Seller Incentives Returning To Fla. Homebuilding Market

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Gary M. Kaleita

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With the housing market for new construction rebounding in certain parts of central Florida, we are seeing more transactions whereby landowners are selling property to homebuilders under circumstances where the seller wants what is sometimes called a "participation incentive," which is the right of the seller to participate in the profits that the builder is expected to realize in connection with the future sale of completed homes built on lots within the property. This arrangement, which was not uncommon during the land boom in the early 2000s, was no longer feasible once the recession hit, but is now beginning to recur in today's market, especially in locations where new housing is in higher demand.

Under this arrangement, the landowner sells their property to a builder for a stipulated purchase price that is paid at the closing, but there is an additional deferred purchase price component that will be due to the seller after closing, when the builder sells lots later. This deferred purchase price can be a stipulated dollar amount per lot, or can be tied to the sales price of the lot with a completed home by the builder. In either scenario, when the builder sells to a consumer, the builder will have to pay the deferred portion of the purchase price to the prior seller from whom the builder initially acquired the property. This raises some potential issues.

1. The amount of Florida documentary stamp tax that will be due when the deed from the seller to the builder is recorded, considering that a portion of the purchase price is being deferred to a later date.

This deed tax is payable on the consideration paid to the seller by the builder. If the deferred portion is contingent on the occurrence of a future event that may never happen (like the construction of a home), or if the deferred portion is dependent upon the future sales price being a certain amount, it may be too speculative under state law to trigger payment of the tax. If the deferred portion is payable in a fixed amount at a future date no matter what, it will be subject to the payment of the deed tax when the builder acquires the property. As you would expect, there is a gray area between these two scenarios that can be open to interpretation.

2. What the rights and remedies of the seller will be if the deferred portion of the purchase price is not paid by the builder when the lots are sold.

A seller may want the builder to give the seller a promissory note for the deferred portion of the purchase price, with a mortgage on the property to secure the builder's obligation to pay it. This is typical purchase money mortgage financing, which provides the best protection for a seller, but it implicates other issues. Notes and mortgages require the payment of Florida documentary stamp tax and intangibles tax, and also typically require the payment of a premium for the seller to receive a mortgagee title insurance policy. These expenses are ordinarily borne by the builder, as the party getting the financing. A mortgage can be foreclosed, which offers an important benefit to a seller. However, it may be possible to avoid the expenses of purchase money mortgage financing if the parties are willing to record an agreement or memorandum of agreement that offers other protections to a seller, as discussed in item 3 below.

3. How to evidence in the public records that the seller will be due the deferred portion of the purchase price when a lot is sold by the builder.

In the absence of a recorded mortgage, it is in the seller's interest to record another document in the public records, so that future purchasers of lots within the subdivision (and their title insurance companies and closing agents) will be aware that the seller is owed money when the lots are sold, and the circumstances which will trigger the payment of that money. This could be done by including a covenant in the deed from the seller to the builder, or in another agreement or memorandum of agreement between the seller and the builder, to protect the seller from a situation where the builder sells lots without paying the seller the deferred portion of the purchase price.

If a purchaser buys a lot from a builder without knowing (based on either actual knowledge or the public records) that the builder owes the seller more money, the purchaser of the lot can buy it from the builder free and clear from any claim the seller may make against the purchaser or the lot. In that event, the seller's only recourse will be against the builder. As such, the contents of such a recorded document can be an important aspect of preserving the seller's right to receive the deferred portion of the purchase price when the builder sells lots, instead of having to sue the builder later.

The parties must be careful, however, to avoid structuring the recorded document as if it were a mortgage. If it is worded so as to secure the obligation to pay money, or create lien rights on the property in favor of the seller, it may be treated by the Florida Department of Revenue as a mortgage, triggering the payment of note and mortgage taxes (and possibly interest and penalties) that the parties wanted to avoid.

4. Whether the seller's right to receive the deferred portion of the purchase price from the builder will be subordinated to acquisition or construction financing that the builder may need.

Many builders finance their purchases of property with acquisition loans, and/or their building of homes with construction loans. Both can be structured as revolving lines of credit, and are typically secured by mortgages on the affected property in favor of the lender. The builder's lender is always going to want its mortgage to be superior in priority to the right of the seller to receive the deferred portion of the purchase price, so that the lender, if they foreclose on the lots, will not owe the deferred portion of the purchase price to the seller merely be completing the foreclosure and acquiring title to the lots (which the seller could claim is a "sale," triggering their payment).

Similarly, the lender will likely want to be able to sell the lot after a foreclosure to a new builder without triggering the payment to the seller. Lenders will likely accept a situation where the payment is due to the seller only when a home is built on the lot, and the lot and home are sold to a consumer, because in this scenario it will be the future builder of the home that has to take care of that payment, not the lender. The bottom line is that the seller and builder who are negotiating the terms of their purchase and sale contract that initially provides for the deferral of a portion of the purchase price should consider whether the builder will be obtaining financing, and how to structure their arrangements in a manner that will be satisfactory to the builder's future lender.

Conclusion

These issues should all be addressed at the time the purchase and sale contract is negotiated between the seller and the builder, or during the builder's inspection period under that contract. As you would expect, these parties have differing interests and will tolerate different degrees of risk, so it is important for each to be represented by an experienced real estate attorney who can protect their client's rights and properly negotiate and document their agreements with regard to these matters.