
Need to know

Pre-empting financier requirements in presale contracts

SPEIRSRYAN

For anyone who will require finance for a property development, ensuring that your off-the-plan presale contracts are in a form acceptable to financiers can mean the difference between a successful development and financial ruin.

Too often we see developers either unable to raise finance or needing to incur significant additional cost and delay due to presale contracts failing to meet the requirements of financiers.

Here are 5 absolutes that all developers should take note of:

Sunset Date

A financier will typically require all presale contracts have a sunset date well after the anticipated development completion date.

Most financiers require the sunset date to be no earlier than 9 months after the forecast completion date of the development.

The sunset date should also be capable of extension for delays arising beyond the control of the vendor.

Failing to get the sunset date right means developers are forced to negotiate contract variations with purchasers to rectify premature sunset dates. Particularly if there are a large number of presales, the time and cost involved in correcting the sunset dates can be significant.

Right to terminate for insolvency

A contract for sale or option deed should never grant the purchaser a right to terminate the contract or option deed due to an insolvency event by the vendor or grantor.

It is imperative for financiers that the mortgagee has the right to step in and complete a development if the vendor or grantor goes bust.

If a purchaser has a right to terminate due to the vendor going bust, a financier will not be able to rely on that contract or option deed as security.

Case Study: We acted for a financier looking to provide construction finance. The undeveloped land was worth circa \$5M. The borrower was seeking \$10M for the purpose of refinance and construction funding. The borrower had executed a put and call option at a sale price of \$16M.

It seemed to stack up, assuming the put and call option was enforceable.

The put and call option gave the purchaser a right of termination. It immediately killed the deal. No financier will risk \$10M on a \$5M property without having a solid exit.



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Enforceability

Similar to a right of termination for insolvency, there can be instances where purchasers have a statutory entitlement to rescind a contract due to the absence of prescribed disclosure documents or Home Owners Warranty Insurance.

An omission of prescribed disclosure documents from a presale contract can be fatal, as a purchaser will have a right to terminate but the vendor will not.

You would be shocked how frequently we review poorly drafted and poorly compiled presale contracts giving rise to statutory rights of rescission.

Case Study: We recently acted for a financier requiring a significant level of presales.

The borrower had not yet obtained a Home Owners Warranty Insurance certificate ('HOWI') and the Borrower's solicitor had failed to satisfy regulation 61 of the Home Building Regulation 2014 sufficiently to obtain the exemption in section 96A of the Home Building Act 1989 (NSW).

The result was that all purchasers had a statutory right to rescind their presale contracts.

All presale contracts required rectification in order to qualify as eligible presale contracts for finance.

The development has not commenced, and condition precedents for funding are still yet to be met.

Reduced deposits

A financier will often require that vendors hold the full 10% deposit, in order for a presale contract to qualify for funding purposes.

If a vendor agrees to a reduced deposit, keep in mind that the presale contract may not be counted towards the minimum presale contract threshold required by a financier.

Foreign purchasers

Many financiers will impose a limit on how many presales can be made to foreign purchasers. Any presales to foreign purchasers exceeding that maximum number will not be counted as qualifying presale contracts for the purpose of finance.

As we move into the next phase in the property cycle, developers will likely encounter an increase in purchasers looking for a way out of their presale contracts.

Ensuring presale contracts are rock solid will therefore be increasingly important, to safeguard the commercial returns of the developer, but also for prospective financiers considering to part with funds.

Developers should make enquiries with potential financiers before they begin entering presale contracts to ensure they will clear the hurdles likely to be imposed for finance.

We reiterate the importance of having your presale contracts properly prepared and compliant with financier requirements. The relative cost of quality presale documents pales in comparison with the potential costs and losses of a botched job.

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