

Unfinished sympathy

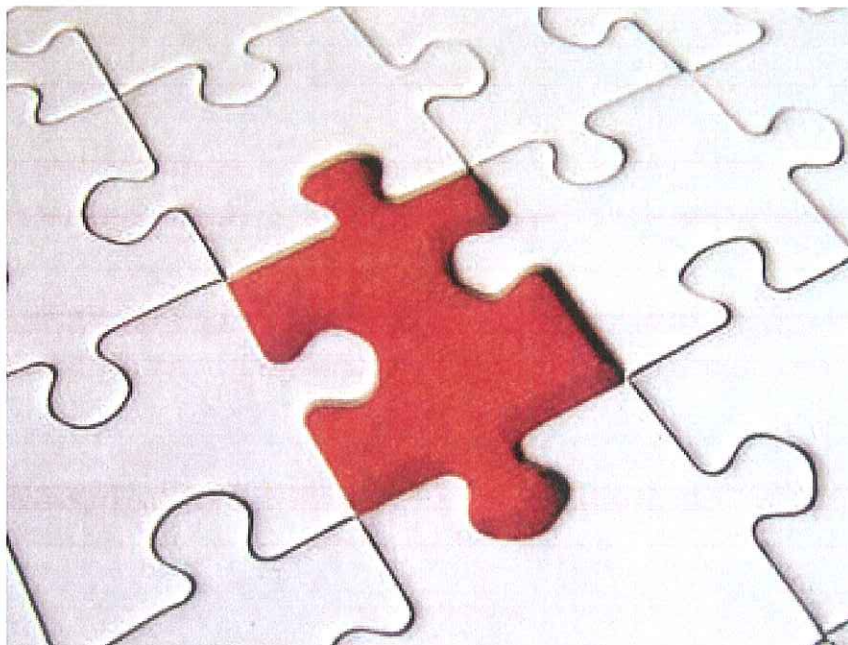
Many buyers have become unable to obtain funding for off-plan purchases that were agreed in better economic times, but there are several options open to purchasers and developers seeking to mitigate the problems this can raise, say **Charles Joseph and Tim Polli**

PROPERTY PRICES FOR residential properties have fallen significantly in the last year or so, despite the best efforts of some estate agents to talk up prices recently. This has been seen, in particular, in relation to flats in urban new-build developments. The developer will almost inevitably have been carrying out the development using borrowed money. Accordingly, where he has already drawn down his loan and started the development, he will be anxious to complete the development and sell the units as soon as possible.

A buyer of a flat in such a development may have bought off plan and before any or any significant building work was commenced. His contract will provide for completion to take place a short period, typically ten days, after the developer has served a certificate that the building works are finished. Importantly, he will have exchanged contracts on the footing that the flat is worth the agreed price, and he will have arranged his finances for the purchase accordingly.

Difficulties can arise in circumstances where, after the building work is complete, and after the developer serves the requisite notice, the purchaser finds himself compelled to purchase a flat for, say, £200,000 (which is what all those involved reasonably thought it would be worth when contracts were exchanged) at a time when it is in fact worth only, say, £160,000. In the real world, the purchaser will have been planning to raise most of the money to buy the flat by way of mortgage. But mortgage lenders have tightened their criteria considerably as a result of the financial crisis and in this example it is very likely that the reduced loan to value ratio will now mean that the buyer is no longer eligible for the mortgage with which he thought he was going to be able to buy the flat.

Of course, the purchaser would have no problem if his obligation to purchase the flat for £200,000 had been subject to mortgage; the mortgage being unavailable, the purchaser would be entitled to walk away from the deal, or to renegotiate the price. However, a developer may not have agreed to



such a term in the contract.

However, the court treats a contract for the acquisition or disposition of land as a contract for something unique, and accordingly specific performance will be ordered where appropriate. The court might refuse specific performance where it would cause great hardship to the purchaser.

In most cases, however, the developer will serve notice to complete and, following the purchaser's failure to complete, rescind the contract. The developer may then re-market the flat for sale, and sue the purchaser for damages.

Settle or fight?

For the purchaser, the options are also limited. He must either suggest a pragmatic solution to settle the proposed claim, or he will have to defend it. He might offer to purchase the flat for a price which he can afford; either the market price, or perhaps a price between the market price and the contractually agreed price. For the developer the attraction is simplicity, speed and lack of cost. This should not be ignored. The developer

will not get more than the market price from another buyer, even if he rescinds the contract for sale (for non-completion) and puts the property back on the market. By selling to the original purchaser, he will realise the flat's market price (or slightly better) without the marketing and legal costs of, and the inherent delay in, finding and selling to another buyer. He will try to retain his right to sue the purchaser for the difference between the original agreed price and the reduced price, but the purchaser's advisers will no doubt try to make it a condition that the reduced price is agreed in full and final settlement of any claims the developer may have. The closer that the 'new' purchase price is to the original purchase price, the more likely the developer might be to accept such an offer.

The purchaser might offer to make a partial payment, with the balance owed to the developer secured by a second mortgage over the flat. However, it is likely that this arrangement would have to be declared to the primary lender, which has the potential to cause delay and difficulty. In any event, even if interest is stipulated for, this solution might



be unattractive to the developer.

