

## Finance Brokers Association of Australia - Response to the Consumer Property Acts Review Issues Paper No. 3

13th May 2016

Dear Madam/Sir,

The Finance Brokers Association of Australia Limited ("FBAA") would like to thank Consumer Affairs Victoria for this opportunity to respond to the Consumer Property Acts Review Issues Paper No. 3.

The FBAA will confine its submissions to respond to Part C, Sections 12 & 13 of the Consumer Property Acts Review Issues Paper No. 3.

### Background

The FBAA was established in 1992 and is the peak industry body for finance brokers nationally. In 2014 the FBAA formed the Vendor Finance Steering Committee with the objective of engaging the Vendor Finance sector and introducing a degree of self-regulation.

In our response to the Review, the FBAA Vendor Finance Steering Committee (the "Committee") will:

- use the term Vendor Finance Broker (hereinafter "VFB"). The Committee uses this terminology to denote an entity that holds the status of an Australian Credit Licensee or Credit Representative of an Australian Credit Licensee; and
- confine our response to residential property. All references to 'property' in this submission should therefore be read as references to 'residential property'.

## Part C, Sections 12 & 13 of the Consumer Property Acts Review Issues Paper No. 3

### **Question 54**

**What is your experience with buying or selling property under a terms contract?  
Do you agree that there is a continuing place for such contracts in today's market?**

The current Committee has more than 26 years of combined experience selling residential properties to consumers with Vendor Finance, with more than 95% of these sales being undertaken using Terms Contracts.

The committee's collective experience is that Vendor Finance has allowed many people to experience home ownership who would otherwise have been locked out of traditional home loan finance.

The people who gain the most from Vendor Finance are the ones that either;

1. Don't have the required deposit but have the servicing capacity to enter the property market; or
2. If they do have the required deposit, their credit has been damaged due to a life event.

It is important to recognise Vendor Finance as an on-going, valid alternative form of finance over the traditional provision of finance products.

The starting position with a Vendor Finance contract is that a consumer wishes to purchase a particular property and chooses Vendor Finance over other traditional forms of finance because their circumstances take them outside of the parameters of the mainstream financiers' lending criteria. Vendor Finance carries more credit risk than traditional finance which is why traditional financiers will not take the deal. It is important to find balance between the consumer's rights and the risk taken by Vendor Financiers. Those offering ethical Vendor Finance do not do so to profit unreasonably from the risk. They do it to include a class of consumers otherwise excluded from the opportunity to source finance for the purchase of their property.

There is clearly a need for Vendor Finance and with adequate control it remains a valid alternative. The FBAA recognises that Vendor Finance is not a proxy for affordability. It is not a suitable alternative for consumers who cannot otherwise afford to meet their obligations. Such consumers include those considered

vulnerable including low income earners, pensioners and those with limited degrees

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of comprehension such as consumers lacking adequate education and those with limited grasp of English (including new migrants).

The Committee asserts there is a continuing place for Terms Contracts in today's market.

### **Question 55**

**Should the current restrictions on sellers under terms contracts be expanded to encompass debt that is not linked to the property but which may impact on the seller's capacity to pass title to the buyer? If yes, what sources of debt should be included?**

The Committee agrees that the financial capacity and existing commitments of sellers needs to be made known and factored into agreements. The simplest way to introduce such obligations, is to have the parties make full disclosure of their financial positions prior to entering into the transaction and to have a qualified VFB assess the capacity of both parties. All debts should be identified.

Such an approach would ensure debt that is not linked to the property but which may impact on the seller's capacity to pass title to the buyer is taken into account.

The challenge of dealing with commitments incurred after the commencement of an arrangement is more complex. Even with contractual terms prohibiting the seller from incurring more debt after the contract is entered into, the only remedy available to a purchaser is to pursue the vendor for breach and if they are in financial distress there will be no effective remedy to the purchaser. However, by requiring full disclosure at the time of commencement it would be possible to identify the position of the parties at the time of commencing the arrangement which in turn would assist parties to identify appropriate remedies if a seller were to subsequently perform acts that impaired their financial position.

