

To Disclose or Not To Disclose— That Is the Question: Residential Real Property Disclosures in Trust and Estates Sales

THOMAS B. GARRETT and VALERIE A. BOEMLER

Fiduciaries selling real property frequently need guidance concerning their disclosure obligations when selling real property. Otherwise they are likely to over estimate the protection of various fiduciary exemptions from many of the statutes mandating disclosures to buyers of residential real property. This may be particularly true when the sale is made on an "as is" basis. This article reviews the more significant statutes applicable in cases of sales of properties improved with four or fewer dwelling units.

The Problems

Assume the personal representative of a probate estate desires to sell improved residential real property constructed in 1925. The property is situated in Northridge in a newly formed Mello-Roos district, and survived the 1994 Northridge earthquake. The surrounding area is a high fire danger zone and is in a designated flood plain. The house's structure and mechanical systems are in poor condition, it was built with asbestos-containing materials, and has no smoke detectors throughout. The interior trim has been painted with lead-based paint. The value of the property is based on the land value and not the improvements. Based on the problems associated with the structure's age and condition, the fiduciary assumes that a buyer would remove the improvements and make a higher and better use of the property. Based on that assumption, the fiduciary presumes that any buyer would have no concern about the structural aspects of the older residence.

The estate decides for a variety of reasons to list the property for sale with a real estate broker, and a third party later submits a bid for the purchase. The fiduciary is willing to accept the bid and requests that appropriate agreements be prepared for the transaction.

THOMAS B. GARRETT received his B.A. cum laude from the University of California (Irvine) and his J.D. from the University of San Diego. He is a partner in the firm of Cheadle, Garrett & Heaton, LLP, in Newport Beach. VALERIE A. BOEMLER is a paralegal with the firm.

Do the normal real property sales disclosures apply to the sale? Does the fiduciary have the duty to disclose the conditions of the property and natural hazards upon the sale of the residential property, Mello-Roos liens, earthquake hazards, and provide operable smoke detectors at the close of escrow? In many cases the answer is no, based on express exemptions in the statutes, but this is not always the case.

Common Disclosure Requirements

In the typical residential real estate transaction that does not involve an estate or a trust, various disclosure forms must be completed or provided by the seller. These include the following:

- Real Estate Transfer Disclosure Statement (TDS) (CC §§1102–1102.18 (residential sales disclosures); the disclosure forms themselves are set forth in CC §§1102.6, 1102.6a);
- Natural Hazard Disclosure Statement (NHD) (CC §§1103–1103.14; the disclosure form itself is set forth in CC §1103.2);
- Lead-Based Paint Disclosure Statement (42 USC §4852d);
- Data Base Disclosure Regarding Registered Sex Offenders (CC §2079.10a);
- Homeowner's Guide to Earthquake Safety (Govt C §§8897.1);
- Commercial Property Owner's Guide to Earthquake Safety (Govt C §§8893.2);
- Booklet on Energy Ratings (Pub Res C §25402.9);
- Booklet on Common Environmental Hazards (Bus & P C §10084.1).

In addition to these disclosure forms, sellers may be required to make other disclosures under the terms of the sales agreement, providing such things as pest control reports.

Statutes Providing Fiduciary or Other Exemptions

Transfer Disclosure Statement

Briefly, CC §§1102–1102.18 mandate that, unless the transaction is exempt, the seller or the seller's agent must provide a Transfer Disclosure Statement (TDS) to a prospective buyer of residential property. The TDS discloses any known defects, hazardous substances, additions and improvements to the property, and other noteworthy conditions. The TDS cannot be waived—even in the case of an "as is" sale. CC §1102.1. Furthermore, an "as is" provision will not enable a fiduciary to avoid the other disclosure requirements, which are imposed by statute and discussed below.

Most estate and trust transactions are expressly exempt from the requirement to provide a TDS. In this regard, under CC §§1102.2(b), (d), Article 1.5 does not apply to “[t]ransfers pursuant to court order, including, but not limited to, transfers ordered by a probate court in the administration of an estate” or to “[t]ransfers by a fiduciary in the course of the administration of a decedent’s estate, guardianship, conservatorship, or trust.” Thus, in the hypothetical situation above, the fiduciary is not required to provide a TDS to the buyer. However, it should be noted that the exemption for trusts does not apply in the case of a revocable living trust where the transfer is by a trustee who is a natural person and who is the sole trustee of a revocable trust, having either been the former owner of the property or an occupant in possession of the property within the preceding year. CC §1102.2(d).

