Real Estate Development Insolvencies, a British Columbia Perspective

By
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I. INTRODUCTION

The purpose of this paper is to share some of the more interesting experiences, as well as legal and practical issues, arising from a variety of real estate development insolvencies. The authors offer insights from their involvement in more than twenty different financially distressed real estate projects throughout British Columbia, including Vancouver based high-rise condominium developments, recreational properties in the BC Interior, golf course developments, single family subdivisions, single family and multi-family developments.

The condominium market in British Columbia has been on a roller coaster ride since the summer of 2007. The state of the real estate market often determines the strategy that a lender adopts when attempting to recover its loans. In a rising market, the lender may often want to cancel presale contracts in the hopes of obtaining a greater selling price. In a declining market, the opposite is true, as the lender or its agent will often go to great lengths to preserve presale contracts.

Under the BC Real Estate Development and Marketing Act ("REDMA")[2] the appointment of a receiver on a development project requires the filing of a new disclosure statement. This requirement gives the presale buyer the right to rescind its contract within seven days of receiving the new disclosure statement. However, filing for creditor protection under the *Companies' Creditors Arrangement Act* ("*CCAA*")[3] only requires an amendment to the disclosure statement. The Court

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1 The writers of this paper are David Bowra, President of the Bowra Group Inc. and Heather Ferris of Lawson Lundell. The writers would like to thank Alan Davies, a Vice President of the Bowra Group Inc. for his comments and suggestions on construction and development matters.

2 S.B.C. 2004, C. 41 ("REDMA").

3 *Companies' Creditors Arrangement Act*, R.S.C. 1985. C. C-36.

appears to support the view that the filing of an amendment to the disclosure statement does not afford the presale purchaser the automatic right to rescind the contract.[4]

Filing under *CCAA* has proven to be the most appropriate option when the lender is attempting to preserve presale contracts. The Court has gone to great lengths to assist in the restructuring of a development, notwithstanding that at the end of the day there may be little if anything available for creditors other than the secured creditor.

Lenders and their counsel have learned that there are pros and cons of both receivership and *CCAA*. While a presale contract is placed at risk in a receivership, filing under *CCAA* does not always give the lender the comfort level it may need to properly manage and oversee construction costs, and ensure a satisfactory and timely completion of a project.

Time and interest costs are the enemy of a real estate development. During the 12 to 18 months that it may take to complete a project, the market can change dramatically. When a project gets into trouble, things take longer to get resolved. When a project has more than one lender, the interest costs can be prohibitive. While lenders often believe that their first loss is their best loss and attempt to sell an uncompleted building on an "as is where is" basis, experience has demonstrated that this option is not really the best, but rather, merely wishful thinking. In the authors' experience, there has only been one situation where the lender was paid out on an "as is where is" basis. In that case, it was not an arm's length transaction, but rather a second mortgage holder taking over the first mortgage holder's position at a large discount.

There are a variety of issues that have to be dealt with in real estate development insolvencies.

- The actual **completion of the construction project**, which involves getting the trades back to work, dealing with the lien holdbacks, retaining consultants and possibly hiring a new construction management team.

[4] Jameson House Properties Ltd. (Re), 2009 BCCA 339.

- Determining the **true cost to complete a project** and developing a realistic schedule of construction that can be used as a basis for presale purchasers making their decision on whether or not to complete their purchase, and for the lenders.

- **Funding the completion costs** of a construction project can be more challenging than one would think. There have been situations where proposals to finish a construction project involved financing costs of 3.5% per month.

- Dealing with the **home owner warranty**.

- **Assessing the existing management** team or hiring a knowledgeable, capable and experienced construction management team to oversee the completion of construction not only on schedule, but also on budget can be a challenge.

- **Dealing with presale purchasers**. While legal counsel may advise that debtors can sue individual buyers who fail to complete on their presale contracts, more often than not the legal costs involved outweigh the recoveries. In a falling market, a 10% deposit is little comfort when the market has dropped 25% from the presale price.

- The **disclosure statement,** which includes the form of purchase and sale contract, is a key document, as is the drafting of amendments or a new disclosure statement which is a requirement in the event of a receivership.

- The **marketing and selling of condominium units** is unique to every project. No two projects are alike, and what works in one situation will not always work in another. The following matters have to be considered: the valuation of the units; the 7 day rescission period; the method of rescission; and the sales and marketing plan. We have used a variety of different methods, including the use of a marketing firm, a real estate agent, as well as selling the units directly as receiver.

- **Dealing with City Hall** forms a large part of any real estate development project. Experience has shown that the smaller the community, the more remote the location, generally speaking, the less sophisticated the parties.

The paper is organized in the following way. Part II addresses inspection of the project and initial report. Part III examines how true costs of completing the project are determined. Part IV discusses the funding of the completion costs. Part V addresses homeowner warranty; part VI construction management and part VII presales contracts. Part VIII discusses the importance of disclosure statements. Part IX reflects on the sales and marketing of units. Part X discusses the importance of dealings with city hall and Part XI provides comments on specific cases.

II. INSPECTION OF THE PROJECT AND INITIAL REPORT

Following the appointment as receiver or monitor under *CCAA* of a real estate project, there is usually a requirement to submit a report to court in a fairly short time frame. Sometimes this is as little as 21 days, and usually no more than 30 days from the date of appointment. The report will usually include: an estimate of the costs to complete the project; a market value assessment of the completed units as well as a value on an "as is where is" basis; an assessment and comparison of the various alternatives including completing the project, and selling the project on an "as is where is" basis; an assessment of the additional funding required and the risks involved with each alternative; and a recommendation to the Court as to the most appropriate options to maximize recoveries to the stakeholders.

In order to determine the cost to complete a project, the following are required: confirmation of the work in place; confirmation from the trades and consultants of what is required to complete the project, and how much they are owed; details of any unfunded holdbacks, and liens filed on the project; confirmation from other parties, such as warranty providers, as to any building deficiencies, building code issues and any other matters that may influence the cost to complete the project; the status of outstanding letters of credit, and construction issues as they relate to local municipalities. Once all this information has been assembled, an estimated cost to complete can be prepared. The

cost estimate must be as accurate as possible as this estimate will be used as the basis for borrowing funds to complete the project.

At the same time the cost estimate is being prepared, it is necessary to obtain a market value assessment of the units assuming the they are completed, as well as an assessment of the value of the project on an "as is where is" basis. While the value of the finished units is usually obtained from an appraiser or realtor, doing an assessment of the value of the building on an "as is where is" basis is quite difficult. Usually it will involve some form of *pro forma* calculation of the net recovery to a third party developer after factoring in overhead and profit, as well as a cushion for construction costs, and the risk of taking over a partially completed project. Dialogue with established developers will help in preparing such an assessment.

