

## **Off-the-Plan Property Purchases: What might happen if I want to 'Walk Away' from the Contract**

Off the plan purchases are very popular with property investors and it seems apartments are now all the rage in Western Australia. There are a number of benefits to buying off the plan (in addition to lifestyle and location choices); including locking in ownership without having to settle for an extended period of time, often resulting in capital growth between the time of signing the contract and the time of settlement.

It may be one or two years after signing the contract before settlement occurs, however, the purchase price is locked in at the time of signing the contract. A number of investors purchase off the plan properties with a view to selling soon or straight away after settlement and capitalising on any growth that may have occurred during construction, although (prior!) consideration should also be given to the capital gains tax implications of this strategy.

Other benefits of off the plan purchases include government incentives, you get to choose your property from those on offer (position, location and outlook) and sometimes the floor plan and colour scheme of the property, there can be tax advantages and being a new build, you also enjoy the builder's seven year guarantee.

Whilst the idea of buying a property now, but paying for it later seems appealing, there are a number of risks which need to be carefully considered when buying off the plan.

Now firstly, and this might shock some, but the property developer's selling agent actually does not act for you the purchaser and is not able to advise you on the legal risks/appropriateness of the contract nor conduct an independent due diligence on the property. We still hear this story too often...

The other significant risk, which has caught many Western Australian investors out, is that the value of the property may actually decrease between the time of signing the contract and settlement. This can cause numerous problems, most importantly with securing finance to purchase the property in the first place (which, materially, isn't usually unconditionally approved until shortly before settlement)

Another risk is that whilst you may have a say a secure job or personal relationship at the time of signing the contract, but as your professional and personal circumstances may significantly change over the course of one or two years and by the time the property is ready and the developer is looking to settle, you may no longer be able to obtain finance.

Critically contracts for off the plan purchases are anything but standard and are nearly always drafted in favour of the developer. There are usually provisions which allow the developer to delay completion, sometimes by several years, conditional vary the



specifications, charge additional fees and costs and restrict your ability to (validly) terminate the contract without financial penalty or damages.

For example, you may have entered into an off the plan contract for the purchase of a property for \$850,000 in 2013, with settlement due in late 2015. As we have seen in recent times, the property market in Western Australia has levelled off and even declined in a number of areas.

The property which is due to settle shortly, may only now be worth \$730,000 on the open market. It is likely that you have paid a 10% deposit, equating to \$85,000. As a result, you can no longer obtain finance for the purchase price of \$850,000 as the property is no longer worth this much.

A common misconception with off the plan purchases is that in such situations, you can easily 'get out' of the contract (i.e. "walk away") by just only forfeiting your deposit. This is generally not the case...

Whilst the developer is usually entitled to keep all of the deposit, the developer can also sue you and seek specific performance of the contract (i.e: force you by to proceed to settlement) or, much more commonly, damages for the difference between the purchase price and the ultimate re-sale value for that property, which can take many months or even years later to eventuate.

Technically this has to do with developer's duty to mitigate their losses, and hence their claim against you will be unliquidated (i.e. quantitatively indeterminate) until they are able to resell such at then-current 'market value'.

So, if the property value drops by \$120,000 and the deposit was only \$85,000, then the developer can seek the shortfall of \$35,000 plus costs and interest from you. The end result can be that you have lost over \$120,000 plus your own costs and the costs of the developer. Further, as a (prospective) property investor, those 'forfeiture costs' can be subsequently very difficult to reconcile for tax purposes, especially as you never ultimately acquired and owned a property.

It gets even messier if you (naively) used your SMSF fund as the outright purchaser and were hoping, usually in these instances, just prior to settlement to be able to borrow the funds to complete the acquisition... This happens more often than we'd like to see. Just ask some SMSF auditors about it too.

The above is merely a couple of examples of the pitfalls which can, and often do, happen with off the plan purchases. Conducting your own due diligence on the property, the market and the developer is just the start. Knowing your rights, obligations and liabilities under the contract is critical.

Whilst it is possible to negotiate amendments to the contract (contrary to popular belief), knowing the risks involved and the contractual consequences, will assist in minimising the loss suffered/maximising any beneficial contractual negotiations as well as of course making a fully informed decision regarding such not insignificant investment.



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It is therefore imperative that **before you sign** the Contract, you seek legal and tax advice so that you are fully aware of your rights and obligations under the contract, as well as the rights and obligations of the developer.

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