

The Legal Consideration

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Housing Development: The Legal Considerations

The aspects of the housing development process that I have been asked to address from a legal perspective are wide ranging, and indeed each could be the subject of a separate half hour presentation, but as I am not allowed that much liberty I have selected a few considerations, and will examine each in the order in which they usually occur.

Let us assume that you want to be a Real Estate Developer; you have been introduced to a number of development properties and have settled on an ideal location. You have done your market survey so you know what price of lot and/or price and type of housing unit you wish to construct to satisfy the identified market.

A. ACQUIRING LAND FOR DEVELOPMENT

The process of getting started is not a simple matter of signing an agreement for sale and paying a deposit. The prudent developer would be advised to consider the following:

1. The Vehicle

One may be excused for assuming that it is always advisable to incorporate a company to take title to the land and to carry out the development, but that is not necessarily so. There are obvious advantages to going that route rather than undertaking the development in one's own name. These include the protection of limited liability and the convenience of being able to divide profits and losses in accordance with shareholding. But we should not forget that companies pay tax on their profits at the higher rate of 33%, as against 25% for individuals. The whole issue of tax planning should be one of the early considerations. In the final analysis the decision as to which route is appropriate will depend on the circumstances.

2. The Vendor

Where the project is to be developed on land in the name of the Minister of Housing, it is advisable to seek legal advice during the negotiations to settle the terms of the land Sale Agreement and any Joint Venture Agreement. These Agreements should set out the obligations of each party and the time frame within they are to be performed. One should at that time ensure that the lands have been declared under the Housing Act, and if not agree when this is to be done. The Stamp Duty, Transfer Tax and other exemptions that are only available to developments under the Act may only be claimed if a Gazetted declaration is in place.

3. The Location

Whether the intended project can be developed in that location will depend in part on compliance with:-

The planning requirements

The Town and Country Planning Act defines the areas in which residential and commercial development may take place. Similarly the Land Development and Utilization Commission Act prohibits the unauthorized development of agricultural land for residential purposes.

The Local Improvements Act prohibits the sub-division of land without approval.

The environmental requirements

The Natural Resources Conservation Authority Act provides for the environmental assessment of the project before approval is granted.

One should consider the density and other similar requirements of the proposed development before committing to purchase.

4. The Vendor's Title

We move next to title considerations. We are now at the point where we have carried out the necessary due diligence enquiries, and have requested the Vendor to send us an Agreement for sale and a copy of his title. These should be examined closely:-

- To establish that the Vendor does in fact own the land. A leasehold interest will not suffice as it is not marketable. In any event Jamaican mortgage institutions will not lend on leasehold security.
- To see what restrictive covenants, easements and other encumbrances affect the land. It is common to find covenants prohibiting sub-division into smaller lots, which would require modification or discharge. This court procedure could take as many as six (6) months.
- To ensure that the title is by plan rather than description. If the latter is the case an application to re-register by plan will be necessary, and this too could take several months. Title by plan (which is what the market and mortgagees demand) may not be issued from a parent title by description.
- To ensure that there are no encroachments or breaches of restrictive covenants. The services of a land surveyor should be engaged to visit the premises for this purpose.

B. The Lot Sale Agreement

The form of agreement for sale of lots in the project will vary depending on the circumstances. In the event that the land is the subject of an agreement with the Ministry of Housing it is usual to invite lot purchasers to sign a Nomination Agreement, in pursuance of which the lot will be transferred directly by the Ministry of Housing to the nominated lot purchaser. In that event no stamp duty or transfer tax is payable on the Transfer Instrument.

Split contracts have also become the norm, although the Stamp Duty Act has been recently amended to discourage this. The practice has developed of placing the sale of land in one agreement and having the purchaser contract in a separate agreement for the construction of a house on the land. As a matter of law this device, if not executed carefully, has always been doubtful as a means of avoiding stamp duty and transfer tax. The amendment puts the matter beyond doubt, as the Construction Contract is now specifically taxable.

