

Flipping Residential Property - Avoiding A Flop For the Owner/Seller

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Since HGTV's debut of "Flip or Flop" nearly two decades ago, every cable network and streaming service has developed programs to promoting the fast cash investment strategy: Buy a distressed residential property, fix it up, and sell it for quick profit. Hollywood's shine makes the process appear fool proof. Many small-time investors with limited remodeling and construction knowledge embark in this side hustle to augment income. The promise of great reward may come with great risk. Pitfalls in the flipping process can expose investors to liability when the work performed, or the disclosures made, do not live up to the buyer's expectations.

Imagine ReHabCo buys a 1920's era bungalow through a foreclosure sale. ReHabCo never occupies the property, but it does review the property condition and creates a plan for renovation. It determines that the old, galvanized plumbing needs updated; the sewer line is routinely clogged; and there appears to be prior moisture in the basement that *might* be from poor downspout direction outside the foundation. ReHabCo removes and replaces some of the galvanized water pipes, where it is easy to see. It hires a company to replace a portion of the sewer line, but not all the way to the main due to the expense. And ReHabCo installs new gutters and downspouts. ReHabCo is now wearing multiple hats: Owner, Designer, Workman, and General Contractor.

After completing the renovation with new paint, flooring and appliances, ReHabCo advertises the project with new plumbing and an updated sewer line. The seller's disclosure does not address the prior signs of water infiltration in the basement. An eager Buyer signs a contract and brings his inspector in to check the property. All exposed piping signal updated materials. The basement is now finished with covered walls, thus impeding the inspector's ability to view the foundation. A sewer inspection at closing shows an open line.

Shortly after closing, a connection point between the galvanized water pipe and the new pipe fails, causing water damage to the kitchen. The sewer backs up in the basement because the line replacement is not graded properly toward the main. And, after a heavy rainstorm the newly finished basement is flooded because of an unaddressed crack in the foundation. The Buyer is clearly upset and looks to ReHabCo to recover its damages. The Buyer may claim breach of contract, breach of implied warranty, negligence or fraud, and may look to enforce state specific consumer protection laws.

What could ReHabCo have done to avoid or limit its potential liability for the Buyer's claims? If you are engaged in house flipping, be mindful that simply putting "lipstick on the pig" leaves you exposed to potential legal liabilities. Should you be named in a legal action, the below recommendations form the foundation for your defense.

1. When purchasing a project house, learn as much as possible about the condition of the home. Is there a prior tenant or occupant to share condition knowledge? What is the age of the home and identify materials used during that construction era that may be well past useful life? Is this neighborhood prone to foundation failures/repairs? Talk to neighbors about the property and the area. You will be surprised what neighbors know.
2. Obtain your own inspections before beginning work. If you are not an expert in any particular trade, get an expert to advise on necessary work.
3. Pull permits from the local municipality where needed. And, inquire about any prior permits issued for work before your ownership. Complete all required inspections and have the city/county sign off on the work.
4. Hire qualified tradespeople to perform specialized projects.
5. Disclose, Disclose, Disclose. When listing the property for sale, you must complete a Seller's Disclosure. Share with prospective buyers what you do know. If you observed signs of prior water infiltration in the basement, state it and explain what steps you took to remediate the problem. If the entire home did not undergo an entire re-pipe, do not advertise it as such. Make available project bids, statements from subcontractors