Clearly, there is a significant amount of information to assemble and put into a report within the time constraints. However, this information usually determines the course of the receivership or *CCAA*. Spending time on a thorough building inspection can save money down the road. Talking to the warranty providers, consultants, and the City inspector is critical to ensure an accurate assessment of completion costs.

On one mid-rise concrete building we were involved in; the warranty provider's inspection reports flagged several building deficiencies, including the fact that each riser and run in all of the exit stairs was different from each other. The height of the risers varied from step to step and the depth of the run also varied from step to step. The variances were significant enough that they did not meet building code requirements. As a result, each tread had to be either ground down or a topping added to have the exit comply with code. The cost of this remedial work was approximately $100,000. The total cost of the rework was approximately $300,000, before the costs of the delay in construction and attendant carrying costs.

On another concrete high-rise building it was found that the developer had amended the plans resulting in an increase in the floor area. The building had been constructed based on the amended plans that had never been submitted to the City for approval. This increase in floor area resulted in the total floor area of the building exceeding the allowable floor area permitted under the Zoning Bylaw and Development Permit. The remedy was to purchase the required floor area from a Heritage Building at a cost of $30,000 and apply for Variance Permit. The Variance Permit was

approved; however, the approval process delayed the completion date by several months further adding to the cost to complete.

We also completed a mid-rise condo project that used the Hambro joist system rather than concrete. During the initial inspection of the building, it was noted that the ceiling channels for the drop ceiling were incorrectly installed (to meet the acoustical requirements under the Building Code) and were not level. The ceiling channels were out of level within some rooms, in some cases, by close to one inch. All ceiling channels that had been installed had to be reinstalled in the correct manner to meet Building Code and levelled, adding considerably to the cost to complete.

III. DETERMINING THE TRUE COSTS TO COMPLETE A PROJECT

It is much easier to finish a project when the existing key trades are still on site. There is nothing worse than taking over a project where the trades have left the project because they have not been paid, and you have to track them down only to discover that they are busy elsewhere. The single, most important enticement to getting trades to come back to the job site is an undertaking to pay their arrears. However, paying their arrears at the outset is not the way to go to obtain an ongoing commitment from the trades to complete the project. Generally, what works best, is to agree to pay a percentage of the outstanding arrears up front and the balance over a period of time coincidental with the completion of the construction of the project. In addition, it is critical that the trades commit to completing the existing contract for the contract price in writing.

Any arrangement with respect to having the trades return to work and paying their old accounts will usually be subject to a Court order. There are certain essential trades, such as the electrical, mechanical, plumbing and sprinkler contractors that it is preferable not to have to replace. Other trades that can be replaced, more often than not, include building suppliers and landscapers.

It is important not to underestimate the time it takes to replace trades and source new trades, or the time involved in the bid processing and replacement of old trades. Construction management is a very structured, orderly process, and anyone embarking upon the completion of a project without a detailed schedule of construction that is properly planned and scheduled is going to fail. For

example, the construction schedule starts with the footings and the foundation and ends with the final clean. There is no point in ordering a trade to put the roof up until the house is framed.

Getting a new trade on a project can be more expensive. New electrical and mechanical trades will require verification that the existing work complies with code. This will always add to the cost of construction. Finding trades that are familiar with the project is also critical. Trades will want confirmation from somebody that the holdback account will be paid. That assumes there is a holdback account, if not, trades will want confirmation that the holdback account will be brought current and that any outstanding holdbacks to trades will be paid. An important part of any takeover project is to ascertain the current status of the holdback.

Some developers tend to order exotic flooring from offshore. In one instance the developer chose to cut costs and sourced the material from South America. The flooring material was of extremely poor quality and 80% of it had to be replaced. Unfortunately, the source in South America had dried up and we were required to source the flooring from a completely different location at a much greater expense.

Consultants are critical to any project and need to be retained for both inspections and final certificates by the city for an occupancy permit. An early determination of any problems with trades, any plan changes which require City approval, or any extras, can add time and cost delays to the completion of any project. Critical consultants are required in every project. These include mechanical, electrical, plumbing and sprinkler consultants. All of these consultants will be required for inspections and final certificates before the City provides occupancy permits.

The site superintendant and construction manager are key to any project. A good understanding of the ability of the site super and the construction manager is an important part of the receiver's mandate.

A good way to independently assess the project is to review any reports prepared by the warranty provider. On several occasions, we obtained an assessment of problems with both the site superintendent and the construction manager by simply sitting down with a representative of the warranty provider. They conduct regular inspections on the site as construction proceeds and can

provide a very good assessment of the status of construction, the quality of construction and management.

We have yet to work on a project that is in trouble where the actual costs to complete construction are similar to those estimated by the quantity surveyor on the project. Unfortunately, the quantity surveyor's report is based on progress claims and information provided by the developer/contractor and will not always reflect unreported extras. Often costs to complete include extra work that is not covered by the existing trade contracts and would not likely show up on any quantity surveyor's report. Smaller developers are less likely to have the construction knowledge to properly factor in cost increases from the presale stage.

The actual construction start can sometimes be 12 to 18 months down the road. Significant construction cost increases can make a project unviable. All too often the developer/contractor is optimistic that things can be brought in on time and on budget without recognizing that construction costs have increased significantly. On a phased development over a two to three year period, costs can increase dramatically. A few years ago, escalating construction costs of 20% over a 6 month period were common.

IV. FUNDING THE COMPLETION COSTS

I am often surprised when I hear lenders of unfinished development projects say they will sell the projects "as is where is". While we have attempted to do this, in the 20 or so projects we have been involved in over the last 2 years, in only 1 instance have we sold a project approximately (75% complete) on an "as is where is" basis and that was to the second mortgage holder. Very few developers are willing to take over an unfinished condo project, unless it is a very unique and attractive location and they can steal it in the sense of 40 to 50 cents on the dollar. Almost always a lender is better off to finish the project and then sell it.

Generally speaking the existing lender is the party that provides the funding to complete a project. Usually this is the case because the lender is unwilling to be primed at a high rate of interest. Most DIP lenders are looking for between 18% and 24% per annum to finance construction completion. On one of the projects at one stage the proposal was a DIP loan commitment letter at a rate of

3.5% per month to complete the project, albeit behind the construction lender. The authors were subsequently able to negotiate the financing rates down to between 1.5% and 2% per month. Once again, the lender in that instance was one of the lenders already involved in one of the projects.

V. HOMEOWNER WARRANTY

Under the *BC Homeowner Protection Act* of 1998 (the "Act")[5] regulations set out minimum standards of coverage for home warranty insurance for new home construction and residential building envelope renovations. In BC in order to sell a residential property in virtually every municipality and district, the vendor has to have homeowner warranty coverage. Home owner warranty coverage is simply insurance; it is an undertaking from an insurer to provide a homeowner warranty upon completion of construction. At any time up until completion of construction or occupancy of the unit, the insurer can cancel the commitment to provide the homeowner warranty.

