rely on what the property owner tells them about the property. Rather, they have an affirmative duty to inspect the property, to be alert to potential problems, to ask questions, and to otherwise discover and disclose matters concerning the property itself, matters impacting or affecting the property or a principal’s ability to perform his/her contractual obligations, or other matters known to be of special importance to a party. *Not only will brokers be held responsible for all statements they utter, they also will be liable for willful or negligent omission of material facts, that is, the failure to affirmatively disclose when there is a duty to disclose.* Misrepresentations and omissions of material fact may result not only in a civil lawsuit, but in a disciplinary proceeding as well. When that little voice is asking “should I disclose this?” the answer generally is yes.