Although a fiduciary is exempt from providing the TDS, this does not necessarily eliminate all disclosure obligations concerning matters that would be subject to a TDS disclosure. Civil Code §1102.1 provides:

The Legislature did not intend to affect existing obligations of the parties to a real estate contract, or their agents, to disclose any fact materially affecting the value and desirability of the property, including, but not limited to, the physical conditions of the property and previously received reports of physical inspections noted on the disclosure form set forth in Section 1102.6 [the Real Estate Transfer Disclosure Statement] or 1102.6a [providing for local optional additional disclosures], and that nothing in this article shall be construed to change the duty of a real estate broker or salesperson pursuant to Section 2079 [providing for the broker’s duty to inspect and disclose in sales of four or fewer residential units or a manufactured home].

It is also the intent of the Legislature that the delivery of a real estate transfer disclosure statement may not be waived in an “as is” sale, as held in *Loughrin v Superior Court* (1993) 15 Cal. App. 4th 1188.

An examination of this language, together with a review of *Loughrin*, suggests two important points. First and foremost, the statute does not supplant California case law concerning nondisclosure. As stated in *Lingsch v Savage* (1963) 213 CA2d 729, 735, 29 CR 201:

It is now settled in California that where the seller knows of facts materially affecting the value or desirability of the property which are known or accessible only to him and also knows that such facts are not known to, or within the reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer.

Inasmuch as this case law duty of disclosure is not supplanted, it would follow that the statutory exemption from the statutory duty does not protect a seller from a claim based on the case law duty.

“[I]t appears that neither the exemption from statutory disclosures nor the use of an ‘as is’ clause will protect a seller against claims based on the case law duty of disclosure.”

The quoted language of CC §1102.1 also raises the question of the effect of an “as is” clause on the duty of disclosure. Although the quoted language overrides the conclusion in *Loughrin* that a buyer could waive the protection of the statutory disclosure, it did not override language in *Loughrin* concerning the effect of an “as is” sale. According to the court:

The theoretical difficulty encountered here is that, contrary to the apparent assumptions of many people dealing in real estate (including some brokers), a sale “as is” is not the equivalent of a waiver of potential claims of misrepresentation. As noted above, the “as is” sale simply means the buyer accepts the property in the condition visible or observable by him. An added provision in the waiver clause, such as contained in this case, indicating the buyer relies on his own inspection of the property, presumably waives any obligation the seller or his broker may otherwise have to inspect the property for defects, and hence may avoid a claim for negligent failure to know of and advise of such defects. Even such augmented “as is” clause, however, does not address the issues of: (1) intentional misrepresentation, (2) fraudulent concealment, or even (3) negligent concealment not related to failure to inspect.

In short, it appears that neither the exemption from statutory disclosures nor the use of an “as is” clause will protect a seller against claims based on the case law duty of disclosure. See *Loughrin v Superior Court* (1993) 15 CA4th 1188, 1195, 19 CR2d 161.

Property Subject to Mello-Roos Community Facilities Act or Improvement Bond Act of 1915 Liens

Civil Code §1102.6b provides that disclosures must be made to buyers of property that is subject to a continuing lien securing a levy of special taxes under the Mello-Roos Community Facilities Act. Additionally, SB 1122, signed into law by Governor Davis on October 9, 2001, amended CC §1102.6b effective January 1, 2002, to include not only special taxes associated with Mello-Roos, but also special assessments for Improvement Bond Act of 1915 districts, which include local government tax assessments to provide public facilities or services that are likely to particularly benefit the property.

Civil Code §1102.2, however, exempts fiduciaries of trusts and estates from the disclosures required by CC §1102.6b. Thus, in our hypothetical situation, the fiduciary is not required to disclose Mello-Roos liens and/or other local special assessments.

