

THE REAL ESTATE DEVELOPMENT MARKETING ACT AND SHIFTING REALITIES

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The boom and subsequent decline of British Columbia's real estate markets over the last few years—combined with the banks' insistence on pre-sales of new strata units as a precondition for construction financing—has led to a plethora of issues and questions for developers and purchasers alike. Due to the inherent uncertainty involved in pre-sales, the B.C. Legislature enacted the *Real Estate Development Marketing Act* (REDMA) to govern pre-sale contracts, which are agreements for the purchase of a new unit and typically entered into before construction starts and subdivision is completed. They are contingent, therefore, on several factors, including successful registration of the subdivision plan and raising of title.

Depending on market conditions, what happens after a pre-sale can be problematic for both developers and purchasers. Pre-selling strata units as a requirement for receiving construction financing forces developers to sell at existing prices—in a rising market, these may well not fully anticipate price escalation. In fact, in the years before 2008, pre-sale prices completely failed to predict the unprecedented rise in construction and labour costs. Developers faced a triple pain: purchasers pocketed large market gains made at the developers' risk; profit margins eroded as construction costs went up; and refinancing was made almost impossible because the banks' inexorable demand for pre-sales effectively capped a project's returns.

Consequently, developers faced two equally unpalatable options: sell a unit under the pre-sale contract at reduced (often zero) return or refuse to complete the sale (and risk a purchaser's likely lawsuit). Some developers, however, were able to renegotiate prices with cooperative purchasers who were concerned about a developer's ability and desire to complete a project.

More recently, the situation reversed as markets tumbled. Purchasers looked for excuses to walk away from pre-sale contracts as values declined and comparable properties became available for significantly reduced prices. An additional complication has been lenders' reticence to provide the expected takeout mortgage financing; units are now often appraised below pre-sale prices, forcing purchasers to inject additional personal equity.

Wrongfully refusing to complete a transaction is not a comfortable option. Purchasers who do so expose themselves to potential liability to the developer for the difference between the contract price and the price (presumably lower) at which the developer can resell the unit. Additionally, in many cases (depending on the wording of the purchase agreement) they may lose their deposits.

Not surprisingly, current condominium market conditions are encouraging some purchasers to look for legitimate ways to escape from pre-sale contracts. They scrutinize projects in search of unmet statutory obligations and discrepancies between a developer's mandatory pre-sale disclosure and the finished product. They hope to find wording that will support a refusal to complete the purchase.

One of the most important sources for unwilling purchasers is REDMA, which came into force January 1, 2005 and establishes developers' disclosure obligations. REDMA's underlying purpose is to protect consumers, as stated by the B.C. Supreme Court in a 2009 case, *Dwane v. Bastion Coast Homes Ltd.*:

It is common ground that the *REDM Act* is a piece of consumer protection legislation and that one of its central objectives is to ensure that material facts are provided to Purchasers when developments are being marketed to them.

REDMA imposes consistent standards of disclosure to ensure that purchasers of unbuilt property know what they are buying and are kept abreast of the inevitable changes that occur between the initial design and the finished building. Additionally, purchasers can change their minds within seven days of the later of the date they sign the purchase contract or the date they receive the disclosure statement from the developer.

By and large, if a developer fails to properly and continuously disclose pertinent information about a project or otherwise fails to comply with the Act, Section 23 of REDMA allows purchasers to 'walk away' from the purchase agreement without penalty. Furthermore, once the initial disclosure is complete, changes to a unit or project which, although properly disclosed, are substantial or material may warrant an action for damages and trigger either a statutory or common law right of rescission for the purchaser.

More specifically, REDMA's requirements for developers of residential developments include the following:

- A developer cannot market a development unit unless it has filed a disclosure statement with the Superintendent of Real Estate (Superintendent) nor enter a pre-sale contract without providing a copy of the disclosure statement to the purchaser.
- A disclosure statement must be in the prescribed form and set out all material facts (see below) as established in REDMA as well as a purchaser's rescission rights.

- Developers have a duty to plainly disclose all changes to material facts as a project evolves and file new or amended disclosure statements.

