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When real estate deals die, deposits are often held hostage

Lawyers who deal with disputes regarding failed real estate sales say requests for advice are the higher than been in years

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A house that sold for more than the listing price in West-end Toronto on April 24.
GRAEME ROY/THE CANADIAN PRESS

There has been a surge in the number of buyers pulling out of their deals to purchase homes, but Ontario industry insiders say home sellers may be in for a long wait if they hope to collect on the deposits made to secure the sale.

At issue is a little-understood set of rules and practices at the real estate brokerage level that can deadlock the release of a deposit if a transaction fails.

“People do not understand how deposits actually work,” said Matthew Wilson, a lawyer who leads the real estate department of London, Ont.-based Siskinds LLP. He’s heard of buyers who were shocked they couldn’t get their deposits back when a deal fails, and sellers shocked that they can’t immediately collect the deposit when a buyer breaks a sales contract. The standard Ontario Real Estate Association agreement of purchase and sale form doesn’t outline what happens to the deposit if the deal collapses. “It’s not really described anywhere,” Mr. Wilson said. “This goes back to the obligations on the real estate agents. Especially if it’s a listing agent, they should be explaining to the seller.”

Lawyers who deal with disputes over failed real estate sales say requests for advice and counsel are the highest they’ve been in years.

“The dollar values are much higher, deposits are much larger, the stakes much higher,” said Tanya Walker, a commercial litigator with her own firm, Walker Law Professional Corp., in Toronto. Ms. Walker said the calls began to increase in frequency after each of the Bank of Canada’s four interest rate hikes in the last year. “I get calls to my office every day from the buyer or seller.” She estimates the volume of her incoming inquiries is up more than 30 per cent from the year before, a trend others in the industry echo.

In the Greater Toronto Area, the average detached home price reached $1.7-million at the peak of the market in early 2022. A 10-per-cent deposit on a deal of that size would place $170,000 in a trust account held by the real estate brokerage. Those funds can only be released in one of three ways: upon the successful completion of a transaction; by written consent of both buyer and seller; or by court order.

There was a time when getting such a court order was fairly routine, but COVID-related disruptions to Ontario’s court system mean the earliest hearing times are often at least 12 months out.

Because the of the court delays, Ms. Walker and others are seeing buyers use timely cooperation on the deposit as a negotiating tactic.

“If you’re the one that’s walked from the deal, you do have a little bit of negotiation leverage to say, ‘I’ll not fight this; I’ll agree to release the deposit and I’ll agree to pay.’

I've settled lots of those cases in my career," said James R.G. Cook a litigator and partner with Toronto's Gardiner Roberts LLP. For buyers trying to break a deal, the options are limited. "You give the client the advice," Mr. Cook says. "You say, 'Look, you're gonna probably lose.' Unless you can prove some sort of fraud or something on the part of the seller, you're really going to have a tough time getting out of the deal."

The alternative to the buyer and seller coming to an agreement to release the deposit can be a very long and expensive legal fight. Mr. Cook has reviewed dozens of cases stemming from Ontario's 2017 real estate price correction. He says in some instances it may take years in the courts and the eventual damages for breaking a deal can be significantly higher than the original deposit.

For instance, he points to the case Prowse V. Noroozi, decided in 2021. In March, 2017 a buyer agreed to put down more than $200,000 in deposit on a $2.45-million deal for a home in King City, Ont., but was unable to get financing and breached the contract. The seller then sold the home for $1.6-million in 2020 and sued the failed buyer for the difference. The seller was awarded $819,571 in damages (over and above the deposit).

Mr. Cook says there have been dozens of similar court cases, but many more settled out of court. "They always say for trials, that you're seeing at best 10 per cent of what's going on out there: most cases settle because [legal fees are] so expensive even in a relatively clear-cut seller-buyer case," he said.

However, some lawyers warn of the dangers of agreeing to a quick settlement, particularly as a commonly used method of obtaining written consent can leave the wronged party without any legal rights to pursue other damages.

The last time Ontario's real estate regulator the Real Estate Council of Ontario pushed out a guidance bulletin to its registrants on the issue of failed deals was in 2016, and in that notice it included language that suggested brokers might seek to obtain a "mutual release" from their clients before releasing the deposit. OREA even has a model mutual release document on their website for brokerages to use.

"Mutual releases are dangerous things, sellers are sometimes pushed into signing a mutual release without legal advice," Mr. Wilson said. Among the things a mutual release does is block a seller from seeking damages for any losses they take if they re-sell the home at a lower price – as happened in Noroozi – than the one originally contracted for.

There are many reasons why buyers believe they can't close and attempt to breach a contract, but a common story experts hear involves failed financing approvals and rapid price drops in the market.

"I've had clients call me: 'I can't sleep at night I'm going to get a divorce, I can't do this,'" said David Feld, lawyer with Feld Kalia Professional Corp. Mr. Feld describes a hypothetical client who agreed to pay $1.7-million for a house in March, only to find out 90 days later that their lender's appraisal of the property says it's only worth $1.5-million, leaving them $200,000 short on the purchase price. To make matters worse, sometimes a buyer in that position also had to sell their own home for a lower price than they'd hoped, cutting perhaps another $100,000 off their purchase budget. The result is a buyer scrambling to find $300,000 in cash to close a deal they may not be able to afford anymore.

"So I beg for a release," Mr. Feld said. "I will offer the deposit and another $50,000 say, to bring it up to a $100,000. Some people like money: they are like 'Hell, I could have $100,000 in my pocket today and still go list the property?' Every negotiation is different, that's why you need a good lawyer in these cases more than ever."

Bosley Real Estate Ltd. broker David Fleming has simple advice for anyone contemplating breaking an agreement of purchase and sale: don't do it.

"In a nutshell it's going to ruin your life … and I'm not exaggerating, there'd be a massive financial penalty and they would live and breathe litigation for the next two or three years," said Mr. Fleming, who has had to counsel many people – some clients some not – in recent months. Nevertheless, there are those he says firmly believe it's only fair that they walk away from a legally binding contract without penalty.

"It's amazing we have to remind people the real estate market is a market and prices do fluctuate," he said. "People should be settling in these cases … but I've seen the way the wheel's turn in their mind: I think there's very few people who are going to say 'Yeah I did that … it's on me.'"

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