

Residential Inspections and Repairs – Procedures and Pitfalls

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Inspections and repairs in residential real estate transactions can be a major source of disputes between buyers and sellers. Many of these disputes arise simply because the parties (and often their real estate agents) do not fully understand or follow the inspection and repair procedures under the standard residential real estate contract. This article will attempt to “de-mystify” the inspection and repair procedures and help all parties avoid costly pitfalls.

Types of Inspections.

What inspections are right for your purchase? The following is a list of various types of inspections (among others) that buyers sometimes desire when purchasing a home: general home inspection, termite, roof, HVAC (air conditioning), septic, mold, defective drywall, permits, lead-based paint, seawall/dock/lift, pool/spa, underground oil tank, radon, asbestos, well, elevator, zoning (zoning opinion letter), soil, and new home construction. Keep in mind that some of these inspections (such as mold) are not permitted under the standard real estate contract, so you may need to attach a separate addendum to allow for certain inspections.

Forms of Residential Real Estate Contracts.

In Florida, the vast majority of all residential real estate contracts are written on the FR-BAR forms promulgated by a joint committee of the Florida Realtors and the Florida Bar. There are two FR-BAR contracts, namely the standard contract and the AS-IS contract. Buyers, sellers, and their real estate agents should consider all legal and practical ramifications when deciding which form to use. The standard contract allows buyer to inspect the property, and requires seller to repair items that are not in working condition (up to a repair limit). Conversely, the AS-IS contract does not require seller to repair anything, but buyer can terminate the contract within the inspection period. AS-IS contracts are most often used with bank-owned properties, estates, and properties in disrepair. Also, a seller may occasionally insist the property be purchased AS-IS because of a substantial price reduction. Inspections and repairs under AS-IS contracts will be discussed in more detail later in this article. But first, we will cover the inspection and repair procedures (and how to avoid pitfalls) under the standard FR-BAR contract.

Repair Limits.

The standard contract contains limits on the amount a seller is obligated to expend on general repairs, wood-destroying organisms (a/k/a WDOs or termites), and closing out open permits. These limits can be expressed in either a dollar amount or a percentage, with 1.5% of the purchase price being the default if left blank. Occasionally a seller will insist that the repair limits be stated as \$0 (or 0%), thereby eliminating any responsibility for making repairs. While a seller may think this effectively converts the standard contract to an AS-IS contract, this is not really the case. For example, the AS-IS contract has better protections for a seller from a disclaimer perspective. More importantly, even with a \$0 repair limit all of the inspection and repair procedures under the standard contract still apply. So unless these procedures are carefully followed, seller may unintentionally give buyer a right to terminate the contract (see step 5 below).

Five-Step Inspection Procedure.

The inspection and repair procedures under the contract are fairly complex and can be difficult to understand and follow, even for a seasoned real estate agent. The following is a simplified five-step summary of these inspection and repair provisions.

- Step 1 – Inspection. Buyer may have a general inspection done within the 15-day inspection period. The general inspection must be done by a professional inspector. A professional inspector is a person who specializes in and holds an occupational license to conduct home inspections, or who holds a Florida license to repair and maintain the items inspected.
- Step 2 – Notice of Repairs. Buyer must notify seller in writing within the inspection period of any general repairs items. If buyer fails to deliver a repair notice prior to the expiration of the inspection period, then buyer waives seller's obligation to make any repairs.
- Step 3 – Estimates of Repairs. Seller must have the general repair items estimated by an appropriately licensed person, and a copy of these estimates delivered to buyer, within 10 days after receiving buyer's repair notice. Alternatively, seller can have a second inspection (which could lead to a third inspection).
- Step 4 – Estimates Under or Over Repair Limit. If the cost to repair all items is under the general repair limit, seller must repair or replace all items. If the cost to repair all items exceeds the general repair limit, then within 5 days after the parties' receipt of the last estimate, two things can happen: (1) seller may notify buyer that seller will pay the excess; or (2) buyer may notify seller which repairs to make up to the repair limit, in which case buyer takes the rest of the general repair items in their AS-IS condition.
- Step 5 – Right to Terminate. If no notice is given by buyer or seller within the 5-day period under Step 4, then either party may terminate the contract up to the closing. This potential pitfall can be avoided by diligently following steps 1-4.

Seller's Repair Obligations.

Seller is obligated to repair or replace all general repair items. Generally speaking, these are items that are not in working condition, meaning the item is not operating in a manner in which the item was designed to operate. Additionally, the contract lists a few specific examples of general repair items, namely torn screens, fogged windows, and missing roof tiles. On the other hand, seller is not obligated to repair cosmetic conditions, meaning aesthetic imperfections that do not affect the working condition of the item. The contract enumerates cosmetic conditions in generalized terms, such as tears, spots, discolorations, nail holes, dents, chips, minor cracks, etc. In addition, the contract specifically states seller is not required to replace cracked roof tiles, curling or worn shingles, or a roof with a limited life. This last example highlights a common problem that occurs with inspection reports. Home inspectors are required under Florida law to report whether an item, such as a roof or an appliance, is near the end of its useful life. A buyer often feels seller should replace these older items or fix other cosmetic conditions. However, seller is not obligated to repair or replace anything as long as it is in working condition.

Gray Areas.

Some repair issues are black and white, but others can be somewhat gray. This point is illustrated by the following three examples.

- Underground Oil Tank. Some older properties utilized underground fuel oil tanks. If the tank is leaking, it's clearly not in working condition. On the other hand, if the tank is not leaking, seller is probably not obligated to remove it (although a lender may require buyer to remove it).

