TALES FROM THE TRENCHES™
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AGREEMENTS FOR SALE:
CREATIVE CASH TAKES TIME AND EFFORT

Two years ago our member ran across an opportunity in his community group. Mom and Dad owned a nice, well-managed condo with a great reserve fund, but their marriage was falling apart. Their CIBC mortgage was in arrears to the tune of $10,000 and condo fees were $4000 in arrears. Dad suffered from a physical disability with no ability to generate income. Mom had taken a job in South America and Dad remained here in Alberta. At the time, condo prices were depressed. The sale price was $200,000. There was only about $10,000 equity in their condo, all of which would be taken up by arrears.

That situation makes it impossible for the sellers to list with a realtor unless the sellers were prepared to pay real estate commissions out of their own pocket. These sellers needed to sell without a realtor. How does an investor creatively purchase this property from a motivated seller? Creative doesn't mean applying for a conventional mortgage with the usual down payment. The best you could do is 15% down with a Canada Mortgage and Housing Corporation (CMHC) insured mortgage and on a purchase price of $200,000 that's a $30,000 down payment. And, even in Alberta, mortgages are not assumable without qualification.

The question is, how could our member, for as little money as possible, get control of this property using seller financing? The answer is, our member employed a real estate strategy known as an 'Agreement For Sale,' abbreviated as 'AFS.'

AN AGREEMENT FOR SALE IS A CONCEPT AND A DOCUMENT

Formerly in wide use across Canada and still in use in Alberta, an Agreement For Sale or AFS is a strategy where the buyer takes control of the property and uses seller financing. The words 'Agreement For Sale' are both the name of the strategy and the name of the security document that the buyer gives the seller.

SELLER'S NAME STAYS ON TITLE

The essential first part of an AFS is that even though the buyer takes full possession of the property and is responsible for taxes, insurance, and maintenance of the property, the title remains in the seller's name. Sellers love that title remains in their name when they are providing the financing.

SELLER ACTS AS LENDER

The second essential part of an AFS is that once you have paid your deposit, if any, the seller is your lender for the rest of the purchase price. The seller may have a large mortgage already registered against the property, a small mortgage, or no mortgage at all. The amount of the seller's mortgage, if any, is usually not a concern to you. You are not assuming the seller's mortgage. He or she is your bank for whatever money you still owe. What the buyer owes to the seller is called the 'unpaid seller's equity.'

There were lengthy negotiations extended by Mom being out of the country. It took a long time to get an arrears statement and any cooperation from the foreclosure lawyer. Finally, we got the arrears statement, which confirmed the existing mortgage to CIBC was $10,000 in arrears. It was time to write the offer.

Now, in many cases and including this Tale, after paying the deposit/cash portion, the amount you owe the seller and the amount the seller owes his lender might be exactly the same in dollar value. That was the situation for our member in what we describe as a 'low/no equity AFS.'

Using a standard Alberta Real Estate Association (AREA) purchase contract and a specialized AFS schedule, he and I wrote up the contract. Lucky for us, Mom had to return from South America so during her two-week visit, we got the contract signed and she went to see a lawyer that I was able to recommend as being familiar with AFS.

NOT ALL LAWYERS KNOW AGREEMENTS FOR SALE

The AFS strategy does not work well with lawyers who don't understand or haven't worked with AFS. Always make sure your seller has a lawyer who understands and who will cooperate in an AFS transaction. I sent a draft AFS document to the seller's lawyer. We finally got the AFS details worked out, although we didn't get everything we wanted.

One ideal AFS component is a power of attorney (P of A) from the seller to the buyer leaving the buyer in full control of the property. The P of A is very useful for a buyer who might have to deal directly with a lender, municipality, or uncooperative post-closing seller (no more skin in the game). The seller did not want to give the P of A on the advice of their lawyer, which later caused our member trouble. However, we did get them to sign a transfer of land to be held on file along with a management agreement.

Having the signed transfer on file facilitated the situation two years later when the AFS matured and our member had to refinance to pay the full purchase price or sell to third party. A management agreement is not as powerful as a P of A, but still useful. And so, with much backing and forthing and time and stress the deal closed and our member now controlled the property. In the end, our member paid the seller $16,000 representing the mortgage arrears, condominium arrears, and $2,000 for the seller's lawyer's legal fees.

… Wait a minute, if the seller's equity was only $10,000 should our member have paid $16,000 cash?

Over the next two years our member battled with CIBC on the question of making the underlying mortgage payment. He didn't want to simply deposit his AFS payment to the seller's bank account because the sellers were in financial difficulty. What if they received our member's payment and then didn't make their mortgage payment?

CIBC didn't want to deal with our member because of the foreclosure history. They didn't like and would not abide by the management agreement. Similarly, the condominium corporation was not cooperative. However, our member finally worked out the details of ensuring the sellers underlying mortgage payment was made, dealt with the condominium corporation, and installed a very satisfactory tenant.

Fast forward two years later and our member wanted to sell the property. The AFS was maturing and the condominium market had recovered. The next issue to deal with was that lenders and title insurance companies have tightened their rules to disallow skip transfers. They want the seller's name on the contract to be the same as the name on title.

The sellers wouldn't cooperate so our member negotiated financing with Calvert Home Mortgage. He transferred the property to himself, put on the new mortgage, and paid out CIBC. Now, the title was in his name and he listed the property, which sold quickly for $268,000.

A rocky, stressful road… leading to a sweet profit. Even allowing for substantial extra expenses and real estate commission, our members annualized return-on-investment (ROI) was 280%.

LESSONS LEARNED:

1. Low/no equity does not equal no value.
2. Power of attorney is ideal for low/no equity AFS.
3. AFS require lots of babysitting. This is a senior strategy. You need education/coaching/solid legal representation before embarking on AFS deals.