Virtually every homeowner warranty commitment letter from an insurer has a clause that says "in the event that the builder goes into Receivership or bankruptcy, the insurer at its option, has the ability to cancel the agreement." Under homeowner warranty coverage, the insurer often will require personal covenants from the developer as well as its corporation. The insurer also requires the developer to post a bond usually in the form of a letter of credit on the project. The amount is usually based on a specific dollar amount per unit.

Unless exempted by the legislation, all new homes are required to be covered by a construction defect warranty, comprising two years on labour and materials (some limits apply), five years on the building envelope, including water penetration, and ten years on the structure. The warranty is sometimes known as the 2-5-10 Home Warranty Insurance. Minimum standards of home warranty insurance for applicable residential building envelope renovations include two years on labour and materials and five years on the building envelope, including water penetration. Home warranty insurance can only be provided by insurance companies authorized and regulated by the Financial Institutions Commission.

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5 *Homeowner Protection Act*, [SBC 1998] Chapter 31.

The Homeowner Protection Office, which administers the Act, ensures that individuals and companies required to be licensed under the Act are licensed and that new homes are covered by home warranty insurance unless they are legally entitled to an exemption. Compliance work includes review and monitoring owner/builder authorizations, ensuring the contractor is a registered builder and is licensed under the program, and that new homes are enrolled and continue to be enrolled in the home warranty insurance program throughout the construction period. As of March 31, 2009 there were three companies offering home warranty insurance for new homes in British Columbia, and three companies offering building envelope renovation warranty insurance.

Warranty providers respond to claims by requiring the residential builder to undertake repairs. However, claims made under a policy of home warranty insurance are ultimately the responsibility of the warranty provider. Accordingly, in the event a builder is no longer in business or does not respond to valid claims made by the consumer, it is the obligation and responsibility of the warranty provider to affect such repairs. The homeowner warranty agreement provides that, in the event of a default, which includes the appointment of a receiver, the agreement shall terminate at the option of the program and the builder shall immediately cease holding itself out as having any rights under the program and any warranty protection with respect to the project.

In a receivership, the receiver will often enter into a new agreement with the warranty provider, the insurer, which outlines the terms and conditions under which the warranty provider will continue to provide coverage to allow the buildings to be sold with the homeowner warranty program coverage. Key elements of such an agreement will include the following:

- a description of the development and its location;
- confirmation that the project is currently enrolled with the insurer and that the insurer has agreed to leave the offer of warranty in place;
- a statement that the warranty provider can withdraw its offer of coverage in the event that the quality of construction or quality of materials do not meet the warranty provider's or industry standards;

- usually the warranty provider will provide technical support which will include regular inspections of ongoing construction of the site.

- In addition, the warranty provider will often offer what's known as a maintenance operations program, which effectively means a five year maintenance schedule and maintenance assessment review. The program is aimed at identifying and reporting failures in the maintenance by strata and any building integrity issues with respect to the envelope for a five year period.

The agreement will include some form of cash security deposit to indemnify the insurer as a result of the absence of the builder member. Such deposit will be held in trust for a period of five years from the date of first occupancy of the building. The warranty provider will undertake that those funds will only be used for apparent defects involving the five and ten year elements of the warranty being water egress and structural defects on the building.

The amount of the deposit required by the warranty provider varies from project to project, but generally speaking it is a dollar amount based on the number of units in the building. In the case of one of the projects, which had 81 units, we were required to provide a security deposit of $6,500 per unit. Assuming the security deposit is not used the full amount will be returned to the receiver five years after the first occupancy in the unit. The receiver also has the option to enter into what's known as a "prepaid service contract" for the first two years after occupancy. Once again, this contract comes with a fee usually in the range of $1,500 to $1,700 per unit.

One project required a security deposit of $525,000, and inspection fee of $4,000, a maintenance program of $25,000 and repair of defect service contract of $138,000. The actual cash outlay was approximately $700,000 of which the receiver would receive up to $525,000 back at the end of five years. Other projects have required different deposits. A 190 unit Vancouver condo project required a deposit of $1.5 million a 108 unit condo project required a deposit of $1 million.

The very first real estate development that we got involved in was a town home development in the Fraser Valley called "Riverbend". On our appointment as a court-appointed receiver the insurer promptly advised us that they had cancelled the coverage, notwithstanding our lawyer's advice that

this was contrary to the court order. This particular cancellation was the start of an effective working relationship with that particular insurer. They realized fairly quickly that there were going to be more insolvencies of developers and they needed to develop a practical approach to dealing with the problem as opposed to just simply cancelling coverage.

This insurer developed a package to assist the receiver, not only in continuing the coverage, but also in improving the quality of the warranty. It is much easier to maintain existing coverage with a warranty provider by posting some form of bond or collateral security to ensure ongoing coverage than to obtain new coverage. The purpose of the collateral security is very simple. Once the building is completed the insurer is liable for any warranty deficiencies, and a developer who is in receivership or under creditor protection is not able to undertake the various warranty repairs.

We have provided a variety of different forms of coverage, ranging from a simple letter of credit, to a charge on the development property. In one project, we provided an indemnity of $1.5 million for a 5 year period, and initially granted the insurer a charge on the assets as opposed to borrowing $1.5 million. Subsequently, when the units were sold, this charge was converted to cash and we were then able to negotiate with the warranty provider for an alternative form of security (by way of a guarantee from the lender who recovered the funds).

VI. CONSTRUCTION MANAGEMENT

One of the dilemmas when taking over an existing project is whether or not to hire a new construction manager or to continue with the existing one. When a company files for creditor protection under the *CCAA*, it is generally an existing contractor that continues to manage the project. In our opinion, this could be fraught with problems. In many occasions, the existing contractor/developer is the one who got the project into trouble in the first place. Continuing to use the existing contractor may only make the problem worse. All too often, restructurings are driven by lawyers without recognition of the real problems.

The real problem is often management. Sometimes, continuing to use existing construction management may ensure the project will continue to incur cost overruns, no matter how vigilant the Monitor. After all, the Monitor under a *CCAA* is nothing more than a party that reports after the

event. Fortunately, in the case of receiverships, the receiver is able to make a decision on whether or not to retain the existing contractor. In the majority of cases where we have taken over a project as a receiver, we have brought in a third party construction management company to finish construction.

In one situation, the lenders wanted to put a receiver in because the developer was dishonest and spending holdback funds and GST refunds on personal expenses as opposed to the project. While the project was not in trouble from a construction point of view, it was in trouble from a financial point of view. As a result a receiver was appointed. We were assured by all of the lenders that the existing construction manager was a star. We discovered within three months of taking over the project that the construction manager was not as good as everyone thought he was. This particular construction manager was not used to having someone looking over his shoulder all the time. In hindsight, we should have put our own construction manager in to finish the project. There is no doubt that the project cost more to complete as a result of being forced to use the existing construction manager as opposed to allowing the receiver to choose its own construction manager.