A seller should not be able to profit from forcing a termination through their own errant actions. It is reasonable that if a seller is in breach of the contract, to the point where the breach cannot be remedied and termination of the contract is required, then certain remedies should be open to the purchaser including:

- the purchaser is able to terminate the contract without being obliged to make payments for occupation; and
- **at the purchaser's discretion:**

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- the purchaser has the first right to refinance the property with a third party financier and pay out the seller, i.e. 'complete' the contract; or
- the property should be sold at public auction and any funds received, over and above the Purchaser's outstanding loan balance plus costs, is disbursed to the Purchaser.

This remedy would enable a purchaser to derive the benefit from any appreciation in the property during the period of their occupation and simultaneously remove any incentive for the seller to trigger a breach.

While not covered by this question, if the consumer withdraws from/terminates a purchase commitment, a reasonable person would expect that they should be treated in a manner very similar to how they would be treated if their circumstances had occurred under a traditional home loan, i.e. an 'industry standard' manner. This would mean:

- all instalments/repayments already made by the purchaser be retained by the seller, such payments being treated as principal and interest repayments against the property; and
- the property must go to public auction, with any funds received, over and above the Purchaser's outstanding loan balance plus costs, being disbursed to the Purchaser (as would be the case for a mortgages in possession sale).

We suggest it would be appropriate to allow this requirement to be mutually waived if the parties reach a satisfactory arrangement. Consideration should be given to whether, in such a situation, the consumer should be required to obtain independent advice on the terms of the arrangement to ensure they have not been pressured into compromising their rights.

If the recommendation to impose a mandatory requirement to use a VFB as an intermediary is adopted (see below), the Committee would consider it reasonable that any fees paid to that intermediary be forfeited if it is found they failed to make reasonable inquiries prior to intermediating the transaction, about the capacity of each party, or, if the outcome of those inquiries should have been that the VFB formed a view that either party could not meet their obligations under the contract (excluding where either party has taken action subsequent to the assessment that has caused the issue). The definition of 'reasonable inquiries' could be aligned with the application of the responsible lending provisions under the NCCP Act and the guidance provided by ASIC in Regulatory Guide 209.

## Question 56

**Should there be greater levels of scrutiny applied to terms contracts ‘brokered’ by intermediaries? If yes, what would you favour:**

- **offences and remedies directed at intermediaries?**
- **requirements on intermediaries to have contracts of sale independently audited for financial soundness before proceeding?**
- **other approaches? Please provide your ideas.**

The Committee believes there should be greater levels of scrutiny applied to terms contracts ‘brokered’ by intermediaries.

Having seen many unsatisfactory Terms Contract arrangements, the Committee believes the average consumer Owner is unlikely to have the knowledge and experience required to successfully manage a mutually beneficial Terms Contract arrangement.

Those entering into such arrangements need to be able to anticipate potential problems and manage the obligations associated. This is a specialist area and as such the Committee recommends that it be made mandatory to use a VFB as an intermediary for Terms Contracts over residential property. Additionally, the Committee recommends the following requirements be embodied in all Terms Contracts.

- (i) Only VFB’s be allowed to broker Terms Contracts that involve a residential property and a purchaser who is a consumer;
- (ii) The VFB’s involvement in the transaction to be declared in the Special Conditions section of the Victorian Contract of Sale or Real Estate;
- (iii) The declaration outlined in point (ii) above will ensure the Purchaser has access to an External Dispute Resolution system at no cost to her/him;
- (iv) The requirement outlined in point (i) above provides a realistic expectation that any monetary finding against the VFB will be paid by the VFB’s Professional Indemnity insurer. All Australian Credit Licence holders are required to carry a Professional Indemnity Policy with a minimum of \$2 million in cover;
- (v) The VFB be required to administer any Terms Contract they broker, including the use of an appropriate Statutory Trust Account, for the duration of the Contract. Alternatively, the VFB declared on the Contract may contract another, appropriately qualified VFB to administer the Contract for its duration.

There has been insufficient consideration of the long term commitment required to administer what are often 20 to 30 year Terms Contracts. Especially in the area of handling Hardship situations. Therefore, in the future, it may be appropriate to have some form of professional approval for specialist Terms Contract administrators.