Natural Hazards

In sales that do not involve estates and trusts, a Natural Hazard Disclosure Statement (NHD) usually is required to inform a buyer of hazardous conditions found in the area surrounding the property in question. An NHD is required if the property is located in a special flood hazard area, an area of potential flooding, a very high fire hazard severity zone, a wildland fire zone in a "state responsibility area," an earthquake fault zone, or a seismic hazard zone. CC §§1103-1103.14; Govt C §§8589.3-8589.5, 51183.5.

In all transactions subject to an NHD, and unless exempt under CC §1103.1(a), the seller (or the seller's agent, except for the fire area disclosures, which must be made by the seller) must provide to prospective buyers an NHD advising that the property is located within one or more of six specified natural hazard zones:

- Earthquake fault zone;
- Seismic fault zone;
- Area of potential flooding after a dam failure;
- Flood hazard zone as designated by the Federal Emergency Management Agency;
- Wildland fire zone (in a "state responsibility area");
- Very high fire hazard severity zone.

The buyer may terminate the purchase agreement if the NHD is not provided "as soon as practicable before the transfer of title." CC §1103.3(a)(1), (c). If the sale closes and the NHD is not provided, then the remedy is the recovery of actual damages, not rescission of the agreement. CC §1103.13.

It is possible to retain the services of a business that will prepare the NHD. This typically is a good, cost-saving idea. Moreover, CC §1103.4(a), (c) provide that the seller, the listing agent, and the seller's agent are exculpated from liability for errors in such an NHD when the errors are not personally known, were based on information provided by public agencies or experts dealing with matters within the scope of their license or expertise, and were not the result of a lack of ordinary care.

In sales involving fiduciaries, similar to the exemption from the requirement for a TDS in a fiduciary setting, CC §1103.1(a)(1), (3) provide that Article 1.7, which requires an NHD upon the transfer of residential real property, is inapplicable to "[t]ransfers pursuant to court order, including but not limited to, transfers ordered by a probate court in administration of an estate" and "[t]ransfers by a fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship, or trust." Therefore, in our hypothetical, the estate is not required to complete and submit the disclosure form for the natural hazards present at its property. However, it is important to note that this does not obviate the need for the fiduciary to disclose to the

buyer the hazardous conditions surrounding the property, which are discussed below.

Guide to Earthquake Safety

A Homeowner's Guide to Earthquake Safety, setting forth maps and information on geologic and seismic hazard conditions throughout California, explanations of related structural and nonstructural hazards, and recommendations for mitigating earthquake hazards, is published as set forth in Bus & P C §10149.

Usually, a seller must complete an earthquake hazards disclosure and deliver to the buyer the Homeowner's Guide to Earthquake Safety as required by Govt C §8897.1 for residences built before 1960. This earthquake hazards disclosure (which differs from the earthquake fault zone or seismic hazard zone disclosures that are a part of the NHD discussed above) must advise a purchaser of the absence of foundation anchor bolts, the existence of specified structural conditions that lack bracing or reinforced masonry, and the existence of rooms above a garage or a water heater that is not adequately secured. Govt C §8897.2.

Once again, however, these disclosures are not required to be provided by fiduciaries. Government Code §8897.1(c)(2), (4) provide that an estate or trust is not required to provide these in "[t]ransfers pursuant to court order, including but not limited to, transfers ordered by a probate court in the administration of an estate" and "[t]ransfers by a fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship, or trust."

(Note that, even if the hypothetical had involved commercial property, the result would be similar and the estate would not be required to deliver to the buyer the Commercial Property Owner's Guide to Earthquake Safety as required by Govt C §§8893.2, 8875.6 for pre-cast concrete or any masonry buildings with wood frame floors or roofs built before 1975. Business and Professions Code §10147 provides for the publication of the Commercial Property Owner's Guide to Earthquake Safety, which sets forth maps and information on geologic and seismic hazard conditions throughout California, explanations of related structural and nonstructural hazards, and recommendations for mitigating earthquake hazards. However, Govt C §8893.3(b), (d) provide that an estate or trust is not required to deliver the guide to the buyer for "[t]ransfers pursuant to court order, including, but not limited to, transfers ordered by a probate court in the administration of an estate" and "[t]ransfers by a fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship, or trust.")