VII. PRESALES CONTRACTS

One of the problems that have occurred in recent years is the ability to maintain, preserve or rescind presale contracts when a development gets into difficulty. When the market is going up, the developer wants to increase the price, when the market is going down; the presale purchaser wants to get out of the presale contract. It is well established law that a receiver can terminate presale contracts. Cases that have dealt with a receiver's ability to disclaim presale contracts have generally affirmed and applied the reasons of *New Skeena Forest Products Inc., Re v. Don Hull & Sons Contracting Ltd.*[6] In that case, the Court of Appeal allowed the receiver to disclaim a timber harvesting contract in the course of the liquidation of certain Tree Farm Licence assets. The Court of Appeal held that the power of a receiver to disclaim contracts is supplied by the order appointing the receiver. The order in that case authorized the receiver to, inter alia:

6 2005 BCCA 154, 74 D.L.R. (4th) 328, 9 C.B.R. (5th) 267 ('*New Skeena*'). *New Skeena Forest Products Inc., Re v. Don Hull & Sons Contracting Ltd.*

(c) apply for any vesting Order or Orders which may be necessary or desirable in the opinion of the Receiver in Order to convey the Assets or any part or parts thereof to a purchaser or purchasers thereof free and clear of any security, liens or encumbrances affecting the Assets.[7]

The Court described this order as the power to sell the assets "free and clear of the interests of other parties."[8]

In determining whether a contract ought to be disclaimed the Receiver and the Courts must weigh "equitable considerations".[9] These were considered by Chief Justice Brenner at first instance,[10] and included, inter alia:

- the fact that the right being disclaimed was merely contractual and not granted by statute;

- the fact that a highly favourable offer for the assets was available if the contract were disclaimed; and

- the fact that all of the other offers to purchase the assets required the contract to be disclaimed.

While there is clear appellate authority for the ability of a receiver to disclaim contracts, the extent of this power has been the subject of recent debate, especially with regard to contracts.

(1) CareVest Capital Inc v. CB Development 2000 Ltd.[11] ("CareVest")

In CareVest, the developer walked away from a 36 unit strata development when it defaulted on its mortgages and the aggregate selling price of the units under the presale contracts was insufficient to discharge them. After ruling that the presale agreements were not capable of specific performance because the property in question did not yet exist, the Court authorized the receiver to sell each of

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7 *Ibid.*, at para. 20.
8 *Ibid.*
9 *Ibid.*, at paras. 7, 20.
10 2004 BCSC 1818.
11 2007 BCSC 1146 ("*CareVest*").

the units at market value free and clear of any obligation of the developer that may have arose under any contract of purchase and sale pertaining to any strata lot.

The Court affirmed the general rule that:

> Specific performance is not a remedy that is available in relation to a contract that requires work and services to be performed or provided, or in circumstances where the ongoing supervision of the court through a court-appointed Receiver/Manager will be required.[12]

The Court concluded that the breach of the presale contracts gave rise to a claim to damages but not to specific performance and the likelihood that the presale buyers would not be able to recover from an insolvent developer, while regrettable, did not change the result.

The Court ordered the receiver to resell the lots at their present market value, but declined to permit the receiver-manager to disclaim any of the presale contracts outright.[13] Mr. Justice Pitfield ordered that the receiver set aside any surplus sale proceeds in trust, establishing a fund to which the presale purchasers could attempt to establish entitlement by way of an equitable charge.

At a subsequent hearing to deal with the issue of priority, the Court found that due to the fact the net proceeds of the receivership were insufficient to cover the principal and accrued interest owing to CareVest on its mortgage to the developer prior to the existence of the presales contracts, it was unnecessary to consider the arguments of the presale buyers that they had acquired an equitable interest under their cancelled presale contracts.[14] In her decision, Madam Justice Garson clarified that Mr. Justice Pitfield did not create a fund for a damage claim the presale purchasers may have against the developer nor did he determine that the monies to be held in trust belonged to the purchasers. Rather, he merely ordered that the funds be segregated and secured so that the presale purchasers could argue later about their entitlement and priority thereto.

The CareVest decision serves to affirm that, as a general rule, specific performance is not a remedy that is available for a contract that requires work and services to be performed or provided or in

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12 *Ibid.*, at para. 14.
13 *Ibid.*, at paras. 26-28.
14 *CareVest Capital Inc. v. Chychrun*, 2008 BCSC 1138.

circumstances where ongoing Court supervision will be required through a Court-appointed receiver. The Court further affirmed this in bcIMC Construction v. Chandler Homer Street Ventures Ltd. and provided examples of when it is appropriate for the receiver to disclaim a contract involving real property.

(2) bcIMC Construction v. Chandler Homer Street Ventures Ltd.[15]

Lenders commenced foreclosure proceedings against a 192 unit development in Vancouver's Yaletown district and a 216 unit project in Richmond, BC. The court-appointed Receiver sought directions that a number of presale contracts be disclaimed. Mr. Justice Burnyeat found that a Court-appointed Receiver's power to disclaim includes the power to disclaim an equitable interest:

> "I am satisfied that the decisions referred to establish the following propositions:
>
> (a) the Receiver and Manager is not bound by the Contracts of either Chandler or Cook entered into before the Receivership unless it decides to be bound by them;
>
> (b) the Receiver and Manager should and did seek leave of the Court before disclaiming the Contracts;
>
> (c) Chandler and Cook will remain liable for any damages if the Contracts are disclaimed by the Receiver and Manager;
>
> (d) any duty to preserve the goodwill of Chandler and/or Cook is owed to those entities and not to the creditors of Chandler and Cook;
>
> (e) **the ability to disclaim contracts applies even if the party contracting with the debtor has an equitable interest as a result of the contract**; and
>
> (f) if a Receiver and Manager decides in its discretion to be bound by the contracts of a company entered into before the Receivership, then the Receiver and Manager be liable for the performance of those contracts."[16]

In determining the issue of whether an equitable interest had arose, the Court gave effect to clear provisions contained in the presale contracts which stated that only contractual rights and no

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[15] 2008 BCSC 897 ("*Chandler*").
[16] *Ibid.*, at para. 58.

interest in land were created by the agreement. In addition as specific performance was unavailable because construction and stratification were incomplete, an equitable interest in the property had not arisen.

The law appears to be settled that a receiver can disclaim presale contracts on a variety of grounds. When the market was high, this presented an easy solution for failed projects: just have a receiver appointed to finish the project, disclaim the presale contracts, and sell the units for current market value. With a falling real estate market, however, the tables have turned, and the issue is how to keep the presale contracts in place and enforce them.

When presale buyers refuse to close, the claim is for damages. Lawsuits involving a large number of defaulting presale buyers are expensive and difficult to manage. In addition with the falling market, the default is often the result of an inability to obtain mortgage financing through no fault of these purchasers, as a result of a tighter credit market, tougher credit requirements of borrowers and lower appraisal value for the property.

