

A Legal View: Contingencies in the Sale Transaction Are an Important Right of A Buyer

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Q: I am a first time home buyer and my agent mentioned that I may want to request "contingencies" in addition to those provided in the standard residential purchase agreement because of the characteristics of the type of homes we have been researching. What are contingencies and what should I consider in determining which contingencies to include in my offer?

A: Contingencies in contract law is a right of one of the parties to condition performance of the contract by that party on the occurrence or non-occurrence of certain events. They allow an offer to be made and a contract to be entered into conditioned upon certain events such as a lender's approval of specified financing that the buyer can perform, or the buyer's acceptance of inspections and approval of physical characteristics of a property. If the contingencies are not removed or waived by the buyer, and the buyer claims that one or more of the contingencies are not satisfied, then the buyer is legally allowed to cancel or terminate the contract and get a return of the deposit. As such, contingencies are an important feature of the sale transaction and they should be carefully considered by a buyer.

The standard residential purchase agreement provides for a specified period for the buyer to complete all investigations and approve all disclosures, reports and other applicable information that the buyer receives from the seller, and approve all matters affecting the Property. (E.g., C.A.R. FORM RPA-CA) These contingencies are in effect conditions of the residential purchase agreement ("RPA"). They are events, not certain to occur, that must occur before the buyers payment of the sale price is due. In other words, the RPA is effective upon execution by the parties, but each party's obligations to close the transaction are subject to, and conditioned or contingent upon, satisfaction of the specified contingencies.

There are many types of contingencies, and the basic types are included in the standard RPA. But a buyer should not hesitate to insist on additional contingencies depending upon the unique characteristics of the property or the intended use by the buyer. The buyer's contingencies can be waived by the buyer; however, there is still a duty of the seller to disclose all known material defects to the property, and duties of the listing and selling agents to conduct diligent visual inspections of residential one-to-four properties.

From the seller's perspective, it benefits the seller to have the contingencies limited in scope and specifically identified, have the contingency period as short as possible, and require the buyer to give specific written notice of an election to terminate the agreement or to approve or waive the contingencies. This places the burden on the buyer to perform its investigation in a reasonable time and then commit to the transaction by approving or waiving the contingencies.

From the buyer's perspective, the buyer normally wants as much time as the seller may allow to investigate the property and perform "due diligence" to determine if the buyer wants to complete the sale after making the offer. If the buyer is not satisfied with the property after making the investigations, the contingency period enables the buyer to terminate the agreement and have the deposit refunded.

One of the most important contingencies for the buyer is whether the buyer can obtain financing for the transaction that complies with the terms specified in the RPA. In effect, in presenting the offer to purchase in the form of the RPA, the buyer gets to set the financing terms it is willing to perform, and then have a period of time to determine if it can obtain such financing. Obtaining a lender's pre-approval can assist the buyer and its agent in completing that section of the RPA.

The buyer will want as much discretion as the seller will permit with respect to a review of the physical condition of the property, and a prudent buyer will conduct a thorough investigation, including retaining a home inspection professional, to assure that there are no surprises after the close of escrow. Such an inspection may include a survey to guard against any encroachments on the property and to confirm the legal boundary lines. Also, the buyer should insist on a reasonable time to perform studies and investigations to determine if the buyer's contemplated development or use of the property is permitted or even physically feasible.

If the property is commercial or rental property, the buyer should include a contingency for the review and approval of all contracts relating to the ownership of the property, including contracts for leases, landscaping, security, janitorial, property management, fire and liability insurance policies, and other services. Reviewing rent rolls is recommended because the property's value is determined in large part by the rents. Obtaining estoppel certificates from the tenants or seller are recommended to prevent post-transaction claims that impact the income stream and legal expenses.

Under the terms of the standard RPA, the buyer must remove all applicable contingencies or cancel the contract in writing using either the C.A.R. Form CR (Contingency Removal) or Form CC (Cancellation of Contract, Release of Deposit & Joint Escrow Instructions). The Form CR provides three options: removal of only particular contingencies, removing all contingencies except for specified exceptions, or removal of all contingencies without any exceptions. A buyer is not required to remove a contingency if any report or disclosure required from the seller has not been delivered within the time specified.

If a contingency is not removed in writing at the end of the contingency period, it continues and allows a buyer acting in good faith to cancel the contract at any time during the escrow. If the buyer refuses to remove the contingencies in writing, the seller can give the buyer a notice to perform, and if it is not complied with by the buyer, the seller can cancel the contract.

Contingencies are a valuable right of the buyer that allow the buyer to cancel a contract after an offer is accepted depending upon whether additional information is learned that causes the buyer to cancel the contract. They should be carefully considered by the buyer based upon the advice and recommendations of the buyer's agent, and they should not be removed or waived without performing reasonable due diligence. Contingencies can be a safe haven enabling an offer to be made with the assurance that a reasonable time will be available to confirm that the property is fully acceptable to the buyer.

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