Booklets on Energy Ratings and Environmental Hazards

A statewide home energy rating program for residential dwellings is in effect under Pub Res C §25942. Under Pub Res C §25402.9, a booklet describing the program is to be published (but is not published yet) by the California Energy Commission. It is recommended that, when published, this booklet be provided to a buyer, although this is not mandatory. This program promotes energy efficiency and provides homeowners with the information they need to make decisions on cost-effective options to improve home energy efficiency.

Similarly, under Bus & P C §10084.1, a separate booklet is published by the California Real Estate Commissioner describing common environmental hazards, with the purpose of educating and informing consumers on environmental hazards such as asbestos, lead-based paint, and so forth. Again, it is recommended that this booklet be provided to a buyer, although its delivery is not mandatory. In this connection, CC §2079.7 provides that delivery of this booklet is deemed to be notice to the buyer of common environmental hazards that can affect the property. The booklet, called "Environmental Hazards: A Guide for Homeowners, Buyers, Landlords, and Tenants," frequently is used in sales transactions and is available through the California Association of Realtors (C.A.R.). The booklet currently includes information on mold. Fiduciaries may, but do not have to, provide buyers with either of these booklets.

Pest Control Report

A pest control report must be supplied only if required by the purchase agreement or as a condition of financing the transfers. CC §1099. See Bus & P C §§8516, 8519, 8519.5. Thus, a fiduciary can negotiate the preparation and the concomitant expense of such a report as part of the bargaining process.

Smoke Detectors

Although a smoke detector is obviously not a disclosure, detectors are worth mentioning here because of the exemption for estates and trusts. Health and Safety Code §13113.8 requires that, upon the sale of "single-family dwellings and factory-built housing," an operable smoke detector shall be installed. The seller of "any real property containing a single-family dwelling" shall certify to the buyer that this requirement has been met. Although in the hypothetical the buyer and the buyer's agents may anticipate that the estate will need to install in the residence an operable smoke detector, Health & S C §3113.8(d)(1), (4) provide that this requirement does not apply to estates and trusts by exempting "[t]ransfers pursuant to court order, including but not limited to, transfers ordered by a probate court in the administra-

tion of an estate" and "[t]ransfers by a fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship, or trust."

Disclosure Requirements Without Statutory Exemptions

While the matters addressed above largely are inapplicable to sales by fiduciaries, nonetheless, natural hazard zones and other conditions must be disclosed to a prospective buyer:

Earthquake Fault Zone

The Alquist-Priolo Earthquake Fault Zoning Act (Pub Res C §§2621-2630) requires a special disclosure for certain properties in earthquake fault areas. See Pub Res C §2621.9. Clarifying definitions are set forth in 14 Cal Code Regs §3601. Earthquake fault zones, or areas of "potentially and recently active" faults (Pub Res C §2622(a)), must be disclosed to the buyer even though the Natural Hazard Disclosure Statement (NHD) may not be required, as noted above. Certainly, the NHD could be used for this purpose (and for the other disclosures described below), or an alternative disclosure may be made. See CC §§1103(c)(4), 1103.2(e).

Seismic Hazard Zone

The Seismic Hazards Mapping Act, set forth in Pub Res C §§2690-2699.6, requires disclosure for properties located in a seismic hazard zone as designated on maps prepared by the state geologist. Thus, if the property is located within a seismic hazard zone, this must be disclosed to the buyer under Pub Res C §2694(a) and CC §1103(c)(5), even though, as noted above, the Natural Hazard Disclosure Statement (NHD) is not required by fiduciaries. See CC §§1103(a), 1103.1(a). Again, the NHD could be used for this purpose.

Potential Flooding Area

Even though the NHD (see CC §1103(c)(2)) may not be required, as noted above, if the property is located within an area of potential flooding shown on a dam failure inundation map, the fiduciary is required to advise the buyer under Govt C §8589.4(a).

Flood Disaster Insurance

Under 42 USC §5154a, the buyer, upon transfer of the property, must be notified to obtain flood insurance if the property is not so insured, or to maintain existing coverage. This notification is required in all sales, including sales by fiduciaries, if the property

is personal, commercial, or residential property for which Federal disaster relief assistance made available in a flood disaster area has been provided, prior to the date on which the property

is transferred, for repair, replacement, or restoration of the property, if such assistance was conditioned upon obtaining flood insurance in accordance with applicable Federal law with respect to such property.

