

Pre-sale assignments – once a quick road to riches – now mean higher down payments and greater risk

Buying pre-sales

Only a few years ago residential pre-sale assignments were a licence to print money. As B.C.'s real estate market boomed, thousands of buyers signed condo pre-sale contracts – not because they intended to move into the suites or rent them out – but because they wanted to “flip” the contracts for a profit. Some condos were bought and sold two or three times before construction was even complete.

In the commercial realm, business owners may opt for an assignment if they change their corporate identity or if they sublease unused space to another business. If all goes well, and the rent keeps getting paid, things go smoothly. However, given that most commercial landlords will experience a tenant dispute and that real estate law is more complex than most people realize, that's a big “if.”

Residential pre-sales

In 2008, much like the global economy, real estate values in Metro Vancouver declined sharply. For the first time in a long time, residential real estate investors caught up in the game were exposed to significant liability.

Those who had managed to flip their pre-sales contracts before the market decline mistakenly felt secure.

Assignments come with significant risks for all of the parties involved, particularly assignors. Unless the assignment agreement expressly states the assignor is free from future liability –



REAL ESTATE INVESTMENT

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and the vendor agrees to it – the assignor remains exposed. If the assignee does not complete the purchase, the assignor can be sued for the damages suffered by the vendor. In a declining market, these damages can be significant.

Prior to the market decline these risks were easily ignored. The market continued to go up and, if a purchaser failed to close, a developer would likely have

been happy to keep the deposit and simply resell the condo to another purchaser at a higher price.

When the market declined, developers were facing a re-sale at a loss and began looking to the assignor to fill the gap. To make matters worse, in April 2010 the required down payment for an investment property quadrupled from 5 per cent to 20 per cent. With that, the likelihood of assignees being unable to complete their purchases increased markedly.

Commercial assignments

The risks to a landlord posed by an assignment are not as obvious as the risks to an assignor of a pre-sale contract. An important risk does not arise from the assignment directly. Rather, the assignment's effect on contractual and legislative obligations poses a risk to the landlord. For example, a commercial lease often requires notice as a precondition to exercising a

right such as termination or a claim to accelerated rent. A landlord must understand how an assignment affects this obligation.

Once a contract is assigned, landlords often cease to deal with the old tenant (assignor) at all. Should the new tenant (assignee) fail to meet its obligations, the landlord will provide notice of default to the new tenant.

In some cases, the landlord may commence a lawsuit against the old and new tenants. If the landlord did not continue to provide notice to the old tenant, the old tenant may successfully defend the claim on the basis that it never received notice. The benefit of the assignment – as opposed to replacement of the contracting parties – will have been inadvertently lost. To make matters worse, the new tenant might not be able to pay a judgment against it, and the

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landlord will be out-of-pocket for damages unless the money can be recovered from the original assignor.

Protect yourself

What can one do to protect oneself? The first step is education.

Do not think of an assignment as a quick way to make a buck. While the investment timeline may be short, a strategy of entering into a pre-sale and then assigning it should be carefully thought out. One should consider the potential downside risk and honestly assess whether that level of risk is acceptable. Too often prior to 2008, people were tying up significant amounts of money into a pre-sale because they “couldn't lose.” It turns out that they could, and did.

If your intention is to enter into a pre-sale contract and flip it before construction is complete, read the contract terms carefully. Often the contract will provide limits on a purchaser's right to assign his or her contract.

Common terms include:

- prohibiting assignments until the developer

meets certain sales thresholds;

- requiring the developer's approval to assign, which may be refused for any reason;
- charging a fee to assign; and
- requiring the assignment to be in writing in the form provided by the developer.

The fine print

If you have decided to invest in a pre-sale and assign your contract, read the assignment carefully. As noted above, the developer may require you to use its standard assignment form. This form is drafted by the developer's lawyers and, consequently, is written to protect the developer's, not the assignor's, interests.

The assignor should be satisfied that the assignee has the means and ability to follow through on his or her obligations. Remember, the only thing standing between the assignor and liability is the assignee.

If the assignment agreement does not absolve the assignor from possible future liability, the assignor can insist upon an indemnity from the assignee. One should be careful to not take great comfort in an indemnity. If the assignee does not complete the purchase, you can expect that the developer will sue both the assignor and assignee. An indemnity is only meaningful if you can collect on it.

Commercial landlords can improve their situation by including language in the original lease and/or assignment providing that notice to an assignee will be deemed sufficient notice to the assignor, thus obviating the need to provide separate notice to the assignor. This, however, may not be enough to overcome statutory notice requirements such as those provided in consumer protection legislation such as the Real Estate Development Marketing Act. A prudent landlord will provide notices required by legislation or the terms of the lease to both the old tenant (assignor) and the new tenant (assignee).

Remember that assignments are legal documents. Prudent parties will get advice from a professional before entering into, or approving, an assignment. ♦

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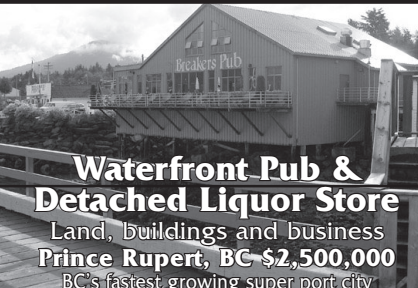
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