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Property buyers: Putting the "do" in due diligence
By Curtis Seltzer

BLUE GRASS, Va.—"Due diligence" is the process of careful investigation that buyers use to identify the values, issues and problems embedded in whatever they're buying.

Since all property purchases are different and no Consumer Reports exists to simplify making choices, each buyer must dig out the story of a seller's dirt.

This research is the responsibility of the buyer—not the buyer's lawyer, not the agents involved, not the buyer's lender or appraiser and not the buyer's third cousin by marriage who was a real-estate agent 20 years ago.

The point of spending the time and money doing pre-offer research is to gather reliable information from which to propose a sensible price and terms.

I advise buyers to do most of their due diligence in advance of making an offer rather than propose a 90-day study contingency. Advance research gives the buyer a fact-based offering price, not an approximate stab in a hostile dark.

Deals have a better chance of getting done when the offering price is as hard as the buyer can make it. A study contingency amounts to a free look for the buyer, and sellers are often reluctant to tie up their properties this way.

Due diligence walks through these steps:

Start with what the seller discloses. Different states require sellers to disclose different types of information. These usually cover "material (important) latent (concealed) defects," which are items not obvious or readily knowable. I often find that sellers do not disclose significant defects, both the concealed kind and those that are observable but not readily understood.

Some states allow sellers to opt out of disclosure. A seller who chooses not to comply with disclosure may have something to hide. A buyer won't know this until he's done with his due diligence.

A buyer can write a contingency into a contract offer that makes the sale depend on the seller disclosing all defects in the deed and property of which he is aware.

Where a seller does disclose a defect, the buyer needs to research all of its

implications.

Boilerplate inspections. Many standard contracts provide for four inspections. The seller usually pays for three: 1) termite inspection, 2) certificate showing that the house drinking water is safe, and 3) septic inspection that indicates the system is in working order. The fourth is the house inspection that is generally done at the buyer's expense, although some smart sellers are now providing a current house report as part of their marketing effort.

Buyers should not waive any of these without good reasons.

The termite inspection should include structures in addition to the house, such as detached garages, barns and workshops. Wood-eating bugs don't confine their dining to the seller's home.

The water-quality test should screen for heavy metals and chemicals in addition to E. coli bacteria.

The septic inquiry should go beyond determining whether the system is functional. A buyer needs to know whether the house's grey water goes into the septic system; it may go into a dry well or straight into a creek. Some counties grandfather these non-conforming practices, but more and more are requiring owners, especially new owners, to upgrade to the current standard, which runs both grey and black water into the septic system.

Buyers should also determine whether the current septic permit fits current and future uses. I've seen a listing for a four-bedroom farmhouse that only had a two-bedroom septic permit. If the new owner adds square feet or another bedroom, additional septic capacity will be required beginning with the two bedrooms not covered under the existing permit. In the worst case, this can mean installing a completely new septic system at a cost ranging from about $3,000 to more than $20,000.

A routine house inspection generally does not cover asbestos, radon and mold.

Fee ownership. Buyers need to understand exactly what the seller is selling. Buyers want to buy property in fee (also fee simple or fee absolute), which means all the rights the land contains—surface, minerals, water, timber, wind and so on. The buyer needs to know before making an offer whether all rights convey and whether the seller is reserving a right or anything else from the sale.

General warranty deed. This type of deed provides the buyer with the most confidence and security. Special warranty deeds, bargain-and-sale deeds and

quitclaims provide the buyer with increasing less security, though circumstances may justify their use. Buyers should determine with their local lawyer what each type of deed means.

Access. Property with an existing vehicle entrance on a state-maintained, all-weather hardtop road is ideal. If no entrance exists on such a road, the buyer needs to check with the state road department to determine whether a new entrance can be put in. A new entrance will require adequate clear sight distance in both directions, which may not be available.

If the seller accesses his property by a road that crosses that of another landowner, the buyer must determine the legality and conditions of this usage. If the seller has a deeded right-of-way easement, the buyer needs to make sure that it's wide enough for his needs, doesn't prohibit certain types of uses and sets forth who maintains what and to what degree. Without a deeded access easement, a buyer cannot assume that he has the right to use any particular road into the seller's property.

If the seller is using his access road on the basis of a landowner's permission, the buyer needs to understand that he may be denied that permission.

If neither deeded access nor permission is the basis of use, the seller may still have a legal right to drive the road if the history of its use meets certain state-determined tests. Establishing a prescriptive easement against a landowner's wishes is one of those legal nightmares best left undreamt.