Flood Hazard Area

The federal government has instituted a national flood insurance program for flood plain management. Under 42 USC §4104a, the buyer, and the servicer of the loan secured, or to be secured, by the property, must be notified of special flood hazards "a reasonable period in advance of the signing of the purchase agreement." The notification is to include a warning that the property is located in a special flood hazard zone, a description of the flood insurance purchase requirements under 42 USC §4012a(b), and a statement that flood insurance coverage may be purchased from the national flood insurance program or from private insurers.

Furthermore, if the property is located in a "special flood hazard area," as defined by Govt C §8589.3, and as designated by the Federal Emergency Management Agency (FEMA), then this fact must be disclosed to the buyer by a fiduciary. See Govt C §8589.3. A Natural Hazard Disclosure Statement (NHD), which is necessary for certain transfers of property within special flood hazard areas (CC §1103(c)(1)), is not required for transfers by fiduciaries, as noted above.

Lead-Based Paint

Disclosure of the use of lead-based paint is required under the federal Residential Lead-Based Paint Hazard Reduction Act of 1992. Under 42 USC §4852d and 40 CFR §§745.100-745.119, for most residential housing built before 1978, the buyer is to be provided a lead hazard information pamphlet, and shall be notified of any known lead-based paint or related hazards. The seller, including fiduciaries, is to provide the buyer with any lead hazard evaluation records or reports, and permit the buyer a ten-day period (which period is negotiable between the parties) to conduct an inspection of the hazards. The purchase agreement also must provide a "lead warning statement." 42 USC §4852d; 40 CFR §745.13. See 40 CFR §§745.100-745.119. In the hypothetical situation presented, a lead-based paint disclosure would need to be provided to the buyers.

Fire Hazard Area

If the property is located in certain fire hazard zones, this must be disclosed by fiduciaries even though the NHD may not be required, as noted above.

Public Resources Code §4125 sets forth the "state responsibility areas" for the purpose of "determining areas in which the financial responsibility of preventing or suppressing fires is primarily the responsibility of the state." If the property is located within one of these fire

hazard areas, this must be disclosed to the buyer. Pub Res C §4136. Civil Code §1103(c)(6) also requires disclosure for transfers of real property within "state responsibility areas," although CC §1103 does not apply to transfers by fiduciaries, as described above.

Furthermore, if the property is located in a "very high fire hazard severity zone" (see Govt C §51178), this fact must be disclosed to the buyer. Govt C §51183.5. An NHD (see CC §1103) is not required for transfers by fiduciaries, as noted above. CC §1103(c)(3). Again, in the hypothetical situation presented, because the property is located in a high fire danger area, a fire hazard area disclosure must be provided.

Water Heater Bracing

Under Health & S C §19211, the seller of *any real property* containing a water heater shall brace, anchor, or strap the heater to resist falling in an earthquake. The seller shall certify to the buyer that this requirement has been met.

Notice Regarding Availability of Information Concerning Sex Offenders

In sales contracts for residential property with four or fewer units, estate and trust fiduciaries are required to give notice of the existence of a statewide database containing the location of registered sex offenders. CC §2079.10a. The C.A.R. provides a Data Base Disclosure Regarding Registered Sex Offenders (Form DBD-11).

Conclusion

While a number of disclosures made and other actions taken by a fiduciary are for the information and protection of the buyer, certain actions must be taken and disclosures must be made concerning certain natural conditions and defects that the fiduciary is aware of and that materially affect value.

Less frequently encountered situations or other disclosures not dealt with here include:

- Disclosures of former military ordnance locations within one mile of property (CC §1102.15);
- Security bars on windows and safety release mechanisms (CC §1102.16) (both of which are inapplicable to trusts and estates);
- Disclosure of release of "illegal controlled substance" on residential real property (CC §1102.18);
- Burglar bars in residences (Health & S C §13113.9);
- Federal law requirements that the seller of a newly constructed residence disclose information about the insulation, including the R-value, and the type and thickness (16 CFR §460.16).

