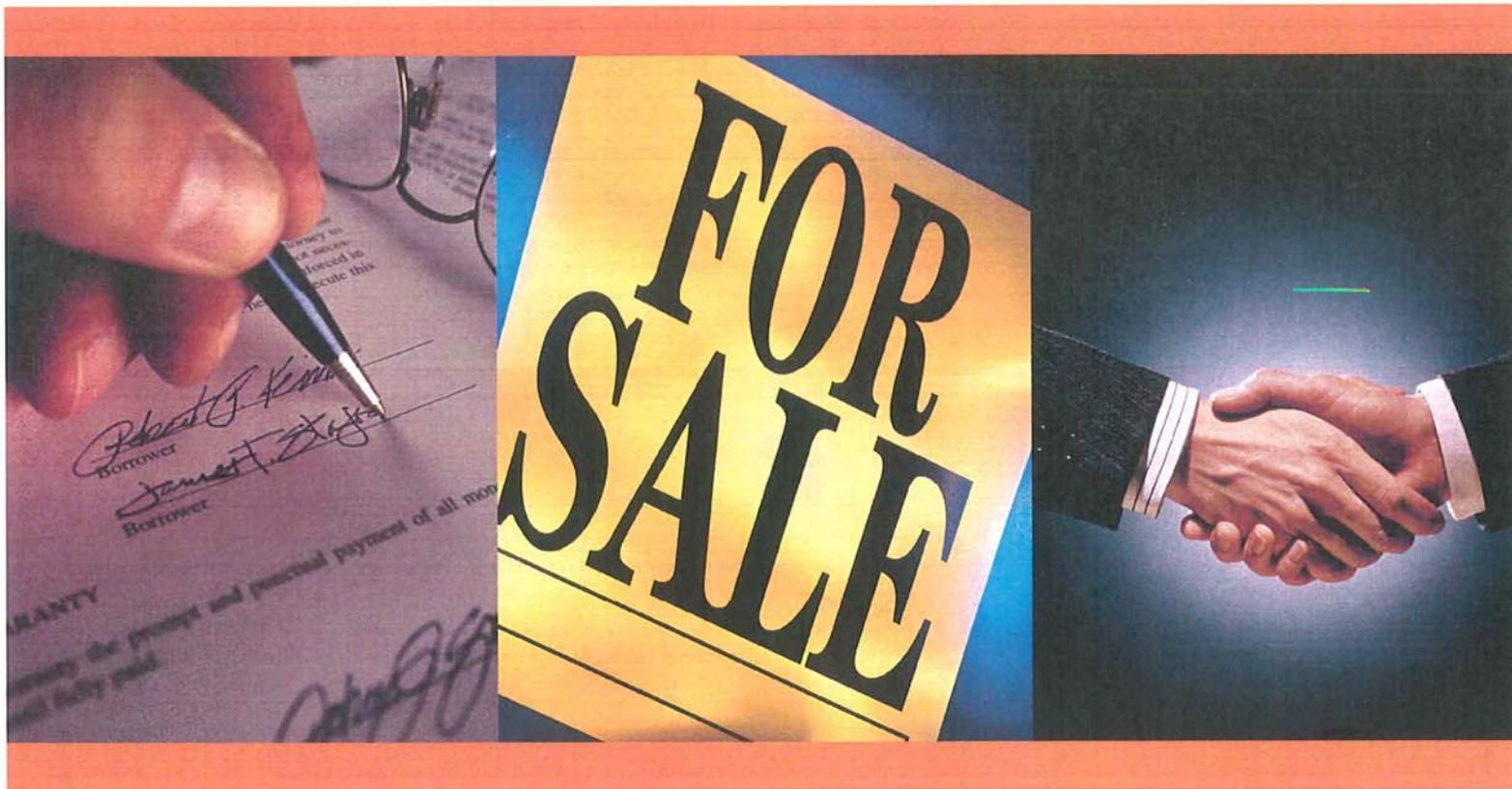




AGREEMENTS FOR SALE ONTARIO

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This image shows a blank sheet of white paper with horizontal ruling lines. The lines are evenly spaced and run across the width of the page. There are no margins, text, or other markings on the paper.

AGREEMENTS FOR SALE IN ONTARIO - DEFINITIONS
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WHAT IS AN AGREEMENT FOR SALE?: An Agreement for Sale ("AFS") is an agreement between a Buyer ("Buyer") and an owner of real property ("Seller") whereby the Buyer pays a deposit on the purchase price, with the balance paid over a period of time on terms as negotiated and agreed between them. Which of the parties takes care of the ongoing costs of ownership is also a matter of negotiation and agreement. The crucial manner in which this kind of arrangement differs from any other (for example a purchase by way of assumption of mortgage or a vendor take back mortgage) is that control of the property immediately passes to the Buyer but title remains in the owner's name until the full amount of the purchase price is paid.