Acreage. Buyers need to determine the acreage a seller can convey based on the deed's boundary description. A surveyor can run the description through a deed-mapper program which prints out boundary lines and acreage contained within them.

Advertised acreage may or may not be accurate. Buyers cannot rely on acreage figures found on county tax maps and in tax records.

A specific acreage number, qualified by "more or less" in the deed, will usually shield a seller who conveys acreage short of that number. A deed-mapper program will pinpoint the exact acreage the deed conveys.

Boundaries on the ground vs. boundaries in the deed. Fence lines and other functional boundaries may or may not align with boundaries in the seller's deed. Misalignments are not infrequent, and acreage errors can be significant. It may be advisable to hire a surveyor to walk the boundaries to check congruence.

Easements. The seller may have a recorded easement to use his neighbor's property, and/or a neighbor may have one to use his. The buyer gets both.

Common easements involve utility lines, underground pipes and roads.

States allow a “hostile” party to establish a prescriptive easement to use another’s property against that owner’s wishes by meeting all the statutory tests. These differ from state to state, but usually require adverse use with the owner’s knowledge that has run continuously for a specified number of years. If the owner has given permission to use his property, prescriptive easement cannot be established.

Buyers should have their lawyer draft language in their offers that requires the seller to disclose any unrecorded easement and any claim of adverse use or ownership.

I generally advise buyers to avoid property that is burdened with a conservation easement. I often advise new owners to evaluate whether donating a conservation easement -- with its many local, state, federal and estate tax benefits -- might work in their circumstances.

Encroachments and boundary disputes. A surveyor’s walk-around can determine whether the fence lines follow the deed. A seller’s operational acreage may fence in a neighbor’s property and/or vice versa. The legality of any encroachment is determined in court. When both parties know that a fence line is off, a buyer can ask the seller and his neighbor to resolve it, subject to his agreement.

A buyer’s contract offer should ask the seller to disclose any known encroachments and boundary disputes.

Orphan parcels. Country property often contains a patch here or there that can’t be accessed or used. A few acres on the far side of a stream that can’t be forded or bridged is one example. Sometimes orphan acreage can be sold to the neighbor who adjoins it; other times, it just hangs out as a tax burden. Inaccessible land should be priced lower than useable land.

Floodplain. Flat land that borders a stream or river is usually in the floodplain and eventually floods. Structural damage to floodplain property can range from nuisance clean up to complete destruction.

Floodplain maps are available for purchase at http://msc.fema.gov. The free maps on the FEMA site were not useable. The county’s land-use planner should have these maps, and, in my opinion, so should local real-estate brokers. A standard topographical map will show the elevation of water-side land.

Sellers do not appear to be required to disclose floodplain. Since it's visible, it's not a latent defect. Floodplain may be indicated on listing information by an abbreviation that incorporates the letter "F."

Zoning. Determine the zoning status of the seller's property and the uses that are permitted within that designation. If a buyer's planned use is not permitted under the current zoning status, the new owner may or may not be able to get a variance or a conditional-use permit. If rezoning is essential to the buyer's plans, make it a contingency in the contract. Have the seller apply in his name with the buyer paying the costs.

Environmental issues. Buyers need to be aware that the presence of wetlands and endangered species or their habitats can limit or foreclose developmental uses of the seller's land. The Army Corps of Engineers has jurisdiction over wetlands and surface waters. The U.S. Fish and Wildlife Service has habitat information.

Other environmental issues to look for include climate issues (drought, hurricane and tornado hazards), water pollution; poisonous or nuisance vegetation; neighboring noise, light, odor or unpalatable activities; dumps of hazardous materials; harmful dusts; an aesthetic sore thumb, like a cell tower in a backyard; earthquake and landslide hazards, among others.

Phase I Environmental Assessment. A buyer may hear this term, which refers to a first-cut effort to identify hazardous substance/chemical contamination of soil and water. A Brownfield Site contains a low level of contamination; a Superfund Site is heavily contaminated. Large farm operations may have small patches that are contaminated by petroleum products or chemicals. Most rural property will not need a Phase I analysis.

Archeological/historical resources. The presence of Native American, colonial, Civil War and other sites on the seller's property will limit its uses, though increase the new owner's status.

Assets evaluation. In addition to looking for a property's warts, it's equally important for a buyer to figure out the market value of the property's individual assets—timber, cropland, pasture, improvements, minerals, water rights, farm income, lease potential, conservation-easement potential and so on. Sellers usually price multi-asset properties as a whole; smart buyers total up the value of the individual assets and determine which can be sold or leased without diminishing the core property.

Don't skimp on pre-offer research. It's your ticket away from risk.
Due diligence deserves doing.

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