

Let the buyer beware! But what about the seller?

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Where would you stand if a property you have contracted to buy or sell is damaged on or before the settlement day?

The concept of "caveat emptor" (let the buyer beware) is frequently quoted in the context of the purchase of real estate – but less so, the concept of "caveat venditor" (let the seller beware). However, it is both buyer and seller who should be fully aware of their rights and obligations when buying and selling real estate.

It is a relatively common occurrence in New Zealand for people to enter into contractual obligations to sell and buy properties on the same day. Typically, this involves a house owner relying to some extent on applying the proceeds of sale from their existing house to help fund the purchase of the replacement. By and large, this arrangement works well in practice – so what's the issue?

What people may not be aware of is that they are walking a tightrope during the period of time between the "unconditional date", the date when all conditions in the contract have been confirmed so that both buyer and seller are contractually obliged to complete the deal and "settlement", the point in time when buyer and seller discharge their contractual obligations to each other. Let's say Sarah was selling her existing house to Matthew and buying a replacement house from Kate, with both transactions settling on the same date. Where would Sarah, Matthew and Kate stand from a contractual point of view if Sarah's existing house was damaged (say by fire that occurred the day before settlement) and she was unable to repair that damage before the settlement date?

The Auckland District Law Society/Real Estate Institute of New Zealand approved form of Agreement for Sale and Purchase of Real Estate (being the commonly used form of contract throughout New Zealand) addresses this occurrence and contemplates two different scenarios:

1. The property being untenable on the settlement date, in which case Matthew could either (a) cancel the agreement to buy Sarah's house, get a refund of any deposit paid and walk away or (b) complete settlement at the purchase price less the amount of insurance moneys received or receivable by Sarah although if Sarah's insurer had agreed to reinstate the property for the benefit of Matthew, settlement would be without deduction; or
2. The property not being untenable, in which case Matthew must complete settlement at the purchase price less a sum equal to the amount of the diminution in value of the property.

Matthew as the buyer of the damaged house is protected by these clauses. However, what about Sarah in respect of her contract to purchase her replacement house from Kate? Sarah may find herself financially unable to settle the purchase on the settlement date, whether that be because her sale contract has been cancelled by Matthew, it is uncertain or disputed as to what would be the amount of insurance moneys receivable by her or the amount of the diminution in value of the property would be or reinstatement of her house by her insurer for the benefit of Matthew is problematic.

Put simply, Sarah would be obliged to settle the purchase of her replacement house from Kate in full on the scheduled settlement date and her unfortunate position under her sale agreement would be irrelevant. There is nothing in the fine print of the Sarah-Kate contract which protects Sarah in the event her house being sold to Matthew is damaged. Failure by Sarah to settle her purchase from Kate on the scheduled settlement date would expose Sarah to a claim for late settlement interest, potential cancellation of the contract and payment of damages to Kate.

While Sarah could have protected herself by making her contract with Kate conditional upon settlement of her sale contract (in which case, Sarah could have cancelled her contract with Kate in the above circumstances if she wished), realistically any well-advised seller of the replacement house is most unlikely to agree to such a condition.

There is no real silver bullet available to someone should they find themselves in Sarah's unfortunate position. From a practical perspective, that person may be able to secure the necessary finance to enable settlement of the purchase to occur but they will then be in a position of servicing the mortgage finance on the replacement house as well as any existing debt to the bank on their damaged house they are trying to sell. The person may encounter a sympathetic seller who is prepared to defer settlement and/or agree to wait a period of time before exercising their rights under the sale agreement, however this cannot be guaranteed. In any case, it will assist the party in navigating this complex scenario if they have an understanding of what their rights and obligations are accompanied by sound legal advice.

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