



A seller's agent and the prospective buyer

After reading this chapter, you will be able to:

- distinguish an agent's specific agency duty owed to their client from the limited general duty they owe to others in a transaction;
- conduct a due diligence investigation to observe property conditions adversely affecting value for disclosure to prospective buyers;
- protect your seller by ensuring all readily known material facts on the listed property are disclosed to prospective buyers before the seller enters into a purchase agreement; and
- understand the need to qualify your representations in a transaction when they are opinions and not based on the results of an investigation into the facts.

fiduciary duty

general duty

material fact

preliminary title report (prelim)

title conditions

Transfer Disclosure Statement (TDS)

A seller's broker and their agents have a special **fiduciary agency duty**, owed solely to a seller who has employed the broker, to diligently market the listed property for sale. The objective of this employment is to locate a prospective buyer who is ready, willing and able to acquire the property on the listed terms.

On locating a prospective buyer, either directly or through a buyer's agent, the seller's agent owes the prospective buyer, and thus also the buyer's

Chapter 1

Learning Objectives

Key Terms

General duty to voluntarily disclose

fiduciary duty

The licensee's obligation as an agent to act with the utmost good faith and diligence for the benefit of the principal who employs them.

general duty

The duty a licensee owes to non-client individuals to act honestly and in good faith with upfront disclosures of known conditions which adversely affect a property's value.

agent, a limited, non-client **general duty** to voluntarily provide critical factual information on the listed property, collectively called **disclosures of material facts**.

What is limited about the duty is not the extent or detail to which the seller's agent may go to provide information, but the **minimal quantity of fundamental information** and data about the listed property which the seller's agent will hand to the prospective buyer or the buyer's agent before the seller enters into a purchase agreement.

The information disclosed by the seller's agent need only be sufficient enough in its content to place the buyer on *notice of facts* which may have an adverse effect on the property's value or interfere with the buyer's intended use.

Transparency as public policy objective

In California's public policy pursuit of transparency in property information between sellers and buyers, the disclosure obligations of the seller's agent to voluntarily inform prospective buyers about the fundamentals of the listed property act to eliminate asymmetry and power relationships in sales transactions. Thus, the seller's agent is severely limited in their ability to engage in any conduct or means at hand to exploit the prospective buyer's lack of knowledge about the condition of the property by use of these disclosures.

The seller's agent may not:

- deliver up less than the minimum level of information to put the buyer on notice of the property's fundamentals affecting value;
- give unfounded opinions or deceptive responses in response to inquiries, or
- stifle inquiries about the property in a vigorous pursuit of the best financial advantage possible for the seller (or the seller's broker).

Gathering facts on adverse features

The methods for gathering *adverse facts* about a property's fundamental characteristics, as well as facts which enhance value, require the seller's agent to actively take steps to make **specific disclosures** when marketing a one-to-four unit residential property for sale, actions which include:

- conducting a **visual inspection** of the property to observe conditions which might adversely affect the market value of the property, and then enter any observations of adverse conditions on the seller-prepared **Transfer Disclosure Statement (TDS)**, also known as a *Condition of Property Disclosure*, if not already noted on the TDS by the seller or if inconsistent with the seller's disclosures, whether or not a home inspector's report has or will be received by the seller [See Figure 1, **first tuesday** Form 304];¹
- assuring **seller compliance** with the **seller's duty** to deliver statements to prospective buyers as soon as possible, namely, the upfront disclosure in marketing documents of routine facts

Transfer Disclosure Statement (TDS)

A mandatory disclosure prepared by a seller and given to prospective buyers setting forth any property defects known or suspected to exist by the seller, generically called a condition of property disclosure.

¹ Calif. Civil Code §2079

about natural hazards (NHD), the condition of the property (TDS), environment hazards (TDS), Mello-Roos liens, lead-based paint, neighborhood industrial zoning, occupancy and retrofit ordinances, military ordnance locations, numerous condo (CID) documents, etc., by providing the seller with statutory forms at the listing stage to be filled out, signed by the seller, and returned to the agent for inclusion in the marketing package to be handed to prospective buyers on their inquiry into additional property information;