A material fact in this context, as defined in REDMA, is:

- a fact, or a proposal to do something, that affects, or could reasonably be expected to affect, the value, price, or use of the development unit or development property;
- the identity of the Developer;
- the appointment, in respect of the Developer, of a receiver, liquidator or trustee in bankruptcy, or other similar person acting under the authority of a court;
- any other prescribed matter;

A developer must disclose a change to a material fact falling under subsections (b), (c) and (d) in a *new* disclosure statement. But, curiously, a change to a material fact falling in subsection (a) usually only requires an amended disclosure statement; nonetheless, if the change is substantial, the Superintendent can require the developer to file a new one.

The distinction between a new and amended disclosure statement is key as it dictates the statutory rights of the parties to a pre-sale contract when a developer's circumstances change. REDMA provides purchasers with a statutory seven-day rescission period following the filing and delivery of a *new* disclosure statement; this allows them to cancel the pre-sale contract without penalty. But REDMA does not attach an express statutory right of rescission to an *amended* disclosure statement (otherwise, presumably, developers would be disinclined to update material facts by way of amendment).

However, the wording of the statute is circular: the definition of "disclosure statement" in REDMA includes the words "any amendment", leaving open the possibility that an amendment may trigger the statutory rescission rights. The Superintendent's position is that the purchaser's recourse when a disclosure statement is amended is either a statutory claim for damages under Section 22 for misrepresentation or common law contract remedies (which may include rescission). Given REDMA's overriding purpose of consumer protection, the lack of statutory rescission for changes to some types of material facts appears inconsistent.

At common law, a signer of a contract can only rescind the agreement if there has been a material misrepresentation by the other party before the completion of the performance of the contract. Changes to items classified in subsection (a) of REDMA's material fact definition (see above) probably qualify as misrepresentations substantial enough to trigger a purchaser's rescission rights.

REDMA deems all purchasers to have relied on misrepresentations contained in a disclosure statement regardless of the type of material fact involved. Therefore, if a developer files a

disclosure statement containing a misrepresentation, the purchaser has a right of action for damages against various entities including the developer, its corporate directors, and any signatory to the disclosure statement. Even if a developer corrects a misrepresentation that existed when a purchaser originally signed a contract, REDMA allows the purchaser to seek damages for the misrepresentation by treating the statement as if it was never corrected. While the protection afforded by this part of REDMA doesn't provide an opportunity to rescind the contract, it does allow purchasers to sue for monetary compensation and, effectively, to receive the value of what they initially negotiated.

Of particular note in the present economic downturn are parts (b) and (c) of the "material fact" definition (see above). The appointment of a receiver would be a decisive step allowing purchasers to rescind a pre-sale contract without incurring the risks described above. However, the window of opportunity is narrow and purchasers should obtain legal advice upon receipt of any new or amended disclosure statement in such a circumstance.

When a development is in financial trouble, developers, as well as their financiers and other creditors, are well advised to seek legal advice *before* a receiver is appointed. They should assess the risk of triggering a potentially devastating turn of events that might allow purchasers to withdraw from their pre-sales contracts. The appointment of a receiver is usually intended to preserve the assets and business of a developer but, given the nature of REDMA's rescission rights, the intervention of a receiver can have exactly the opposite effect—pre-sales will evaporate, destroying a project's value and financiers' ability to recover their loans from the developer.

The past year marks the first time the real estate market has slumped since REDMA's enactment so it is difficult to predict how the legislation will affect other interest holders. Developers' financiers are the most likely group to be impacted. To take one possible scenario: a financier of a pre-sold development may find itself unable to appoint a receiver without facing an argument from guarantors of the developer's loan that the appointment was imprudent and prejudicial to the guarantors, thus releasing them from their guarantees.

REDMA is designed to govern developers and purchasers throughout the pre-sale and construction period with an overall intention of protecting purchasers. The courts have not yet had much occasion to consider REDMA so it's unknown how they will balance the above interests while interpreting the legislation. In the interim, approaching the pre-sale process with a broad view and understanding of how REDMA may affect the various involved parties is wise.