The question is: when would this kind of arrangement be beneficial and how precisely would it work? Like any other business dealings between people, various factors play into what makes any particular contractual arrangement ideal or advisable. Some of these factors are explored below.

BACKGROUND: This way of financing a purchase was, at one time, actually quite well known in Ontario. Here is why. Historically, banks would extend mortgage financing based on a down payment requirement that was much more substantial than it is currently. Often the requirement approached 50% of the purchase price. That is simply the way, at one time, it used to be. Since only a small segment of the population was in a position to make this size of down payment, an alternate arrangement was used to facilitate purchase transactions that allowed for a much lower down payment. This was the AFS.

Now, of course, the landscape has changed and banks can lend up to 80% and more of the purchase price. There are many that would disagree with the wisdom of allowing for mortgages up to 95% of the purchase price but the general consensus is, in effect, that this is a much better arrangement than the 50% down payment scenario.

As a result, Agreements For Sale became the forgotten financing tool. Why would you need to use an AFS when you could now get your financing from a bank likely at a better rate and on better terms? That fact is you would not.

However, consider the fact that there are still Buyers that would like to purchase properties but, despite the broader availability of bank financing, still may not qualify for such lending. How, then, can a Buyer come to own property that is financed with bank money? The answer is that this can be achieved by assuming a mortgage that is already registered on title. Now, if mortgages were fully assumable (in the sense that they could be assumed without the bank's approval), then Sellers could simply transfer title in their property to a Buyer and the Buyer would take on all of the responsibility of ownership including a direct relationship with the bank as owner / lender.

However, the most important thing to note in all of this is that, in Ontario, an institutional mortgage is not automatically assumable without the lender's consent. A bank mortgage can typically be assumed only when the intended purchaser first qualifies with the existing lender. The AFS is a strategy for a Buyer to purchase property without engaging a direct relationship with the bank and by financing the purchase with what could be called Seller financing, as opposed to bank financing. The AFS circumvents the problem of the non-assumable mortgage and can be useful whether you are buying or selling.

HOW THE AGREEMENT FOR SALE WORKS: The process begins in the usual manner with the offer and acceptance of an otherwise typical agreement of purchase and sale. The difference is that the transaction is stated to be proceeding by way of Agreement for Sale. The basic premise is that, under such arrangement, the Buyer makes a deposit of a certain negotiated amount of money with the balance payable under a financing structure which could be called the "Unpaid Seller's Equity". For example, if the sale price was \$200,000.00 and the deposit was \$10,000.00, the Unpaid Seller's Equity would be \$190,000.00. The Buyer makes payments to the Seller under the AFS, on terms agreed to, and the Seller continues to make payments to her bank. Control of the property passes to the Buyer at the time the deposit is paid but title (and the mortgage with the bank) remains in the Seller's name.

In terms of documentation, the standard Ontario Real Estate Association (or Toronto Real Estate Board) form of agreement of purchase and sale can be used provided it is clearly stated that the transaction is proceeding by way of Agreement For Sale and the Agreement For Sale is attached as a schedule. The AFS is key and must be well drafted to encompass both the terms of the Seller's financing, as well as each party's rights and obligations and what remedies are available in the event of default by either the Buyer or the Seller.

Profit to the Seller arises from the margin on the sale price and / or on the interest rate. That is, any excess in the sale price over its fair market value, on the one hand, and, on the other, the higher interest rate payable on the Unpaid Seller's Equity over his interest payable on the mortgage on title to the bank.

THE FORM OF AGREEMENT: You will find that proceeding by way of AFS is not the norm in Ontario. In order to use this strategy, you will have to understand very clearly how it works, when it works, and how to make this information available and clear to potential Buyers, Sellers and, perhaps more challengingly, to their lawyers.

Begin by having a form of AFS that is specifically and purposefully drafted. With this in hand and fully understood, an investor, whether Seller or Buyer, will have the knowledge and credibility to market the concept to others. As well, depending on whether you are a Buyer or a Seller, you may wish to differently negotiate certain aspects of the arrangement and, therefore, this needs to be considered if one is intending on using a template.

The AFS document needs to address all aspects of the Buyer / Seller relationship including assignability, insurance, taxes, maintenance and repairs, default, remedies, payouts, renewals, interest rates and how they are calculated, and, numerous other details. If there is an existing mortgage, which there likely will be, the term of the AFS, or time frame within which the Buyer must pay out the Seller's Equity in full, should coincide with the term of the existing mortgage. That way, when the mortgage is due, the AFS is due as well. There should, as well, be a clause that allows for a renewal of the AFS that is tied to any renewal of the existing mortgage.