- **reviewing and confirming**, without further investigation or verification by the seller's agent, that all the information and data in the disclosure documents received from the seller are consistent with information and data known to the seller's agent, and if not, correct the information and data; and if the seller's agent has reason to believe information might not be accurate, either investigate and clarify the information or disclose uncertainty about the information to the seller and the prospective buyer in the documents;
- advising the seller on **risk avoidance procedures** by recommending the seller obtain third-party inspections of the property's condition and its components (roof, plumbing, septic, water, etc.), to **reduce the exposure** to claims by a buyer who might discover deficiencies in the property not known to the seller or the seller's agent or worse, they were known and not disclosed **prior to acceptance** of a purchase agreement, and on discovery make a demand on the seller (and the broker) to correct the defects or reimburse the buyer for the costs incurred to correct them; and
- **responding to inquiries** by the prospective buyer or buyer's agent into conditions relating to any aspect of the property with a full and fair answer of related facts known to the seller's agent which are or might be considered detrimental to the value of the property and does so without suppressing further investigation or inquiry by the buyer or the buyer's agent since the inquiry itself makes the subject matter a **material fact** about which the prospective buyer may want more information before completing negotiations or acquiring the property.

material fact

Information which would likely affect the price and terms a buyer is willing to pay for a property.

A seller's agent's statutory duty owed to prospective buyers to disclose facts about the integrity of the physical condition of a listed one-to-four unit residential property is limited to prior knowledge about the property and the observations made while conducting the *mandatory visual inspection*.

To complete the disclosure process, the seller's agent serves as a conduit through which property information provided by the seller is filtered before the seller's agent passes it on to the prospective buyer.

Accordingly, all property information received from the seller is reviewed by the seller's agent for any inaccuracies or untruthful statements known or suspected to exist by the seller's agent. *Corrections or contrary statements* by the seller's agent necessary to set the information straight are included

The pass-through of filtered information



Human resources: (be)low-level management by brokers



After reading this chapter, you will be able to:

- recognize the natural equilibrium of approximately 1.5 active agents for every active broker in a stable market;
- track agent and broker licensing and renewal trends through oscillations in the market cycle;
- anticipate the effect a return to core economic principles and real estate fundamentals will have on broker and agent licensing; and
- implement strategies to operate a successful brokerage office and keep claims from clients and others under control.

risk reduction program
sticky pricing

turnover rate

In a stable market, a *natural equilibrium* develops between active real estate agents and brokers. This ratio has historically found balance at the level seen in 2002; approximately 1.5 active agents for every active broker. [See Figure 1]

After a protracted period of inflated agent population, the ratio is returning to historic norms, with an average of 1.6 agents for every active broker going into 2014.

As real estate entered its boom phase of the market cycle in the mid-2000s, new agents arrived en masse with the optimistic belief that extra money was to be had working real estate. In 2006, following the peak of the boom, there were a total of 2.6 active agents for every active broker. The high number of agents accompanied an inflated market, with unsustainable prices and little sense fundamentally.

Chapter 2

Learning Objectives

Key Terms

The entry and exit of agents

Keep in mind that the active licensee totals in Figure 1 understate the real depth of the problem, as many licensees remained technically “inactive.” They presented themselves as licensees to **speculate** in property as principals or negotiate purchases for family members, all without being employed by a broker.

Agents speculate on the market

In October 2006, for instance, there were 261,683 active agents, but a total of 376,561 Californians held agent licenses. Compare this to the more stable period of January 2000, when there were 122,260 active agents and 196,524 total agent licensees. Rather than just providing brokerage services to other individuals, the superfluous agents—active and inactive — bought and flipped properties. They speculated in the market while operating as insiders pulling (or saving) a fee when they, their family members and their friends decided to buy the property they located.

Even now, as we anticipate a return through 2014 to core economic principles (supply for sale vs. demand by actual user-occupants rather than speculators) and real estate fundamentals (price-to-rent and mortgage-to-income ratios) in the residential and commercial markets, Figure 1 shows the licensee population has nearly returned to the standard 1.5:1 agent-to-broker ratio. Expect that to remain constant through the trough in licensee numbers, which **first tuesday** expects to end in the 2016-2017 period.

Licensing in the economic recovery

Will this ratio last after the trough in licensee population?

Not likely. The boost in home prices experienced in the end of 2012 through 2013 caused increased optimism among the agent population. The perception of a healthy real estate market due to price increases has lured more individuals seeking career opportunities to become real estate agents. Sales agent and broker licensing jumped in Q1 2013 and remained at their highest levels since the housing crisis fallout in 2008.

Insufficient **lender regulation** to protect public institutions and society from harm creates a mentality that will eventually lead to another destructive real estate boom. When this happens, possibly around 2018-2020, agents will begin to rapidly multiply once again, and standards will diminish.