- Rodents or Pests. The contract doesn't address rodents or pests (or health risks in general). Rodents and pests are not wood-destroying organisms, so they are outside of the WDO inspection provisions of the contract. The best argument is probably that the entry point for the rodents is a structural defect, and seller must remedy the condition caused by the defect (i.e., patch the hole and eliminate the rodents).
- Broken or heaved driveways or walkways. These conditions are often caused by tree roots. One can argue these items are not in working condition. But driveways and walkways are not included in the list of items under the definition of working condition. Driveways and walkways are however mentioned in the list of items under the definition of cosmetic conditions, which specifically excludes minor cracks. So by implication a major crack (or heave) is probably a defect requiring repair.

Repair Standards.

The contract requires appropriately licensed persons to make all repairs and replacements in a good and workmanlike manner. Examples of appropriately licensed persons are roofers, plumbers, and electricians. However, a handyman or seller can make a repair if the repair does not require an appropriately licensed person. The contract further requires seller to provide buyer with paid receipts of all repairs. Finally, any replacement items (such as appliances) must be of a quality or value equal to or greater than the item being replaced.

WDO (a/k/a Termite) Inspections.

A wood-destroying organism (or WDO) is anything that causes wood to deteriorate, whether insect or plant life. A WDO inspection is done to determine the existence of past or present WDO infestation and damage caused by such infestation. The WDO inspection and repair procedure is similar to the general inspection procedure, but it is different enough to potentially cause confusion. Buyer must deliver a copy of the WDO report to seller within the 15-day inspection period. Seller must then deliver estimates to buyer for repair of the WDO damage and necessary corrective treatment. Seller is obligated to fix and/or treat the property if the cost is at or under the WDO limit. If the cost is over the WDO limit, buyer may either agree to pay the excess or designate which repairs or treatment to do (not exceeding WDO limit). Again, if buyer fails to do this, either party may terminate the contract up to closing. The parties can avoid this potential pitfall by carefully following the WDO inspection and repair procedure.

Inspections Under AS-IS Contracts.

There are some important distinctions regarding inspections and repairs under the AS-IS contract compared to the standard contract. For example, there are no restrictions on the types of inspections, and buyer can self-inspect. As previously mentioned, an important aspect of the AS-IS contract is the right to cancel if buyer is not satisfied with the condition of the property after inspection. To avoid termination, seller will often agree to make certain repairs, or alternatively agree to a repair credit or a price reduction. If seller agrees to make repairs, keep in mind that there are no repair standards under the AS-IS contract. This means, for example, that seller or a handyman can make the repairs. Buyer should therefore require that all repairs be done by appropriately licensed persons and receipts be provided.

Related Contract Addenda.

There are two addenda to the standard contract that are relevant to the inspection and repair discussion. The first is the AS-IS addendum. This is the addendum that can be used with the standard contract to convert it to an AS-IS contract. If you are preparing the initial draft of the contract, it is better to start with the AS-IS contract form (rather than the general form with the AS IS addendum). The AS-IS addendum is very useful, however, if you decide to convert the

standard contract to an AS-IS contract. This often happens when seller insists that buyer takes the property AS-IS because seller has agreed to a substantial price reduction.

The other addendum is the “Right to Inspect and Right to Cancel” addendum, which is a type of hybrid. This addendum can be very beneficial for a buyer because buyer has a right to cancel (similar to an AS-IS contract), and seller is still obligated to make repairs. Under this addendum, buyer can terminate the contract within the right to inspect period if the property is not acceptable to buyer. However, if buyer elects to proceed and has conducted inspections, then seller is required to make repairs up to the applicable repair limit.

Other Related Contract Provisions.

Several other contract provisions are related to inspections and repairs. These contract provisions are summarized as follows.

- Property Maintenance Requirements. Seller is required to maintain the property in the same condition as of the contract date (ordinary wear and tear excepted). This includes maintaining the lawn, shrubbery, and pool. The failure to meet these property maintenance requirements usually comes up during the walk-through.
- Walk-Through Inspections. Buyer is allowed to perform a walk-through inspection of the property immediately prior to the closing to verify that: (1) all items of personal property are on the property; (2) seller has maintained the property as required by the maintenance requirement; and (3) seller has made all required repairs and replacements.
- Repair Escrows. If seller has not met the maintenance requirements or has not completed all repairs, 125% of the estimated cost is escrowed, with any excess funds returned to seller after the repairs are made.
- Repair Credits. In lieu of actually making the repairs, seller may offer buyer a repair credit. Keep in mind that lenders will typically not allow a repair credit, but they do usually allow a “closing cost” credit. An advantage of a repair credit is buyer gets to fix the problem the way buyer wants it fixed, which also allows buyer the opportunity to upgrade the item. On the other hand, a disadvantage of a repair credit is that it is sometimes difficult to know the extent of the problem until repairs have begun. A good example of this is a leaking pipe, which may also have caused mold or water damage behind a wall.
- Access and Utilities. The contract requires seller to provide utilities and access to the property for inspections, including the walk-through. Accordingly, seller shouldn't disconnect utilities until after the walk-through.
- Seller Disclosures. Seller typically provides a written seller's disclosure statement to buyer. However, seller's disclosure of a defective condition does not relieve seller of the obligation to fix the disclosed defect unless seller amends the contract to eliminate this obligation. If a deal falls through, seller is still obligated to disclose to a new buyer any defects identified in the previous inspection report. Finally, an AS IS contract does not negate seller's requirement under Florida law to disclose hidden defects.

Understanding the intricacies of the contract's inspection and repair procedures will help buyers, sellers, and their real estate agents avoid pitfalls and successfully close their deals. For questions regarding inspections and repairs, or for assistance with your closings, please contact Jeff Grebe at (941) 329-6619 or jgrebe@williamsparker.com.