In Ontario, very few, if any, lawyers will have a sophisticated version of the Agreement For Sale. The strategy, in Ontario, is just not currently in use to any significant degree at all. Therefore, it is strongly advisable that the investor with knowledge in the area maintain control of the drafting of the AFS document. Your lawyer ought to prepare the AFS, regardless of whether you are the Buyer or the Seller.

THE ESSENTIAL DIFFERENCE OF AN AFS: The difference between an AFS and an assumption of mortgage is the timing of the closing or, more clearly stated, the timing of when title changes. With an AFS, title remains in the Seller's name and the Seller continues to make the mortgage payments to the bank. The bank's records do not change. Title changes only once the Seller's equity is paid in full which occurs, usually, when the Purchaser is in a position to arrange bank financing. The existing mortgage is then paid out, the Seller receives his or her profit, the notice documents are discharged, title is transferred into the Purchaser's name and the new mortgage is registered. Just like any typical closing.

CONCERNS OF THE BUYER: With title not being in the Buyer's name, there are a number of factors, indeed risks, that need to be addressed. Firstly, in order to prevent the Seller from disposing of the property in breach of the arrangement, notice of the AFS or other form of document should be registered on title. Secondly, a Buyer will have to consider how to ensure financial obligations continue to be honoured such as mortgage, insurance, utility, realty tax, condominium fee and other payments. Thirdly, a Buyer must consider what remedies need to be provided for and how these are exercised in the event of default by the Seller. All of this must be clearly outlined in the AFS and, therefore, much thought must be given to ensure appropriate and sufficient language is utilized. Also, consideration must be given to whether the use of an AFS triggers the so called "due on sale" clause in the existing mortgage. The point here is that a Buyer needs to have good legal advice and properly drafted documents in order to ensure things go smoothly and, if not, what remedy can be invoked quickly so that the investment is preserved.

Crucially important to the Buyer is the matter of insurance. Since the nature of the Buyer's interest in the property is different from that of an owner, special consideration must be given to the unique nature of the AFS transaction to ensure that such interest is properly and adequately protected. You will need to have a clear conversation with your insurance broker and retain one that understands this kind of transaction.

CONCERNS OF THE SELLER: The primary concern for the Seller is whether the Buyer will have the ability to make good on his or her obligation to make monthly payments towards the Seller's equity. This is a question of due diligence on the part of the Seller and is entirely within the Seller's control. In the event of default by the Buyer, the bottom line remedy is legal action similar to a foreclosure. The important point here is that the AFS needs to be very clear as to what precisely is the remedy available to the Seller so that a Court will have clarity in making a determination on the issue. A Seller will want to be able to get control of the property as quickly, as efficiently and as cost effectively as possible. That said, using the courts to recover property after a defaulted AFS will be time consuming and expensive to a Seller.

Also, consideration must be given to the possibility that a Buyer might not treat the property as would a prudent owner. What if construction liens are registered against title for failure to pay for materials or services provided to the property? Again, it is a matter of having a contract that addresses the issue and provides remedies that are clear and enforceable.

WHY AN AFS IS ATTRACTIVE TO A SELLER: Firstly, the market for Buyers is increased since the scenario allows for purchases that do not require new financing. Many Buyers do not qualify for any kind of bank financing. Banks have various policies and formulae that they use in order to qualify, or not qualify, a prospective borrower. By using the AFS arrangement, the Seller becomes the lender and determines whether or not he or she wishes to take on the Buyer as a borrower. This gives the Seller bargaining power that could give rise to a higher purchase price or, just as important, allow for the sale of a property that might be difficult to sell for any number of reasons.

Secondly, a Seller can eliminate any mortgage pay out penalties by deferring the final transfer of ownership to coincide with the date when that mortgage matures.

Thirdly, a Seller in financial difficulties may be able to achieve a better result than by disposing of the property in the usual manner. He or she may have experienced difficulties in managing the property in terms of tenancies, repairs, etc. Cash flow may have become a problem and, perhaps, the Seller is having trouble meeting financial obligations. Also, a Seller may have little or no equity in the property. He may have bought at the height of the boom. Prices have fallen. The high ratio mortgage now has a principal balance larger than the fair market value of the home. The Seller's equity may, in fact, be less than zero. Often, a Seller may find herself in a situation where she is not able to devote the time and resources necessary to get the investment back on its feet. In such a situation, a Seller will have minimal ability to do what is necessary to sell the property in the normal way for a fair price. The leverage of an AFS may give the Seller the ability to sell the property at a higher price. Although the receipt of profits, if any, is deferred until final transfer of title, it may make a lot of sense to enter into some kind of alternate arrangement that will (i) transfer the burden of ownership on to someone else and (ii) potentially eliminate any losses that would otherwise be sustained.