It will be up to **California’s Bureau of Real Estate (CalBRE)** to protect society from adverse licensee conduct. To do so, they will need to tighten up the agent licensing exam before 2016 to control a too-permissive passing rate. This move will limit new agents to the most qualified, dedicated and committed.

Whether the *CalBRE* will be politically able to do this in the face of opposition from big brokerage offices is doubtful. Large brokerage operations require a constant high number of agents-for-hire to blanket the market when momentum takes hold.

California demographics, and the extremely low present demand by occupying homebuyers, point to this return of “excitement” in the field of

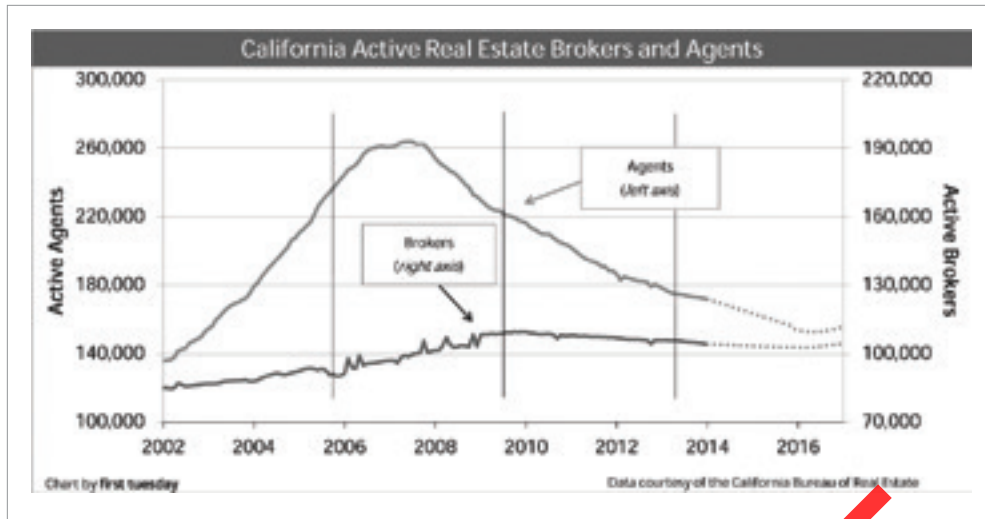


Figure 1

California Active Real Estate Brokers and Agents

ONLINE UPDATE

Visit ftjournal.us/market-charts for the most recent chart data.



real estate around the time period of 2017-2018. By then, the rate of buyer-occupant homeownership will have dropped from 60% in 2005 to at or below 53% by 2017. Thus, fewer brokers and agents will be needed to service the purchase and sale of homes.

As mortgage rates continue their steady long-term rise commenced mid-2013, downward pressure will be put on home prices. This will work well for brokers and agents representing investors interested in acquiring income property. But slipping housing prices are unlikely to attract more buyer-occupant homeowners unless growth in the job market returns to the pace in the mid-1990s of 350,000 to 400,000 annually in California.

In early 2008, 7% (1 in 14) of all single family residences (SFRs) in California stood vacant, owned by:

- speculators;
- buyers of second homes (which were acquired in large part due to speculative fervor); or
- lenders (in the case of real estate owned property (REOs)).

In 2013, home sales volume essentially matched the years 2009 through 2012. 2014 is forecast to have a home sales volume of below 2013, a trend that will not be reversed until the speculators move on and prices drop. For brokers and agents looking forward, sales volume and pricing are forecast to rise measurably after 2015, though rising mortgage rates will dampen sales prices.

With the current batch of licensee entrants embracing more sustainable, long-term real estate strategies, the “quick-buck” real estate agents are continuing to exit the stage.

No longer do we see the sort of high competition between agents that helped push up prices from 2003-2005. The return of lending fundamentals, pushing higher down payments will set a slower pace in the real estate market than

Agent and broker population, past and future



Employment: a prerequisite to renting or owning

After reading this chapter, you'll be able to:

- apply employment trends to your local real estate industry; and
- anticipate real estate sales volume and price movement in the months ahead.

real demand

Of all the factors affecting California real estate, **employment** has the most impact. This is true in good economic times, and times of economic recession and financial crisis.

Without jobs, wage earners have *insufficient financial ability* to make rent or mortgage payments. Thus, the unemployed are forced to move in with relatives or friends, negatively impacting the housing market.

High unemployment stems from businesses' inability to provide work. When the economy is slow, businesses have no need to occupy and use retail space, office suites, warehouses for inventory and distribution, industrial buildings for production or land for development. Thus, commercial real estate experiences high vacancy rates, and much rented space goes unused.

