

Off-plan buyers beware

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The market

The residential market, particularly in London, continues to be very active with new developments coming to the market. We see this trend continuing as there is still a distinct shortage of residential units in London.

Many buyers purchase off plan from a developer well in advance of the estimated construction completion date. Very often a buyer will negotiate a right to sell on his/her purchase contract to a sub-buyer. Whether or not this is achievable is a matter for negotiation with the developer.

Where sub-sales are accepted by a developer then, depending on the terms of the original contract, the onward sale to the sub-buyer can be by way of sub-sale contract or, more usually, by way of an assignment of the original purchase contract.

Mortgage Market Review

Due to recent changes in the UK residential mortgage market, it has become increasingly difficult for a sub-buyer to obtain UK mortgage finance on any type of sub-sale arrangement. This has been exacerbated by a tightening up of the UK mortgage rules as a result of the changes introduced by the Mortgage Market Review, which came into force on 26 April 2014. As a result it would appear UK lenders are taking a more rigorous approach in applying the Council of Mortgage Lenders Conditions (CML Conditions). The CML Conditions set out industry standard terms, which apply to residential mortgage loans.

One of the CML Conditions concerns "length of ownership" with lenders requiring a minimum six month period of ownership. So in the context of a new residential development the buyer must be buying from a developer who has owned the "unit" for six months. However, this condition can never be satisfied in the context of a sub-sale as the sub-buyer is never buying directly from the developer. This condition is reinforced

in the CML Conditions with most lenders now stating that "sub-sales where the seller (i.e. the original buyer) has owned the property for less than six months and/or assignable contracts will not be acceptable".

Who should be concerned and why?

So who should be concerned about this sub-sale mortgage issue? The answer is that it affects all parties where a sub-sale remains to be completed. For example:

- Buyers – if their sub-buyer fails to complete the buyer will remain liable to the developer on the original contract unless the contract has been novated, which is unusual. The buyer will be at risk of losing their deposit paid to the developer, although this will normally be less than the deposit they could claim from their sub-buyer. However, depending on market conditions a developer may pursue a claim against the buyer for further damages for breach of contract and/or specific performance, requiring the buyer to complete the contract. Depending on the terms of the sub-sale the buyer may not be able to "step back in" to complete the purchase to "save the contract" and their deposit. Their only recourse will be to rely on their own sub-buyer's indemnity.
- Sub-buyers – a sub-buyer who is relying on mortgage finance may now be unable to finance their purchase, even in circumstances where a mortgage offer has previously been issued. If a sub-buyer fails to complete on time, then they will be liable for interest on late completion. If the delay persists their deposit may be lost and they may also be liable to a claim from the buyer (i.e. their seller) for breach of contract and damages for any loss incurred by the buyer.
- Developer – if a sub-buyer defaults the developer will keep the original buyer's deposit and may also have a claim against the original buyer for damages.

The developer will need to decide whether or not to pursue specific performance against the buyer and the developer's decision will usually depend on market conditions. For example, in a rising market the developer may well choose to keep the buyer's deposit and remarket the unit. Conversely, in a falling market, the developer may seek to compel the buyer to complete the sale. If this is not possible or the court declines to enforce the sale, the developer will be entitled to any loss suffered as a result of the failure to complete (accounting for the deposit), including the costs of remarketing and the loss in value of the property as a result of selling at a lower market price.

What should market participants do now?

We would recommend that, as a sub-buyer, you check your mortgage application and (if applicable) the terms of your mortgage offer as soon as possible. It is best to be clear what your lender's attitude to sub-sales (in whatever form) is. For the original buyer or the

developer it is preferable to raise this mortgage issue now with the sub-buyer, on the basis it is better to know in advance whether or not the sub-buyer is going to have difficulty in completing the unit purchase. If the sub-buyer is not able to perform, steps should be taken to mitigate the situation, not only from a practical perspective, but also to comply with any court requirement to mitigate loss arising from breach of contract.

How can Dentons help?

Dentons acts, in a number of capacities, in relation to sub-sale arrangements – be it for the original buyer, the sub-buyer, the developer or the lender. As a result, Dentons has a wealth of experience in finding bespoke solutions to protect the various parties involved. We have also been working closely with a number of industry experts, such as the leading residential agents and developers, to find a workaround for this recent sub-sale/length of ownership issue.

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Note: The UK for the purposes of this note means England and Wales