Practitioners will find that two C.A.R. forms—Probate Purchase Agreement (and Receipt for Deposit)

(C.A.R. form PPA-11) and Probate Advisory (C.A.R. form PAK-11)—are very helpful forms to use for probate, conservatorship, or guardianship sales. The Probate Advisory form provides useful information on a number of the disclosure items described in this article. The Probate Purchase Agreement form contains the usual provisions for sales involving estates: It provides that the property is being sold “as is”; provides for court confirmation or transfer by advice of proposed action, and provides for real estate brokerage commissions in the event of an overbid. C.A.R. forms may be obtained through the C.A.R. website at <http://www.car.org> or by writing to 525 South Virgil Avenue, Los Angeles, California 90020.

Although the Probate Purchase Agreement (and Receipt for Deposit) form is very useful in probate situations, often a fiduciary will be presented with a standard offer form by a potential buyer. This is problematic and time-consuming in a probate estate in that the counteroffer must address the disclosures and exemptions as well as the issues relating specifically to the probate process. To avoid these unnecessary difficulties, the fiduciary might arrange with the estate’s real estate agent at the outset that the multiple listing provide that all offers be presented on the Probate Purchase Agreement (and Receipt for Deposit). Alternatively, the fiduciary could present a counteroffer stating that the original offer must be converted by the offeror to a Probate Purchase Agreement (and Receipt for Deposit) form.

Unfortunately, the C.A.R. only publishes a form specifically designed for probate, conservatorship, and guardianship estates and no forms are available specifically for trusts. Specific forms for trusts certainly would be helpful, as well as a counteroffer form that would include all of the necessary adjustments to make a standard offer form comply with estate and/or trust law.

In closing, it should be noted that disclosures may be desirable from marketing or risk-management perspectives even when they are not required by statute. Many purchase offers will provide for various independent inspections, and brokers confronted with their own liability concerns may encourage such provisions. Further, a fiduciary—particularly one who is not also a beneficiary of the estate or trust—may deem it safer to procure and disclose inspection reports rather than relying exclusively on an “as is” contract term.

The New Minimum Distribution Regulations: A First Look

The long-awaited (almost 15 years since the first proposed regulations were issued) “final” regulations hit the Internet late on April 16, 2002—the day CEB staff was preparing to send this issue of the Reporter to the printer. Because TD 8987 is a mere 149 pages long, readers will need to wait for the June issue for an in-depth analysis. Fortunately, a fast perusal reveals that readers will not be facing any critical deadlines in the next two months. That perusal also reveals a lot of good news. The following is our quick and dirty “first look.”

Retention of Basic Approach of the January 17, 2001, Proposed Regulations

The “final” regulations (actually including a few temporary regulations) follow the basic scheme of the regulations proposed last year. Under that scheme, most retired employees (using that term to include the person for whom an IRA is maintained) will calculate minimum distributions by dividing the account balance by a “divisor.” During the life of the employee, the divisor is usually based on the joint life expectancy of the employee and a hypothetical beneficiary who is ten years younger than the employee. This method for calculating the minimum distribution continues through the year of death. Beginning in the year following the year of death, the divisor will be based on the life expectancy of the “designated beneficiary,” if there is one. If there is no “designated beneficiary,” the divisor will be based on the attained age of the beneficiary in the year of death. In both cases the initial post-death divisor is determined in each subsequent year by subtracting 1 from the previous-year divisor. For details, see Dennis-Strathmeyer, *The Tooth Fairy Is Alive: Proposed Pension/IRA Rules Simplify Planning*, 22 CEB Est Plan R 100 (Feb. 2001).

Effective Dates

The regulations are officially effective January 1, 2003, and apply to minimum withdrawals for calendar years beginning on or after that date. Reg §1.401(a)(9)-1, A-2(a). However, the preamble to the regulations provides: “For determining required minimum distributions for calendar year 2002, taxpayers may rely on these final regulations, the 2001 proposed regulations, or the 1987 proposed regulations.” In short, you can use the new regulations for 2002 if you wish. (This might be the case because of the new Uniform Lifetime Table; see below.)