The falling real estate market and the incentive for presale buyers to walk from their contracts has seen various legal issues raised regarding REDMA[17] in an effort to provide those buyers with new rescission rights. REDMA is fairly new legislation and the case law is sparse. However, new cases appear now to provide some clear direction regarding those rescission rights, especially in insolvency.

It is now established law in BC that a receivership requires the receiver to file a new disclosure statement, while a filing under the *CCAA* does not. It simply requires an amendment to the disclosure statement. An amendment to the disclosure statement according to REDMA, as well as case law, has determined that a presale purchaser cannot cancel the contract. However, that has not stopped legal counsel from attempting to apply to Court for an order seeking a declaration that the presale contract is voided as a result of the *CCAA*. Indeed, we are involved in a current situation where counsel for some 20 presale purchasers is attempting to set aside the *CCAA* on the grounds that it is not appropriate and to have a receiver appointed. Needless to say, if their counsel is successful, the clients will be in a position to cancel the presale contracts.

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[17] S.B.C. 2004, C.41 ("REDMA").

It is also clear in many cases that legal counsel decision whether or not to use a receivership or a *CCAA* based on the need to preserve the presale contracts. In a declining market the need to preserve the presale contracts often outweighs the lender's need to control the construction process. In our opinion, this is sometimes short term gain for long term pain. If the object of the exercise is to maximize recoveries, while preserving presale contracts may ultimately generate higher overall revenues, failure to properly control the costs of completion means ultimate net recoveries are not maximized. Delays in construction as well as increased costs in construction due to poor construction management and site supervision can eliminate any increase in the ultimate selling price of units.

On one project we were involved in, the lender made it clear that they were not prepared to fund construction costs to complete the project unless all presale contracts were terminated and the receiver was then able to resurrect at least 40 new presale contracts at a net value of not less than $17 million. This represented 50% of the total units in the project. As a result, we were put in the unenviable position of having to meet with the presale purchasers and give them both the good news and the bad news.

The good news was the project was going to be completed. The bad news was that they would be required to pay a greater amount if they wanted to buy the unit. Fortunately, as a result of several meetings with presale purchasers, we were able to convince at least 30 of the presale purchasers to buy their units at the increased price.

The media often likes to play a role in "fanning the flames" of condominium problems and for several months during the market meltdown in Vancouver, the media were all over the latest receivership story. They were taking photos of the irate presale purchasers who were either being robbed by a receiver who was not prepared to honour their presale contract, or alternatively, depending on where the market was at, being forced by a unfair receiver to fulfil the terms of their presale contract.

There was one individual who bought a high-end condo penthouse for $1.4 million only to profess in the media that he really had no knowledge of purchasing real estate. Unfortunately what the media failed to point out was that this individual had been buying and selling real estate for the last

18 years, a matter that was evident in his affidavit. In any event, notwithstanding incurring a certain amount of legal costs in trying to enforce the contract, the receiver waited out the presale purchaser, the market rebounded, and the presale purchaser came back and ended up buying the unit at $1.2 million as opposed to $1.4 million.

VIII. DISCLOSURE STATEMENTS

A disclosure statement is a public document the developer is required to file with the Superintendent of Real Estate. In the case of a creditor restructuring under the *CCAA*, an amended disclosure statement is required. In the case of a receivership, a new developer is taking over the project and a new disclosure statement is required to be filed. The form of contract of purchase and sale is also amended and a prudent receiver will draft a contract of purchase and sale which reflects the fact that the developer is in receivership and that all sales are subject to Court approval. The receiver will also require a minimum deposit, a non-subject offer and usually completion dates which are the later of 10 days after Court approval and occupancy permit. The contract should also allow the receiver plenty of room so that in the event there are delays in construction, he will have up to 6 months after the date of Court approval to complete the transaction.

The Superintendant of Real Estate reacts when a developer continues to market a product when it is in financial difficulty. Usually there is a threat to issue a cease trading order. Prudent developers in trouble provide an undertaking to the Superintendent of Real Estate not to market under such conditions.

When must revised disclosure statements be issued as a result of restructuring?

In Dwane v. Bastion Coast Homes Ltd.[18] ("Coast"), the issue before the Court was whether a purchaser had a statutory right of rescission under REDMA[19] in respect of a contract to purchase strata property when the purchaser was not given existing amendments to the disclosure statement, along with the disclosure statement, before entering into the purchase agreement.

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18 2009 BCSC 726 ("*Coast*").
19 S.B.C. 2004, c. 41 ("*REDMA*").

REDMA provides purchasers with the following right of rescission in section 21(3):

> 21(3) Regardless of whether title, or the other interest for which a purchaser has contracted, to a development unit has been transferred, if a purchaser is entitled to a disclosure statement in respect of a development property under this Act and does not receive the disclosure statement, the purchaser may rescind, at any time, a purchase agreement of a development unit in that development property by serving a written notice of rescission on the developer.

A disclosure statement is defined as a statement that discloses material facts about a development property, prepared in accordance with the REDMA, and includes any amendment made to a disclosure statement.[20] Material facts are any of the following:

> (a) 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;
>
> (b) the identity of the developer;
>
> (c) 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;
>
> (d) any other prescribed matter.[21]

The purchaser argued that s. 15 of REDMA, read with the definition of "disclosure statement", meant that both the disclosure statement and copies of any amendments then in existence must be provided to a purchaser before he or she enters into an agreement to purchase a development unit. Section 15 states:

> 15 (1) A developer must not enter into a purchase agreement with a purchaser for the sale or lease of a development unit unless:

[20] *REDMA*, s. 1.

[21] *Ibid.*

(a) a copy of the disclosure statement prepared in respect of the development property in which the development unit is located has been provided to the purchaser,

(b) the purchaser has been afforded reasonable opportunity to read the disclosure statement, and

(c) the developer has obtained a written statement from the purchaser acknowledging that the purchaser had an opportunity to read the disclosure statement.

(2) A developer must:

(a) retain a written statement obtained under subsection (1)(c) for a period of 3 years or a longer period prescribed by regulation; and

(b) produce the written statement for inspection by the superintendent on the superintendent's request.

The defendants countered that there is a distinction to be made between disclosure requirements and a right of rescission as a purchaser should not be able to rescind unless there has been a significant change in the developer's promise or information. In support, the defendants pointed to the distinction in the REDMA between when a new disclosure statement is required (where there has been a material change or where the superintendant so requires) and when only an amendment is required (where the change has not been material).[22]

Madam Justice Smith rejected the arguments of the defendant and determined that a purchaser is entitled to rescind a purchase contract if they have not been given proper disclosure of changes to the plans prior to signing the purchase agreement. As REDMA is essentially consumer protection legislation, one of its central objectives is to ensure that material facts are provided to purchasers when developments are being marketed to them.[23]

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22 *Ibid.*, at para. 63.

