

## Why Do We Have Deposits?

When buying real property, purchasers typically submit a deposit with their offer to purchase. The deposit is considered part of the purchase price and is ultimately credited towards the purchase price on closing. In this way, a deposit is a down payment, but it is also a sign of good-faith. The deposit acts as an incentive for the purchaser to complete the agreement of purchase and sale. Without a deposit, the buyer will not feel the immediate pain of improperly failing to comply with its obligations under the contract. While it is true that a vendor could sue on the agreement of purchase and sale for damages even in the absence of a deposit, this typically involves a long, drawn-out and costly litigation process. Accordingly, a vendor should be satisfied that the amount of a deposit covers possible damages such as subsequent sale at a lower sale price. On the other hand, a prudent purchaser's solicitor will include a clause in the agreement of purchase and sale limiting the buyer's liability to the amount of the deposit.

### How Do Deposits Work?

When an agreement of purchase and sale is entered into, the purchaser generally gives the deposit to a real estate agent or real estate lawyer to hold in trust until the agreement is completed. Deposits made payable directly to the seller should be avoided. A deposit made payable to a listing brokerage, or to a lawyer's trust account is not immediately available to either the purchaser or the vendor and brokerages and lawyers are less likely to improperly release a deposit. Also, deposits held in trust by a broker or lawyer are protected by an insurance fund.

Deposits will typically be returned in situations where the seller is in default of the agreement or if the contract cannot be completed through no fault of either party. Where an agreement cannot be completed due to a default of the buyer, the deposit will be forfeited. Deposits in Ontario are released when a sale goes through, when the parties mutually agree or a mutual release is signed by the parties, or when a court order directs the release. If two parties cannot agree that a deposit can be released, the deposit must remain in a trust account (or be paid into court) until a court order is obtained.

### What If There Are No Damages?

What happens if a buyer repudiates a contract, but the seller is then able to sell the property at a higher price and therefore does not suffer any damages? The British Columbia Court of Appeal answered this question in *Tang v. Zhang*, 2013, BCCA 52. When the buyer in *Tang* failed to complete the purchase, the seller put the property back on

the market and was able to sell it to a third party at a higher price. The British Columbia Court of Appeal held that even if no damages were suffered, a deposit is to be forfeited to the seller if a buyer wrongfully fails to complete a purchase. The court also held that if damages could be proven, the deposit would count towards them.

One of the fundamental principles of contract law is that damages are based on the actual loss suffered by the innocent party when there is a breach of contract. Damages are intended to restore the innocent party to the position that it would have been in had the contract been fulfilled. However, the position with regard to real estate deposits is that they are non-refundable except in situations where the deposit is so large that it is unconscionable. The reason for this can be traced back to the English Court of Appeal decision of *Howe v. Smith* (1884) 27 CH. D. 89 where Lord Justice Fry stated that a deposit was "not merely a part payment, but is then also an earnest to bind the bargain so entered into, and creates by the fear of its forfeiture a motive in the payer to perform the rest of the contract."

A defaulting purchaser may be successful in getting all or part of a deposit returned where the deposit is unconscionably large and where the seller is seeking to disguise a penalty as a deposit. While there is no hard and fast rule about how large a deposit must be in order for it to be unconscionable, deposits comprising 10% of the purchase price have been deemed acceptable by the courts. In *Tang*, the purchase price of the property was \$2,030,000.00, and the British Columbia Court of Appeal found that a deposit of \$100,000 was not unconscionable. In *Palkovics v. Barta* (2013), 2013 Carswell BC

1137, a deposit of \$400,000 which represented less than 10% of the purchase price was found to be well within the permissible range of deposits and an acceptable amount intended to motivate the contracting purchaser to carry through with the bargain. However, in *Heshmet & Associates Investments Ltd. v. World Land Ltd.* (1983), 43 A.R. 193 (Alta. Q.B.) the court found that the vendor was entitled to retain the deposit, but varied the amount to 10% of the purchase price, down from 13.4%. For a purchaser to be entitled to receive their deposit back, a letter of demand should be prepared by that party's lawyer, which seeks the return of the deposit as well as any interest provided for in the purchase agreement.

### How Much Should A Deposit Be?

The answer will largely depend on where the property is located. Deposits for residential homes, for example, are typically larger in Toronto where demand has been outpacing supply. In other areas of Ontario, deposits for residential homes can be as little as a few hundred dollars. There are many variables depending on the type of transaction, the motivation of the parties and the state of the real estate market.

Purchasers of new homes or condominiums should also be mindful of the deposit protection provided by the Tarion Warranty Corporation. Deposits paid on new condominium units are protected by Tarion up to a maximum of \$20,000.00 and deposits paid for all other new homes are protected by Tarion up to \$40,000.00. Buyers who are asked to give deposits greater than these amounts should ensure that builders have excess deposit insurance. Excess deposit insurance can protect purchasers and can enable builders to use purchasers' deposits as a low-cost and easily-accessible source of financing for their projects.

The consequence of a deposit that is too small (in the case of the seller) or too large (in the case of the buyer) can be serious. Very often, a purchaser may be an assetless entity, so the deposit constitutes the only tangible means for the vendor to enforce a transaction or to obtain compensation for damages where the purchaser fails to comply with its contractual obligations. The size of the deposit, how/by whom it is held pending the closing of the transaction, and its role in the event of a default, are all matters that should be considered carefully by lawyers and their purchaser and vendor clients **before** an Agreement of Purchase and Sale is entered into.



**Steven Pordage** is a member of the Commercial Real Estate Practice.

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