Alternatively, the developer might agree to enter into a shared ownership arrangement with the purchaser in order to achieve a sale. The purchaser would buy a share of the property and rent the remainder. This might be cheaper for the buyer but the arrangement is more complex as it would be necessary to have some arrangement whereby the buyer's share increases from time to time and the rent attributable to the remaining part decreases. For the developer, the initial part sale will help to reduce borrowing and the regular rent might help to maintain cash flow. On the other hand, there are complications which might arise from the landlord and tenant part of the relationship and which might be unattractive to both parties.

If no practical solution can be agreed, a purchaser seeking to defend the claim will have to consider carefully whether the obligation to purchase had actually arisen. He may do so either by attacking the entire contract or by suggesting that his obligation to purchase had never arisen.

Careful wording

So far as impugning the entire contract is concerned, the marketing materials provided to the purchaser when the developer was marketing the off-plan development should be considered. It is not unusual for developers to encourage purchasers to deal with a specific mortgage broker partner who might even be part of the same corporate group. The developer, whether in the written marketing materials or orally in the marketing suite, may have suggested that the broker would be able to arrange the necessary funding. The precise words used, and the context in which they were used, will become important. The courts will not give legal effect to a mere marketing 'puff', but the more intense the selling techniques employed by the developer, the more chance there is that unwise statements might amount to a misrepresentation or a collateral warranty as to the availability of

funding. If an actionable misrepresentation can be made out by the purchaser then, unless he has already affirmed the contract, he can rescind the contract *ab initio* thereby discharging the entire contract. A counterclaim for breach of a collateral warranty would not discharge the purchaser's obligation under the main contract, but would effectively render the developer liable to the purchaser for the damages which the purchaser might otherwise be ordered to pay.

So far as the obligation to purchase is concerned, the changed circumstances brought about by the economic crisis are most unlikely to have caused the contract to be discharged by frustration. Frustration describes the position where performance of the contractual obligations in the changed circumstances would involve a radical or fundamental change from the obligations originally agreed. In our example, the obligations of the parties are substantively, if not wholly, the same as they were when the contract was made; the developer is to sell the flat to the purchaser and the purchaser is to pay for it.

Were the conditions precedent to the obligations to sell and to purchase properly and fully satisfied? If the developer was not entitled to serve notice of completion, or if the notice was not properly served by the developer, then the obligation to complete would not have arisen. Further, in the intervening period, any long-stop date for completion of the development and service of those notices may have passed, entitling the purchaser to elect to treat the contract as discharged.

Ready, willing and able

If the developer has purported to rescind, the purchaser ought to consider whether the developer was entitled to do so and has done so properly. The developer would have to have been ready, willing and able to complete according to terms of the contract (or, at least, substantially so) otherwise he would not have been entitled to serve notice to complete. If he

was not entitled to rescind, or has not done so effectively then, by *purporting* to rescind and by (erroneously) continuing to act as though he had validly done so, the developer might be said to be indicating that he did not consider himself bound by the contract, thereby entitling the purchaser to accept the renunciation and terminate the contract, discharging himself from his obligations.

Quantum might be an issue. If the deposit actually paid is less than the sum agreed, then the developer may claim the balance as a debt. Similarly, he can claim the solicitor's costs of preparing the notice to complete as a debt. He may claim a number of other heads of damage, such as, obviously, the difference between the original purchase price of the flat and the price for which the flat is eventually sold, assuming that the sale price is a fair reflection of the value at the date of breach (which it may not be in a fast-moving market). Although, in general, contractual damages are assessed as at the date of breach, the court can depart from that rule when it is just to do so. Other heads of loss might be the added costs of estate agents and solicitors, and loss of ground rent and service charges from the date when completion should have taken place until the date on which the flat is resold.

The developer is under a duty to mitigate loss and so must take reasonable steps to avoid or minimise his losses. In practice, provided that the flat is promptly re-marketed for a realistic price (after the contract has come to an end) then the developer will have satisfied his duty. Interesting issues might arise if a number of flats in a development are sold as a portfolio to a new purchaser at a discount when several purchasers have defaulted. They may allege that the developer has failed to mitigate his loss; the developer will insist that the sale of the flats as a portfolio was perfectly reasonable and in the ordinary course of his business.

If the developer's damages claim exceeds the deposit paid to the developer, then the developer must give credit for that deposit paid. However, where the deposit exceeds the damages claim, the developer will, in practice, be permitted to keep the excess. The court has jurisdiction under section 49(2) of the Law of Property Act 1925 to order repayment by a vendor of any part of the deposit but, in cases such as *Midill (97PL) Ltd v Park Lane Estates Ltd* [2008] EWCA Civ 1227, the court has recently made it clear that the jurisdiction will not be exercised in a defaulting purchaser's favour unless the circumstances are exceptional or extraordinary.

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How to avoid problems in off-plan conveyancing

Those advising developers should:

- consider specific performance as a remedy in the alternative to rescission; and
- consider a degree of flexibility in trying to find a solution which minimises the time and cost involved in disposing of the property.

Those advising purchasers should:

- consider whether the contract can be rescinded for misrepresentation, or whether there might be a claim for breach of a collateral warranty;
- consider whether the developer has properly and sufficiently complied with all conditions precedent;
- consider whether specific performance might cause great hardship to the purchaser; and
- consider whether it can be suggested that the developer has failed to mitigate its loss.