Thirdly, an AFS transaction allows a conservative Seller investor to achieve a higher degree of predictability on the return to expect from a property investment since the capital appreciation is locked in at the time the AFS is signed. Of course, when properties rapidly rise or fall in value as they have done, for example, in Alberta in the recent past, a Seller might miss substantial equity appreciation or, conversely, lock in a huge gain.

In any event of all other factors, it eliminates any real estate commissions and mortgage pay out penalties, allows a Seller to defer capital gains taxes and earn a better return on equity than that offered by banks.

In addition, the AFS arrangement is very much like a regular transfer of ownership since the incidence and responsibilities of ownership are, in effect, passed on to the Buyer. The Buyer is responsible for all the usual costs of ownership including realty taxes, condominium fees, utilities, insurance, etc. The Buyer will treat the property like it was his or her own and will, in addition, assume all the tenancy obligations and other responsibilities of property management.

And lastly, while essentially all of the obligations of ownership pass on to the Buyer, title does not. Title remains with the Seller until all monies owing, plus interest, are paid in full.

In summary, an AFS gives the investor Seller a larger market for Buyers, a reduction of the costs typically associated with a regular sale, a predictable return on investment, and the ability to reduce loss while, at the same time, passing the burden of ownership on to someone else while still retaining title.

PAYOUTS: Consideration should be given to the matter of pay out of the Seller's Equity; when should this occur, should there be a pre-payment privilege and, if so, on what terms. If a Seller is interested in a long term interest spread income generator, it may be appropriate to insert a pre-payment penalty provision. With normal bank financing, the mortgage is set for a specific term of years and pre-payment cannot occur without a penalty, typically the greater of three months interest or the interest differential. Therefore, perhaps at a minimum, a Seller may want the Buyer to pay any payout penalties on the existing mortgage. At the extreme, a Seller may want pay out penalties on her existing mortgage AND pay out penalties on the AFS. On the other hand, the parties may want to consider no interest penalty at all.

One of the attractive features of the AFS might be that a Seller is different from a bank and has much more flexibility in terms of financing that can be arranged. A Buyer whose financial situation improves substantially will be able to get institutional financing, pay out the Seller's Equity and pay the lower interest rate offered by the bank. On the other hand, this may never occur and a Seller must be mindful of the possibility that the Buyer will not be in a position to pay out the Seller's Equity in accordance with the terms of the AFS. The AFS must contemplate such a scenario and provide resulting remedies that are simply and easily enforced.

WHY AN AFS IS ATTRACTIVE TO A BUYER: An AFS allows a Buyer to purchase property without the need to qualify for bank financing. The Buyer looks to the Seller to provide the financing and, in the result, essentially negotiates the terms of that financing with the Seller. A Buyer should bear in mind that such financing, like any other private financing, typically comes at a higher cost. With that in mind, it remains a matter entirely open to negotiation. For example, a Buyer could fairly negotiate for a reduced interest rate in exchange for a higher purchase price, which can be a very good bargain since the balance of the Seller's equity will be paid in the future when the market value of the property may, likely, have increased.

Secondly, as outlined above, in a situation where the Seller is experiencing financial difficulties with the property and is motivated to sell at a time when a regular sale will result in the Seller losing money, a Buyer will have a degree of leverage in negotiations. This leverage is balanced against the Seller's leverage in offering to finance the transaction.

Thirdly, although there is no immediate transfer of title, the Buyer gets effective control of the property, along with the other incidences of ownership as described above. The Buyer can move in to the property, rent it out, assign her interest in the AFS to someone else such as a tenant or other Buyer, lease-option the property to a tenant Buyer, sell an option without a lease, etc. [In theory, the Buyer could also sell her interest to a subsequent Buyer where she might get some money immediately and the balance secured by way of a subordinated agreement for sale or other security that charges her Buyer's interest in the property. I say in theory because this truly is treading in new territory. The point being, however, if one has an interest in property (as in our scenario under an AFS), that interest can be sold and secured, provided there is no contractual prohibition on so doing].

COMMENTS ON POTENTIAL TAX TREATMENT: Any profit made by way of an AFS is, of course, taxable and will be taxed either as a capital gain or as income, again depending on one's personal situation. Interest income is typically assessable in the tax year in which it is received. The CRA might allow capital gains to be taken into account over a number of years similar to the way profits received through a vendor take back mortgage are treated. Of course, this being a tax matter, one should get specific advice from a tax adviser versed in these issues.

SUMMARY: An AFS is certainly a valid investment strategy when properly implemented. As always, good results will be achieved through education, due diligence and clear communication between parties. If you have any questions or comments, **please contact Robert Di Vincenzo, Barrister & Solicitor, at 416-962-2666. I would be very happy to talk to you further.**