Lowndes

Insights

Buying Property From a Seller Who Doesn't Own it Yet

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Gary M. Kaleita

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The Central Florida real estate market is still relatively strong. As a result, some speculators have been placing single and multiple properties under contract for purchase, only to offer to sell the property that they don't yet own to a Buyer for development. It is not unusual nowadays for this scenario to occur when the proposed development is a residential subdivision.

Sometimes the speculator adds value to the property by obtaining development approvals while the speculator has the property under contract. Sometimes the speculator wants to "flip" the property without actually purchasing it, by assigning its purchase contract to the Buyer who then closes with the Owner. Other times the speculator is willing to close on the purchase with the Owner and then deed the property to the Buyer, which increases the Seller's transaction costs.

Whatever the goal may be, here are a few issues for the Buyer to consider:

1. Does the Seller actually have the property under contract to purchase?

The public records will not disclose that (unless the Seller and the Owner have recorded a memorandum of their contract). It is not unusual for the Buyer to request a copy of the Seller's contract with the Owner, even if it has to be redacted to remove confidential information like the purchase price the Seller agreed to pay to the Owner. This will also enable the Buyer to verify that the time periods for the performance of various activities under the contract with the Owner are compatible with those to be established in the new contract between the Seller and the Buyer, such as periods associated with title and survey review, due diligence inspections, obtaining of entitlements, and closing.

The Buyer should definitely get a copy of the Owner's contract if the Buyer is contemplating accepting an assignment of that contract and closing with the Owner, as opposed to closing with the Seller after the Seller closes with the Owner.

2. Does the Seller have the right to grant the Buyer access to the Owner's property for the Buyer's due diligence activities?

The Buyer's contract with the Seller should include a representation by the Seller that this is the case. The Owner may not know that the Seller is contracting to sell the Property to the Buyer, and may be confused to find representatives of the Buyer doing investigations on the Owner's property.

3. All contracts contain multiple representations and warranties by the Seller. These should be carefully reviewed and modified to reflect that the Seller is not yet the Owner. The representations should include the following additional affirmations or covenants by the Seller, to the effect that:

The Seller does have the property under contract for purchase, identifying the Owner and the property;

The contract with the Owner is in full force and effect, and no event has occurred that would constitute a default under that contract by the Seller or the Owner;

The Seller is not aware of the existence of any defenses to the enforcement of the Seller's contract with the Owner; and

The Seller will deliver to the Buyer copies of any notices sent by Seller to Owner or received by the Seller from the Owner.

Can the Seller include all the representations that would typically be provided by the Owner? Probably not. Has the Seller conducted any due diligence already that would enable the Seller to make representations about the Owner or the Property, even if they are only made to the best of the Seller's knowledge? Probably so. Any gaps will be the kinds of Owner representations that are probably customary, but cannot be made by the Seller (or are being made only to the Seller's knowledge), so present potential risks for the Buyer.

4. If the Seller fails to close on the purchase of the property on account of the Seller defaulting on the contract with the Owner, it should constitute a default by the Seller under the contract with the Buyer. If the Seller fails to close on the purchase of the property on account of the Owner's default, what should happen? At a minimum, the Buyer should be able to terminate its contract with the Seller and recover the Buyer's deposit. It may be possible to negotiate with the Seller for the Seller to reimburse the Buyer for all or some portion of the Buyer's due diligence expenses, but the Seller is not likely to agree to this because it may have to absorb its own due diligence expenses. However, if the Owner has defaulted, the Seller will have remedies against the Owner to recover damages and/or to obtain specific performance of the Owner's contract. Perhaps the Buyer can require the Seller to pursue those remedies so as to make the Buyer whole if the Buyer would prefer not to walk away from what was expended in the deal. Perhaps, if the Seller has the right of specific performance against the Owner, the Buyer would prefer to have the Seller assign the contract to the Buyer so that the Buyer can pursue that remedy against the Owner.
5. One final consideration is whether it may be possible to provide for the Seller to close on the purchase from the Owner, but to name the Buyer as the Seller's designee for the purpose of the Owner deeding the property (and conveying entitlement, etc.) directly to the Buyer at closing, instead of to the Seller. This avoids the need for two consecutive deeds, and has some complicating factors, but can yield savings in transaction costs since it would not be necessary to pay duplicate documentary stamp taxes (for two deeds) and duplicate insurance premiums (for two title insurance policies). It should be noted, however, that even if this savings is achieved, the Seller is no doubt making a profit on the transaction, so the Florida Department of Revenue considers that profit subject to its own documentary stamp tax. As such, if this approach is used the Seller should be required to pay that tax.

If you have any questions about buying a property that is not owned by the seller yet, please contact Gary Kaleita at Gary.Kaleita@lowndes-law.com.