

Preconstruction Sales

1031

Knowledge

What Is a Preconstruction Sale?

Preconstruction sales are real estate purchase transactions which commence prior to construction of the new project's (typically condominiums) completion. Preconstruction prices are usually lower than those of existing or "already built" properties. Developers discount the prices of these units to create an incentive for purchasers to buy a property "they can't see, feel or touch". Developers sell preconstruction properties in order to secure their construction loans on the project. Lenders may require that 50% to 80% of a project be pre-sold in order to approve the construction loan and subsequently the beginning of the construction process.

THE PROCESS

1. Reservation Agreement – The developer organizes site plans, floor-plans, prices and amenities of the Condominium project which, initially, are subject to change. Units are reserved by purchasers with a minimum "intent to buy" deposit which is usually 5% or less of the purchase price. The deposit is placed in an interest-bearing trust account and is refundable to the purchaser at any time during this stage.
2. Right of Rescission Period – The condominium documents, which have been approved by the State, are delivered to the Purchaser for examination. These documents contain the exact details of the project, including the final site plan, floor-plans, amenities, by-laws, etc. A potential purchaser then has fifteen days to approve the documents and decide whether they will complete the purchase of the property specified.
3. Contract for Sale – The purchaser delivers the balance of the required earnest money deposit, which is usually 20% of the contract purchase price. At this point, the contract becomes binding to both parties.
4. Closing of the Sale – The Certificate of Occupancy is issued upon completion of the condominium unit.
5. The purchaser performs a walk-through inspection of the property and attends the closing where funds are disbursed and settlement is completed.

Be sure to inform the seller (developer) of the intent to perform a 1031 exchange and that the contract will need to be assigned to a qualified intermediary. Although closing dates for preconstruction properties typically are not specified in advance, it is critical that a taxpayer desiring to perform a 1031 exchange meet the following time requirements: (A) After the relinquished (sale) property sale closes, the taxpayer must identify the replacement property within 45 days of the sale closing. (B) The purchase of the replacement property must be completed within 180 calendar days from closing on the sale relinquished property. Clearly indicate in the preconstruction purchase contract the taxpayer's intent to perform a 1031 exchange. One suggestion to potentially help alleviate time pressures for closing on the replacement (preconstruction) property is extending the closing date on the relinquished property once it is under contract. The 45/180 time requirements begin after the relinquished property sale transaction closes, so postponing this closing gives a taxpayer a higher probability that the replacement property will be completed within the exchange period.

Compliments of:



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