23 *Ibid.*, at paras. 69-70.

The Court found that the right of rescission under s. 21(3) is available to any purchaser who was entitled to a disclosure statement, but did not receive it. As "any amendment to a disclosure statement" was included in the definition of "disclosure statement," Madam Justice Smith held that there was "nothing in the wording of the legislation, or in the overall scheme of REDMA, that is inconsistent with a reading of the words "disclosure statement" in s. 21(3) as including amendments."[24]

Madam Justice Smith concluded by stating:

> "If a disclosure statement has already been amended by the time a purchaser signs a contract, the purchaser should know that fact and know what the amendments are, for the simple reason that the purchaser is entitled to know what it is that he or she is purchasing. **To require developers to provide copies of existing amendments along with the disclosure statement is not to impose an onerous burden on them**, and is consistent with the legislative objective of consumer protection."[25] [emphasis added]

Insolvency professionals must be very careful when selling to provide all disclosure documents at the time the contract is entered into to ensure that they don't inadvertently prevent giving rise to new rescission rights after the initial seven (7) day rescission period has passed.

The use of the *CCAA* has proved to be assistance in maintaining presale contracts. The usual argument raised in insolvency is that there has been a change of developer which requires the filing of a new disclosure statement, which immediately gives rise to a new 7 day rescission period. The *CCAA* vehicle allows the original developer to stay in possession thus defeating that argument, however, other REDMA issues have been raised in *CCAA* filings.

In Jameson House Properties (Re)[26] ("Jameson House") presale purchasers of residential condominium units under construction on West Hastings Street in Vancouver, appealed the

24 *Ibid.*, at paras. 70-72.
25 *Ibid.*, at para. 74.
26 2009 BCCA 339 ("*Jameson*").

approval of the Final Order in the developer's *CCAA* proceeding, claiming among other things, that the developer failed to meet certain disclosure obligations under REDMA, thereby affording the purchasers certain remedial rights.

The Final Order granted by Chief Justice Brenner[27] included terms which declared that the presale agreements were in full force and effect and denied the appellants any right to terminate, rescind, or repudiate their presale contracts or to take the position they were not enforceable due to any matter, specifically issues regarding the identity of the Developer that arose before the implementation date of the plan of arrangement (the "Plan").[28]

The purchasers had argued against the approval of Final Order, and again on appeal, on the grounds that the Plan contemplated a change of the identity of the Developer thereby requiring the Developer to file a new disclosure statement under REDMA and the Developer's failure to do so gave the purchasers a right of rescission. Under REDMA, "'developer' means a person who, directly or indirectly, owns leases or has a right to acquire or dispose of development property."[29] As part of the Plan, the Developer had entered into a financing agreement with Bosa Properties Inc. ("Bosa"), under which the Developer would continue on as such, however the corporate structure of the Developer would change with respect to its shareholders and the composition of its board of directors.

In his decision granting the Final Order the Chief Justice concluded that the change in the corporate ownership and control of the Developer did not amount to a change in its identity, stating:

> The term "identity" in the statute has not been judicially considered. The Petitioners say that the identity of the developer when the project started was Jameson House and that the identity after it is completed will be Jameson House. While the directors and shareholdings will change, the identity of the developer will remain the same. The law has long recognized the corporation as a body separate from its

27 *Jameson House Properties (Re)*, 2009 BCSC 964 ("*Jameson* BCSC").
28 *Ibid.*
29 *REDMA*, s. 1.

> shareholders (Salomon v. Salomon [1897] AC 22). Strictly speaking, this is so in the case at bar.[30]

Madam Justice Levine at the Court of Appeal agreed, stating that there was nothing in the statute that suggested that the Legislature intended that the identity of the developer within the meaning of REDMA would change if the corporate ownership or control changed.[31] As such, disclosure was not required under REDMA as a result of a corporate restructuring.[32]

The purchasers also appealed on the grounds that the Developer was required to file and provide an amended disclosure statement when the financing fell away in October, 2008 and its failure to do so gave them the right to rescind the presale agreements.

Section 16(3) of REDMA requires a developer to file and provide an amendment to a disclosure statement where the developer becomes aware that a disclosure statement (including an amended disclosure statement) contains a misrepresentation of a material fact. In April, 2007 the Developer filed an amendment to the disclosure statement stating that it had received a firm commitment for construction financing from HSBC Bank Canada. The purchasers claimed that when this financing fell through, the Developer was required to file a further amendment to the disclosure statement.

The Chief Justice concluded that the failure of the original financing was not a material fact. As previously discussed, a 'material fact' under REDMA includes fact which would "affect the value, price, or use of the development unit or development property."[33] For the Chief Justice it was unclear how the value, price, or use of the development had been or would be affected due to the loss of original financing as:

> …The developer was able to continue work on the project until November 12, 2008. The principals of the developer held an honest belief, until just prior to the filing that they would have access to sufficient construction financing.

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30 *Jameson* BCSC, at para. 10.
31 *Jameson*, at para. 26.
32 *Ibid.*, at para. 29.
33 *REDMA*, s. 1.

> More significantly, if this restructuring is approved by the Court and if it succeeds, the purchasers will be entitled to receive precisely what it was they contracted for…[34]

The Court of Appeal agreed. Implementation of the Plan would serve to provide the purchasers with, at the very least, exactly what they had contracted for. As such the failure of the original financing was not a "material fact" and did not trigger a requirement that the Developer file an amendment to the disclosure statement.

This decision goes a long way to resolving some of the issues relating to the interaction between the *CCAA* and REDMA. However, in Jameson House the Chief Justice did provide an alternative basis for his decision in that the stay provision in the *CCAA* allowed him to stay any rescission rights that the presale buyers may have without having to deal with the merits of those rights under REDMA. Unfortunately, the Court of Appeal decided on other grounds and thus did not address that part of the lower court's judgment. Accordingly, although addressing individual issues or alleged breaches of REDMA may be fact specific, if is still a realistic possibility that the *CCAA* may simply stay a purchaser's rescission rights under the REDMA.

IX. SALES AND MARKETING OF UNITS

In a pre-sold project that is in financial difficulty, when the market is in decline presale purchasers usually look for the exit. A lender then has to decide whether it will attempt to preserve the presales or recognize that it may have to sell the units again. In a receivership all presale purchasers have the right to rescind.

Every project is different, however, it is fair to say when the market declines by an amount greater than the deposit on the purchase price which is often 10%, presale purchasers "out of money" will look seriously at their right to rescind. While there are some who have invested time and emotional money in the project and want to continue to complete, the vast majority of presale purchasers have historically been investors looking to make money through a short term investment. These investors generally walk when the market has declined.

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[34] *Jameson* BCSC, at paras. 18-19.

