Backing out of a deal

Real Estate

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Alexei Vella

Purchasers may regret making an offer on a house, but reneging can be costly.

In real estate sales, the doctrine of *caveat emptor* rules. And although the onus is on the buyer to beware to ensure they know what it is they are buying, the risks for both the buyer and seller in a volatile market can be very real and some just want to get out of the deal.

A flurry of residential real estate activity erupted in communities across the country last year, resulting in competing offers, bidding wars and often astronomical prices. Fearing home prices would continue to escalate, eventually pricing them out of the market, many buyers jumped in, often presenting offers above asking and without conditions.

At the same time, the Bank of Canada, concerned that household debt was reaching a crisis stage and threatening the country's overall economy, tightened up mortgage lending rules, imposing stress tests on borrowers. Consumers were also facing higher mortgage rates from lenders. That all meant that Canadians couldn't borrow as much as they would have been able to borrow just a few months earlier.

"We were getting calls from people who were either looking to get out of their agreements of purchase and sale or sellers who were asking about their rights and terms of enforcing them," says Gregory Sidlofsky, a certified specialist in civil litigation with Wagner Sidlofsky LLP in Toronto.

Buyers knew the risks they were taking by waiving conditions on their offers, he says, but that presented a problem for some when it came time to confirm financing. Some buyers saw the market soften after they presented their offers to purchase but before they sold their own house. For others, the new stress test rules had come into play at the closing date, meaning they couldn't qualify for as large a mortgage as they would have had earlier.

For some, it ended up in disaster. In Toronto, a couple fearing they would lose out on their dream house that was listed at $2 million offered $2.25 million only to realize they had overextended their ability to finance the home. At the end of the day, not being able to close cost the Hu family $500,000, leaving them with absolutely nothing to show for it. In *Gamoff v. Hu*, the would-be purchasers lost their $30,000 deposit and the Ontario Superior Court of Justice ordered they pay the sellers $470,000 in the lost value of their would-be dream home after they backed out.

Knowing that the threat is more than just the loss of the sometimes substantial deposit has helped others avoid court, says Sidlofsky. When advised of their rights and obligations and the possible costs of a challenging action, a defaulting buyer may be motivated to negotiate and settle instead.

Ali Sodagar saw similar pressures during the 2007-08 economic crisis when buyers of a development didn't want to complete their purchase and the developer remarketed the properties, selling them at a shortfall.

"At that point, everyone was looking to see whether there was a material misrepresentation in the disclosure statements that were filed with the superintendent of real estate and anywhere from the exact square footage to completion date to the developers' financing requirements," says Sodagar, principal of Sodagar & Company Law Corporation in Vancouver.

A misrepresentation is one of the few ways a buyer might be able to pull out of a home purchase agreement, but in today's re-sale market, the days of obvious misrepresentations — such as a seller pulling the carpet over a hole in the floor — are long gone. And $10,000 of flood damage in the basement of a $2-million deal might provide the opportunity for discussions on holdback provisions, but they won't get the buyer out of the deal.

A failure or misrepresentation only allows a way out of the transaction if it is considered fundamental to the transaction or a significant part of the essence of the property. But a problem with the warranties alone won't be enough, says Irvin Schein, a senior partner and chairman in Minden Gross LLP's litigation group. A problem with a warranty — something that isn't material and not considered to be a significant shortcoming such as basement flooding — does not offer a buyer a way out.

"There is going to be a fine line sometimes," says Schein, "and that's the nightmare."

The client must decide whether to roll the dice or not, and that decision is likely based on a lawyer's advice. The challenge for the lawyer is to figure out if the transgression is serious enough to justify termination of the transaction before closing.

The question is if the misrepresentation will deprive the purchaser substantially of what they bargained for. A warranty issue, on the other hand, is related to a quality or aspect of the home and any related problems are remediated through negotiation. The lawyer then needs to decide if the transgression is serious enough to justify termination of the contract.

"He [the lawyer] better make the right call here because, if he's wrong, the consequences can be very serious," says Schein. "The lawyer has to characterize it somehow, correctly, in order to arrive at the appropriate legal consequences."

These issues are more likely to occur in a rising market when the stakes are higher. He points to the 1980 recession, which led to a flood of cases of people trying to get out of deals, which happened again about a decade later.

"Just like the market is cyclical, cases of this nature are cyclical," says Schein. "If you have turbulence in the real estate market in either direction, you're going to find litigation of this nature."

The risk for the lawyer is being drawn into the litigation, which occurred in *Gilbert v. Marynowski* before the Supreme Court of Nova Scotia last summer, although it was unsuccessful.

The purchasers tried to back out of a deal after they failed to sell their properties, but selling their own properties was not included in the condition of purchase. They said they believed that their only loss would be the deposit and that they didn't realize they would be sued for the shortfall of what they were willing to pay and what the condominium sold for in the declining market.

"The losses escalated as the market went down and it sold for quite a loss," making it a $100,000-plus case, says Ian Dunbar, a partner in the McInnes Cooper Halifax office, who represented the real estate agent.

They sued their lawyer and real estate representative, claiming they were never advised to include that in the conditions. The respondents provided the contract as evidence, which did lay out the possible consequences were they to default on the purchase.

The best protection for the professionals involved is to walk the client through every clause of the contract. But the road splits between what is reasonable practice and what is the perfect, ideal practice, says Dunbar.

"What I think the case stands for, more than anything, is that where you're alleging that what someone has done is below the industry standard, it's on you to get evidence on that," he says. "The fact that they didn't have expert evidence meant that [it would be difficult for the court to say] that this was below the reasonable standard of care of a lawyer or a realtor without any expert evidence.

"I think it also stands for the proposition that you can't just say that because something went wrong in hindsight that it's everybody else's fault."

Sellers, too, may seek to pull out of a deal, particularly if they see the market moving upward after they signed the agreement to sell.

Calgary real estate lawyer Jeffrey Kahane's client was buying a condo from a divorcing couple who wanted to drop out of the deal on the premise that they were going to stay together. But Kahane, principal of Kahane Law Office, calculated the costs from professional fees to storage to the extra cost of buying a home at the now-higher values and came to a bill in excess of $150,000, but he suggested his client would agree not to purchase for $100,000. The seller opted to close instead.

In 2016, Alberta also introduced the opportunity for the seller to get out of the deal if a buyer is late with the deposit. And, if it's the seller's desire not to go ahead with the sale, they need to communicate that to their agent so that the broker doesn't accept the deposit when it does arrive. A broker's acceptance of the deposit is an acceptance of the contract.

The same thing applies to the waiver of conditions.

"Ultimately, time is of the essence. If someone is late on something, it's there for a reason," says Kahane.

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