There is no longer any point in preparing split contracts where the Vendor of the land and the contractor are the same person. Note that the developer is still entitled under the Transfer Tax Exemption Order 1974 to a rebate of three-quarters of the amount that would otherwise be levied for transfer tax. There is also a discounted flat rate of Stamp Duty (\$150) on residential mortgages, not exceeding \$450,000, created at the time of transfer of the land.

C. DURING THE DEVELOPMENT

While the project is progressing numerous issues will arise. I have selected two:-

1. Security for Interim Financing

Like many lenders to developers the JMB requires a first mortgage over the property, and where the borrower is a company, a debenture over its other assets. These will be supported by the personal guarantees of the directors and the assignment of a policy on the life of the "keyman". Where the

land is owned by the Minister of Housing the Bank will accept an assignment of the Land Sale and Joint Agreement in lieu of a mortgage, as the Minister is not entitled in law to mortgage Crown property.

It is essential that the returns of the company to the Registrar of Companies are filed up to date, to avoid any threat of the company being struck off. It is standard practice for the security documents to be prepared by the Lenders' Attorney and the provision of these documents will involve the payment by the Developer of Stamp Duty and Attorney's fees.

2. The Real Estate (Dealers and Developers) Act

One should be particularly careful to ensure that the provisions of the Act have been complied with. In particular the Act stipulates that where a developer has entered into a prepayment contract:-

- He is obliged to register with the Real Estate Board so long as the project comprises more than five (5) units: Section 26(i)(a).
- That all requisite approvals should have been obtained: Section 25(i)(c).
- Copies of all planning approvals should be deposited with the Board: Section 26(i)(d).

One should also be careful to observe:-

- The often ignored requirements re advertisements in the regulations under the Act (location map. etc.).
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- That all payments received from purchasers should be placed in a trust account pending closing: Section 29.
- That a maximum of 90% of those funds may be accessed as work progresses, in accordance with a certificate for work already done and materials already supplied:- section 31(3).
- So long as any part of these funds are used the developer is obliged to register a charge over the entire property in favour of the Board which will rank *pari passu* with the Bank's security: Section 31.

For these and other reasons the JMB insists that all sale proceeds be placed in an escrow account which is closely monitored.

The Closing

The main concerns at the time of closing are not so much technical as practical. These include:-

Getting the transfer executed and securing the splinter titles in due time.

- Collecting the shortfall, escalation and interest from the purchaser.
- Collecting the proceeds of the long term mortgage.
- It is essential to lodge the pre-checked plan (laying out the project) and the subdivision approval with the Registrar as early as possible as the surrender application will not be accepted unless it refers to the number of the pre-checked plan (the "DP Number").
- In the case of a development under the Registration Strata Titles Act the strata plan is the equivalent of the pre-checked plan. The strata plan describes the lots into which the building has been divided, and should not be completed by the surveyor until the structure is near completion (in practice the completion of the belt course is regarded as an acceptable stage for this purpose).
- The construction contract should provide for payment of the balance of the construction cost at practical completion. This may be certified by an engineer or quantity surveyor, and triggers the start of the defects liability period, during which certified defects are to be corrected.
- Escalation is often a major legal consideration at this stage, and arises where the cost of

construction has exceeded that which the developer forecasted. The extent to which this is recoverable is entirely dependent on the terms of the construction agreement and, very often, practical considerations like the ability of the purchaser to pay. Too much care cannot be taken when drafting escalation clauses so that they fully protect the right to recover these unexpected cost increases.

- The claiming of interest on late payments is also a relevant consideration. Here one should be guided by the common law rule that any attempt to recover more than one's actual loss will be treated as a penalty, which is unenforceable.

Finally

Experience has taught that many of the mistakes that are made during the development process can be avoided with careful planning and competent advice. You would be wise not to follow the example of those developers who think that they can reduce costs by avoiding professional advice. More often than not mistakes are made, time is lost, and time in the development business means money.