We have used a variety of different methods for selling units. These include, hiring large international marketing firms, using independent realtors and selling units through a receivership sale. There is no one method that is appropriate for every case.

In one of our larger projects, we started off with a marketing firm that we fired after 60 days. When we asked them why they were not selling, they told us that they were not a sales firm, but a marketing firm. We were subsequently recommended to a realtor by another well established and reputable marketing firm. This realtor was very successful initially. Unfortunately, as construction dragged on and the market started to decline, it became tougher and tougher to generate sales. We concluded that taking the property off the market until such time as the construction had been completed was the best option. Once the project was completed, rather than call back the realtor to market the project, we held a receivership sale conducted by the receiver.

While we have had receivership sales subsequent to this project, we are not sure that we will continue with this process. That particular receivership sale was extremely successful. In a period of 2 days, we managed to sell 39 of 44 condo units in downtown Vancouver. The average unit price was $400,000. The sale took a lot of time and energy to plan. Fortunately, the media following up on the story really helped our marketing approach, as did the location of the project, which was in the Yaletown district of downtown Vancouver. At the end of the day, however, one thing sold the units, and that was price. They were priced to sell, and the units represented a good deal.

We completed the sale of 25 town home units in Sicamous in the summer of 2009. Sicamous is in the interior of BC in the Shuswap right between the Mara and Shuswap lakes. It is a resort community visited mostly by Calgarians, being some five hours from Calgary and some six hours from Vancouver. The selling period is a very short period of three months.

We sold these units at approximately 50% of the price they were selling for the previous year. That said we were still selling 3,400 square foot units for $750,000.

We started the sales program off by hiring a realtor only to conclude, within 60 days, that the realtor was not cutting it. We changed the approach and had someone on a full time basis located on site to market the units on behalf of the receiver. This person was not a realtor, but had a real estate

background. We did not pay him a commission. We paid him a salary. We managed to sell all 25 units in a 60 day period primarily because of the pricing. We also furnished some of the units in order to make the buyer's decision easier. This marketing strategy worked. A total of 8 of the 15 units we sold in the project in the last 30 days were furnished.

X. CITY HALL

You will have to deal with some form of City Hall. If a developer has changed plans and a project is covered by development permit and you have not obtained city approval, the project can be delayed as will Court approval of sales. City Hall varies in terms of their ability to turn things around, and in some instances, you may have the misfortune of having to deal with a city administration of one person. We have discovered that in the more remote communities, the level of expertise and the timeframe to turn things around seems to be dependent on the size of the municipality. That said, there are some very large municipalities that are not considered to be developer friendly.

XI. SOME WAR STORIES

(i) The Sophia, Vancouver

This project was an 81 unit condo development in a Vancouver suburb. 79 of the units had been presold in the period January to June 2008, of those 79 presales, 19 presales had been assigned to third parties. There was approximately $24 million of debt, a $20 million prior first mortgage at 7% per annum, and a $4 million second mortgage at 20% per annum. In addition the equity in the project was provided by third party investors, some of whom ended buying units in the building.

The site construction manager on the project held a mortgage on the property (in fourth position) for $135,000 and had bought one of the prime units. The estimated cost to complete was $9.2 million. This was over and above the $24 million that had already been spent. The then current market value of an average unit was approximately $490,000 versus the average presale price of $375,000. After commission, the difference in presale price and current market value was in excess of $7 million.

The 19 assignments were sold for an average price increase of approximately $85,000. The monies for 8 of the 19 assignments' were held in trust, the remaining 11 assignors had taken the proceeds. Several of the presales were at significant discounts to the then market value. One of the reasons was that these units were sold to investors and/or trades or consultants. We estimated that 20 units were underpriced at the then current market by an average of $85,000 a unit.

When we conducted our option analysis, we concluded the sale of the project on an "as is where is" basis was the worst option. The most practical approach was to finish the project, cancel all the presales and resell them at current market value with the lenders' and the Courts' approval. We ended up offering all presale purchasers the right to buy at current market value less 10%.

A total of 35 of 79 presale purchasers chose to buy at the new discounted market value. We were then forced to attempt to find other presale purchasers in order to reach the threshold requirement that the lenders had put on the receiver in order to fund completion costs. The lenders indicated that they wanted $17 million in presales and 40 units in number before they would fund the receiver to complete the project. This funding requirement took the receiver two months to achieve.

The sales of the remaining units was very difficult. Notwithstanding several attempts using different marketing firms, we discovered that we could only sell units once the building was completed.

We ended up providing a security deposit to the warranty provider of $5,500 per unit for a five year period. This money will be returned to the receiver at the end of five years. We also agreed to pay a service contract of $1,700 per unit for the warranty provider to provide warranty service post occupancy.

(ii) Riverbend, Coquitlam

This was a 36 unit strata town home development in the Lower Mainland of Vancouver at various stages of construction. Some of the units were just bare strata lots, others were around 30% to 80% complete.

Costs to complete were estimated at $3.2 million; significantly more than the quantity surveyor's estimate of $1.5 million. The presale prices represented an average of approximately $80,000 less than the current market value. We reviewed a number of options which included:

1. Complete the development and sell the units at the pre sale prices;
2. Complete the development and sell at current market value;
3. Sell the entire project on an "as is where is" basis;
4. Complete the development with the exception of the bare lots, which would be sold "as is where is";
5. Complete the development with the exception of any unit that was less than 60% complete, which would be sold "as is where is".

The total debt was $12.3 million, which included $8.5 million by way of a second mortgage to CareVest.

The estimated recovery to the lender ranged from a shortfall of $2.6 million under Option 3 to a shortfall of $4.6 million under Option 2. While we considered the option of selling the project on an "as is where is" basis, we never actually went to market on this basis. It was clear, however, that any developer would require a significant discount on the current loan of $8.5 million, notwithstanding that the market had increased. The development was completed by the receiver and the units sold at current market value. This required an additional $3.8 million in funding. The presale contracts were cancelled by the receiver, but it offered these purchasers the right to buy their unit at current market value.

The home warranty provider cancelled the home warranty insurance coverage. As a result, we were required to find a new contractor registered under the Home Warranty Program. The home warranty provider did reissue coverage, however, this required the payment of a management fee and a cash security deposit. This deposit was refundable after 5 years.

The completion of the construction of all units, including the bare lots, took approximately 9 months.

(iii) Chandler, Homer and Helmcken, Vancouver

This development was a 192 unit condo development in the Yaletown district of downtown Vancouver. At the date of the receivership, there were only 9 unsold units. The total debt on the project was $55 million, which was comprised of $47 million at 7.75% per annum, $3.1 million at 16% per annum and $5.2 million at 24% per annum.

Collectively, the secured creditors did not want to sell the building on an "as is where is basis" as they knew there would be a significant discount. The costs to complete the building were estimated at $27 million.

