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Buying Time

Mortgage problems with purchasing pre-sale condominiums

By **Harjot Atwal**

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(July 17, 2019, 2:21 PM EDT) -- In the past, many of my clients considered pre-sale condominiums to be lucrative investments. The familiar mantra remains "buy low, sell high." Whether you intend to live in a residential unit, work in a commercial unit, rent out such units or try to sell or assign your condominium unit once the building is complete or nearly complete, the aforementioned investment strategy is usually based on the presumption that real property generally appreciates over time.

I know this sounds attractive. After all, while you wait for your investment to bear fruit before it becomes time to sell, you either get to live or work in your newly constructed condominium, or you find a tenant to cover your property carrying costs.

Enter the mortgage dilemma. What if you are depending on a bank lending you 80 per cent of the purchase price of the condominium property, you get pre-approved by the bank, sign the Agreement of Purchase and Sale (APS), become contractually obligated and the bank later backs out all of a sudden?

Or, what if the bank later decides to lend you substantially less money and leaves you holding a much lighter bag, as you struggle to find a secondary source of funds that will allow you to close the deal? Now, is everything starting to sound a bit less attractive?

Surprisingly, this happens more often than you would think. For example, between April and July of 2017, a number of my clients' financing arrangements were cancelled by banks just before their closing date. Other clients had their principal mortgage amounts greatly reduced and were told they should get a private mortgage to make up the difference (despite interest rates on such private mortgages being at least eight to 12 per cent per annum).

The reason for these financing difficulties was the unveiling of the new mortgage stress test, which made it more difficult to qualify for a mortgage. While it came into effect in October 2016, it still took about six months before it affected the market and caused property values to plummet. Unfortunately, anyone who signed an APS before April 2017 was now realizing why only being eligible for 80 per cent of the current appraised value of the property was a problem.

If, for example, someone offered $750,000 for a property and they were expecting an 80 per cent mortgage for $600,000, but the property depreciated to $700,000 so that they were only eligible for $560,000, then they were now in the unenviable position of trying to make $40,000 materialize out of thin air.

While this phenomenon was not unique to pre-sale condominiums, it turned out to be particularly difficult for my condominium clients.

This is because many of them had already taken occupancy of their condominium units on the interim closing date, so they were now living there or working there. If their financing then fell through before the final closing date, they were suddenly facing the prospect of being forced to vacate the property.

As a real estate lawyer, I had to explain to my clients that the situation was actually worse than that, since an APS signed with a builder is almost always very one-sided. If the builder is not able to close for any reason whatsoever, they typically just have to return your deposit and there are no further legal consequences for them.

On the other hand, if you as the purchaser are not able to close, the builder will not only keep your deposit (which is typically at least $100,000 on a $750,000 property), but they will retain the right to sue you for any consequential damages they incur (for example, if they later sold that same property for $600,000, they could sue you for the $50,000 difference not yet recovered plus legal costs).

What did my clients want to do now? Well, the answer invariably was to try to buy more time. This is where the bleeding started, depending on how "unfriendly" the builder and their lawyer decided to be. While some were "nicer" than others and willing to negotiate extension terms, one particular builder charged an 11.6 per cent interest rate on the balance due on closing and $250 plus HST per calendar day in addition to legal fees.

It certainly seemed unfair that one of my clients paid over $4,000 for an eight-day extension, especially since they signed their APS five years beforehand, and a typical builder APS allows the builder to extend the closing date several times without any penalty.

What other options did my clients have? Other than finding a new bank or pursuing a private mortgage, they could have requested to assign the APS. If the builder consents to it, assigning an APS to a third party is an excellent option, since you essentially sell the property without paying any land transfer tax (which is $22,950 in Toronto on a $750,000 purchase), but I have seen builders charge $5,000 plus additional legal fees for granting such a privilege.

Ultimately, while purchasing pre-sale condominiums can be lucrative investments given the right market conditions, prospective purchasers should be aware of the potential perils involved. As history has demonstrated, even the best-laid financing plans of mice and men can go awry, regardless of whether you have excellent credit.

If you or your clients want to pursue pre-sale condominiums, then it is best to obtain a real estate lawyer's advice regarding the risks and liabilities involved with a specific APS before signing on the dotted line.

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