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Welcome to the first issue of *Property Speaking*. This newsletter will be published electronically about three times a year, more if there are burning issues or there is news that may have an immediate impact on your business or personal affairs.

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It is all part of our service to you, ensuring you receive quick efficient communication of property news, articles and stories of interest.

In this issue:

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NZLAW
AN ASSOCIATION OF INDEPENDENT LEGAL PRACTICES

Buying at a Mortgagee Sale

Pitfalls for the unprepared

It is said that every cloud has a silver lining, and one of these might be buying a property for a good price at a mortgagee sale. Whilst market commentators have noted that the increasing number of mortgagee sales can provide good investment opportunities in the current market conditions, a buyer needs to be aware that purchasing a property at a mortgagee sale is a very different proposition from buying direct from the owner.

When buying at a mortgagee sale, a purchaser should be aware of the following:

1. Do your homework

As with any purchase, you should have a good appreciation of the property's market value. In mortgagee sales this is particularly relevant as the purchase price is usually less than the market value due to the risk factors identified below.

As banks and other mortgagees usually sign unconditional contracts for mortgagee sales, it is imperative that you undertake due diligence on the property well before the sale.

The terms of a mortgagee sale typically include none of the usual vendor warranties such as confirming building consents and code compliance certificates. We strongly recommend you get a LIM report, inspect the local council's property file and have a building expert assess the condition of any structures on the property before you commit to the purchase.

In a similar vein, it is very important that you ask us to review the terms of sale before bidding at auction. At auction, a buyer is deemed to have accepted the title to the property and cannot raise any objections about the title nor claim any compensation for errors or mis-descriptions of the property. The mortgagee sale agreement also usually allows the mortgagee to withdraw from the agreement if the registered owner repays the debt secured by the mortgage. As a buyer, you will not be able to sue the seller for such a withdrawal, even if the vendor defaults on settlement.

Under a mortgagee sale agreement there are no guarantees about the state of the property, nor of the chattels and fixtures. Chattels could be removed from the property before settlement, and the property may not be in the same state of repair on the settlement date.

2. Buying at auction

As well as the successful bidder being expected to pay a 10% deposit at the auction, in a mortgagee sale situation the property is likely be at the buyer's risk at the fall of the hammer. Insurance should be arranged either before the auction, or immediately afterwards.

3. Settlement

A mortgagee sale agreement will usually not guarantee vacant possession on settlement. Therefore, on settlement there may be tenants on your new property, or even the former owner.

If there is a tenant, or if the owner is still living in the property following settlement, you will be responsible for removing the occupants from your new property. If the tenant or the former owner does not peaceably leave, you may need an eviction order. A tenant may claim their entitlement to remain in the property after settlement based on a tenancy agreement; this may not have been disclosed to you before settlement.

Conclusion

If you intend buying at a mortgagee sale you should be aware of the specific risks relating to a sale of this nature. The price may be very attractive, but beware of the pitfalls.

Is your Deposit Safe?

A tip for property buyers

In these uncertain economic times, if you are buying a property you should be mindful of the risks involved in allowing the deposit you have paid to be released to the seller before settlement.

In New Zealand it is standard practice for the buyer to pay the deposit to a stakeholder, usually the real estate agent, when the agreement is signed. That stakeholder retains the deposit until either the date the agreement becomes unconditional or the date the buyer's ability to object to the title ends, whichever is the later of those two dates. After this, the stakeholder pays the deposit to the seller. If the stakeholder is the real estate agent, the agent's commission is usually deducted from the deposit and the balance is forwarded to the seller before settlement.

New Zealand out of step

It has been observed that this practice is out of step with most other countries; overseas a stakeholder usually holds the deposit until settlement. The rationale given for the New Zealand treatment is that by releasing the deposit before settlement the seller (in the case of a residential transaction at least) can use the balance of the deposit received from the buyer as a deposit on their own purchase of a replacement property.

However, this arrangement can pose a credit risk if the transaction does not settle and the seller has, in the meantime, spent the deposit.

The situations in which this could happen include:

» The seller is a fraudster, or simply disappears with the money, or

» Where the balance of the purchase price payable on settlement is insufficient to discharge the seller's mortgage. In this situation, the seller may be unable to settle, and may also be unable to refund the deposit paid by the buyer.

These risks can be minimised by the agreement stipulating that the stakeholder will retain the deposit until settlement. Including such a stipulation may be unpopular with sellers who anticipate being able to use the deposit for their own purchase. Similarly, any requirement that the deposit be held until settlement (without the agent deducting their commission) will affect the real estate agent.

Minimising risk

If the agreement is signed without such a deposit retention clause being inserted, then the remedies to address the potential risk are very limited. The buyer's lawyer can ask the seller's lawyer to prove the seller has the ability to transfer title on settlement. If the seller is unable to demonstrate this, then the buyer is entitled to insist the stakeholder retains the deposit until settlement.

If you are buying property, do talk with us before you sign an agreement so that we can check the title for mortgages. Once that is known, a decision can be made on whether or not to amend the agreement to protect the deposit.

On-selling Properties before New Titles are Issued

There could be tax implications

If you buy and on-sell properties in a new subdivision or development you should be aware of a new ruling which could change the taxation treatment of on-sold properties before a subdivision plan is deposited.

Recent ruling

The Inland Revenue Department's (IRD) Adjudication Unit has recently ruled that where land in a subdivision is on-sold before the survey plan deposits, the purchaser does not acquire an interest in the land until the plan deposits. As a result of this ruling, the IRD considers that any profit from a resale of the property made before the subdivision plan is deposited is deemed to be taxable income.

The ruling arose as a result of the purchase and on-sale of a section in Central Otago, however it has particular relevance to anyone who buys a house or an apartment off the plans. The following scenario is an example of how the unprepared could be caught by the new ruling.

> *A couple buys a residential apartment 'off the plans' in Auckland. They are buying strictly for investment purposes, and they intend renting it out. Unfortunately, after signing the agreement to buy the apartment off the plans, the couple loses money in a finance company collapse, and there will no longer be enough money to complete the purchase of the apartment when the new title issues.*
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> *The couple therefore puts the apartment (still under construction) on the market. A buyer is found, with settlement of the on-sale to be contemporaneous with the couple's purchase from the developer. When the new title is issued, the couple settles the purchase and completes settlement of the on-sale on the same day. A modest profit is made on the on-sale.*
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> *As a result of the large number of people buying and on-selling sections and apartments, the IRD now undertakes a routine activity audit identifying 'quick sales' on the Land Titles Register. The IRD spots that this apartment was bought and sold on the same day, and a full tax audit of the couple's affairs begins.*

Profit likely to be taxable income

Under the new IRD ruling, the profit on-sale in this fictitious scenario would be taxable income, even though the couple originally intended to buy the apartment for investment purposes. It would still be considered taxable income if they had intended to live in it, and only a change of circumstances had caused the apartment to be on-sold before the title was issued. The same principle would apply if the couple bought a section with the intention to build on it but, through a change in personal circumstances, were forced to on-sell before the subdivision plan was deposited and the new title issued.

Legal commentators have argued the relevant sections of the Income Tax Act were not designed to apply in this way to taxpayers who are forced by circumstances to sell their property. However if you are buying property, you should be aware of the IRD's view that any profit made on an on-sale of a section or an apartment before the subdivision plan is deposited is likely to be taxable income regardless of the intentions or circumstances of the taxpayer.