This development went into receivership as a result of a lawsuit filed against the developer. All presale contracts were honoured by the receiver unless the presale contracts were below market value as at the date of the purchase and sale agreement. We obtained a third party analysis on the presale contracts and noted that 4 presales were "gifted" to non-arms length individuals and 11 presales which were sold below market value at the date of the presale contract. In addition, there were two presale contracts that did not have any deposits held in trust.

Real estate prices were still strong in the Vancouver area in early 2008 and we did not expect too many presale purchasers to rescind their contracts once the new disclosure statement was filed by the receiver. A total of 15 presale purchasers rescinded their purchase and sale agreements.

At the date of the receivership, there was a stop work order issued by the City of Vancouver for the top 3 floors of the building as the developer had decided to reconfigure the Penthouse condo's from 6 penthouses to 4 larger penthouses without amending the Development Permit. In addition, the new penthouse configuration increased the FSR over the maximum allowable by 410 square feet. The receiver had to make the necessary amendment applications to the City of Vancouver and purchase an additional 410 square feet of FSR. By the time the necessary approvals were obtained from the City, there had been a 5 month delay in construction of the top three floors of the building.

The building was completed in October 2008 and we attempted to close over 170 contracts within 30 days. Due to financial crisis of September 2008 and drop in real estate prices, we quickly found

out that many presale purchasers were unable or unwilling to complete the purchase of their unit. This resulted in 36 buyers not completing their purchase and those units became available for resale.

By the end of 2008 we had a completed building but still had 50 units to sell. We determined that the only way purchasers would buy was if they were going to get a deal. It was decided that the receiver would conduct its own sale of the remaining units on one weekend and advertise that the units were up to 40% off previous selling prices.

This strategy worked as all but 4 units were sold by the end of the sale weekend.

(iv) Garden City, Richmond

This development was a two tower condo development in the Richmond, BC. The construction of first tower ("Tower I") of the project was completed and 94 units of the 106 unit condo development were sold and occupied. The second tower ("Tower II") was a 108 unit condo tower that was approximately 75% complete. We became the receiver over Tower II and the 12 units in the Tower I.

At the date of the receivership, there were 51 unsold units. The total debt on the project was $32 million which comprised of $19 million at 7.75% per annum and the balance at rates of between 16% and 24% per annum. The remaining costs to complete the building were estimated at $16 million.

As this development went into receivership as a result of a lawsuit filed against the developer, unless the presale contracts were sold below market value as at the date of the purchase and sale agreement, the receiver was not going to cancel the contract. We obtained a third party analysis on the presale contracts and discovered that 10 presales were sold below market value at the date of the presale contract. All 10 contracts were cancelled by the receiver.

Once the new disclosure statement was issued by the receiver, 5 presale purchasers rescinded their purchase and sale agreements. After cancelled contracts and rescinded contracts, the receiver had a total of 61 units available for sale.

It was decided the Vice President of construction of the developer would be the construction manager of Tower II. The New Home Warranty provider for this development, Travellers Guarantee Company of Canada ("Travellers"), took some comfort that the existing VP of construction would see the project to completion. However, Travellers required the receiver to post $1 million in security, which was refundable, for New Home Warranty Coverage.

Construction was completed in June 2008. As presale purchasers could "touch, feel and see" the completed units in Tower I, the sales for the project were a little easier to generate than other non-completed developments we have been involved in. The Tower II was completed in June 2008 and all of the units were sold and conveyed by August 2008.

XII. SUMMARY AND CONCLUSION

In our experience, while it is important to preserve presales in an unfinished construction project, that should not be the only determining factor. In many cases, the market may have deteriorated by an amount greater than the amount of the presale deposit, which is sometimes 10% but more often 5%. In a market where prices are off 20%, the fact that a purchaser has a 5% or even a 10% deposit does not mean that they are going to want to complete the purchase. More often they are prepared to walk even if it is a 10% deposit.

Accordingly, the decision on whether to file *CCAA* or receivership made on the basis of attempting to preserve the presale contract is often short sighted. In our opinion, managing and properly supervising the costs of construction and scheduled completion of the project can be the more important factor in maximizing recoveries.

Time is the enemy of a construction project. In instances where a development has more than one lender, the second lender's interest rate can be anywhere from 12% per annum to 24% per annum. It does not take long for a 24% interest rate to eat through any equity a developer has.

We have been involved in several projects where the second mortgage holder has recovered nothing on his investment. We have also been involved in several projects under *CCAA* where the developer has continued to finish the project only to incur further cost overruns, time delays, as a result of

poor quality of construction and poor project management. In hindsight several *CCAA* filings should have been receiverships, since it would have been a more cost effective method of maximizing recoveries, notwithstanding this would have meant the majority, if not all of the presale purchasers' contracts would have been terminated.

When there are no presales, receivership gives the lender greater control over completion of the project. The presale game has changed. It's extremely difficult to generate presales today. Buyers are not just worried about the current market value of their unit, but also where the market is going, whether their pre-approved mortgage will survive a market downturn, whether the receiver is going to build their unit, and whether they are going to get what they agreed to purchase in the first place as represented to them by the developer. Interestingly enough, the home owner warranty issue does weigh heavily in their decision.

Marketing depends on whether it's recreational or city product. Recreational property has a short selling period, and a 10% discount doesn't cut it. Price per foot doesn't matter: in the end it's the price that sells. Having the right price point makes all the difference.

Selling uncompleted units with a promise that they will be finished doesn't work. The buyers today want to see the finished product. Sometimes the buyers or the vendor's fertile imagination isn't enough and you have to market the units already furnished.

The investor market has disappeared in large part and the first time buyer is taking their time. Getting financing is tougher, and lenders are being very tough on appraised values.

The days of handing projects over to marketing firms and just waiting are long gone. Receivers need to be actively involved in the sales and marketing process. They also need a lot of leeway from lenders in order to affect sales on a timely basis. Having pre approval from the Court to sell individual units at a certain price level helps. Receivership sales can work in the right market and if properly priced. It's a lot easier to sell 50 condos that average $300,000 than to sell 25 condos that average $500,000. There are simply more buyers.

There is no cookie cutter approach. Each situation needs to be assessed on its own merits. Recognizing the market value of your property is key. Price sells.

Balancing the need to keep presales with the need to manage costs of completing construction, may lead to different approaches depending on the cooperation of the developer. The more practical the developer, the easier the situation. However, even a practical developer will have difficulty in understanding that to sell in this market may require a discount of anywhere up to 50% of prices that were being achieved in markets of a few years ago.

The simple advice to a developer is to take whatever action the lender could reasonably be expected to take if they were in control and were trying to get their money back. Once you have figured out what that strategy will be, you implement it, taking away the need for the lender to enforce its security. If you are already in control of a distressed property, or are about to take control, then you need to know your options. You need to know what the real costs are and what the real value of the project is.

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