Demand (**real demand**, as opposed to artificial demand) rises for all types of real estate when local jobs increase, as during periods of economic development. Additions to the local labor force tend to drive up rents and

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Learning Objectives

Key Term

Income for the necessities of life

real demand

The demand of end-user buyer-occupants in the real estate market.

Figure 1
California Payroll Employment

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Figure 1 and Figure 2 track the number of people employed in California. These charts show total employment numbers statewide (Figure 1) and for California's five most populous counties (Figure 2). The gray bars indicate periods of recession in the United States (as tracked by the National Bureau of Economic Research).

property prices in the vicinity when the point of optimal occupancy has been reached. On the other hand, a decline in the number of local jobs reduces the need for all types of real estate, as during a recession. [See Chapter 28 and 32]

Jobs set the trend

The current trend in the number of individuals employed in a region sets the direction for:

- the volume of rentals and sales during the following 12 to 18 months; and
- the price movement of rents and prices paid for the use and occupancy of real estate during the following 24 to 30 months.

Jobs issues which affect the level of rents and prices paid for property include:

- the quantity of employed individuals;
- the quality of existing jobs; and
- the type of jobs existing and developing in the local market.

Quantity of employed individuals

Historically, California jobs create homeowners and tenants on an approximate 50:50 basis, with half of all households owning the residence they occupy and the other half renting it. This number leaned toward more homeowners and fewer tenants during the Millennium Boom. However, the homeownership rate has rapidly declined in recent years.

The appreciation or depreciation of property values is triggered by increases or decreases in local population density and the economics (numbers and pay levels) of local jobs.

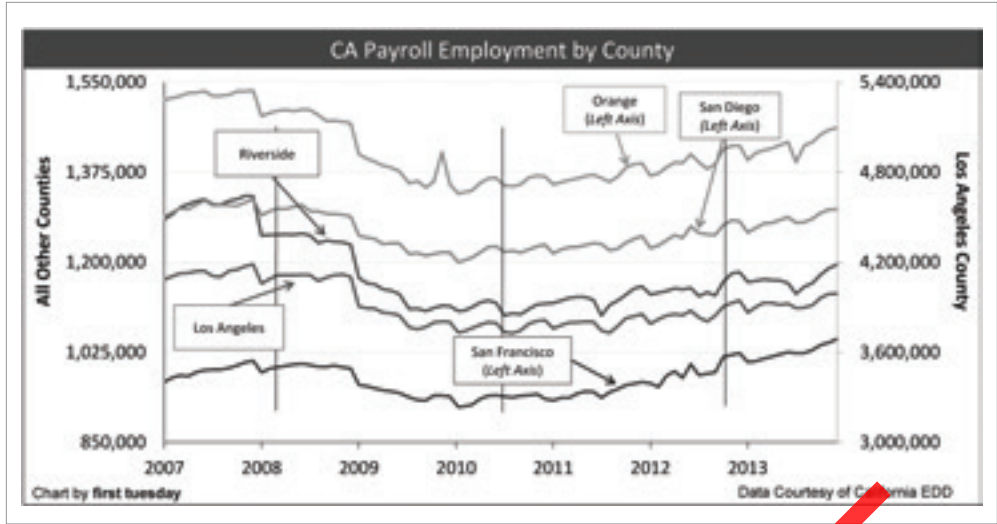


Figure 2
CA Payroll Employment by County

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Of California’s largest counties, *San Francisco* has experienced the quickest job growth since the 2008 recession, surpassing their pre-recession levels. This is largely due to the area’s prospering technology industry. All other populous counties have yet to return to pre-recession employment levels.

The unemployed and underemployed are of little to no concern to the present real estate market. Unemployment numbers tell us only who *cannot participate* in the real estate industry. Individuals first need a full-time job before they can buy or rent. [See Figure 3]

See Figures 1 and 2 for historical and current projections of the number of people employed in California, and in its most populous counties.



Figure 3
CA Unemployment

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Figure 3 depicts joblessness – those receiving unemployment benefits – in California over the past 30+ years as a percentage of the state’s total labor force. The figures do not include those who have dropped out of the job market or are voluntarily unemployed. The chart encompasses several run-of-the-mill recessions. Unemployment today is a higher percentage of the labor force, rising faster during 2008 and 2009 than at any time since just after WWII. We suspect our recovery will be correspondingly longer than any recession during the past 55 years, and more like the years after WWII.