## **General Comments Regarding Terms Contracts**

The following suggestions from the Committee are designed to improve the Terms Contract in the Consumer market:

- **Zero Loan Balance at End of Term.** Make it compulsory that all Terms Contracts be amortised so there is a zero loan balance at the end of the term of the Contract. This stops short term arrangements being used that force a balloon payment on the consumer Purchaser. The Australian Securities and Investments Commission recognises the use of balloon payments may have the effect of rendering a loan unsuitable where the discounted short-term payments are affordable but where inadequate consideration has been given to the consumer's capacity to meet the higher, residual balloon payment: The following is an extract from ASIC's Regulatory Guide 209.68

### ***"Example 10: Balloon repayments***

*Some products involve a large 'balloon' payment at the end of the loan term. While a consumer may be able to manage the regular repayments under the loan, whether the product is suitable for them also depends on whether they will be able to make the final, much larger, payment. We would expect the credit licensee to satisfy themselves that the consumer understands, and has the capacity to cover, the final repayment before offering this type of product to the consumer. "*

- **Public Auction in Default/Termination Situation.** If the Purchaser finds themselves in a Default/Termination position, then the property must go to public auction, with any funds received, over and above the Purchaser's outstanding loan balance plus costs, being disbursed to the Purchaser. We suggest it would be appropriate to allow this requirement to be mutually waived if the parties reach a satisfactory arrangement. Consideration should be given to whether, in such a situation, the consumer should be required to obtain independent advice on the terms of the arrangement to ensure they have not been pressured into compromising their rights.

- **Independent Legal Advice.** Because of the lack of general knowledge in the community regarding Terms Contracts, it's suggested that consumer Owners and consumer Purchasers be required to get independent legal advice before executing a Terms Contract over a residential property.

## Terms Contract Processes

The Committee believes the necessary protections can be imposed on a relationship when a VFB acts as an intermediary in a Terms Contract between the consumer Owner of a residential property and a consumer Purchaser by requiring the following eight processes to be undertaken:

- **Listing the property** – i.e. entering into an agreement to assist a residential property Owner sell her/his property via a Terms Contract;
- **Marketing the property** – ensuring all marketing meets the requirements of the Australian Consumer Law and National Credit Code;
- **Application** – conducting the application process according to the NCCP Act's Responsible Lending requirements;
- **Qualification** – qualifying a prospective Purchaser in accordance with the NCCP Act's Responsible Lending Requirements;
- **Instructing a Solicitor** – to draw up the Terms Contract in accordance with the National Consumer Credit Protection Act ("NCCP");
- **Possession** – ensuring the pre-possession checklist has been completed, prior to the Purchaser taking possession;
- **Administration** – ensuring the Terms Contract is administered, for its entire duration, in accordance with the National Credit Code;
- **Refinancing** – giving assistance, as required by the Purchaser, with refinancing from the Terms Contract into a traditional home loan.

If this transaction were to be undertaken by the consumer Owner, i.e. without the aid of a VFB, the first process in this list, i.e. Listing, would not be required.

The Committee's collective experience is that the average consumer Owner is unlikely to have the knowledge, experience, and in some cases the necessary degree of engagement, required to undertake all seven processes in a manner that is consistent with the requirements of all the legislation surrounding Terms Contracts. As a result of trying to do it themselves and not having a full grasp of the requirements, consumers are acting to their own detriment by unwittingly waiving important rights and obligations or agreeing to egregious terms.

The Committee suggests that it should be compulsory for a consumer Owner, planning to sell his/her residential property with a Terms Contract to, as a minimum, engage the services of a VFB on a consultative basis, to ensure the following processes are conducted within legislative requirements:

- Marketing the property;
- Application;
- Qualification;
- Instructing a Solicitor;
- Possession;
- Administration.

## **Part C, Section 13 of the Consumer Property Acts Review Issues Paper No. 3.**

### **Question 57**

**What are your experiences of rent-to-buy contracts? Can you provide any examples where a buyer has successfully purchased a property using the rent-to-buy method?**

The Committee have been looking at the viability of rent-to-buy (Lease + Option) contracts in the consumer space for approximately two years. We have witnessed many residential rent-to-buy contracts and estimate well less than 50% of all residential rent-to-buy contracts proceed to a successful 'exercise' of the Option.

The Committee believes the three main problems inherent in rent-to-buy contracts, causing such a large failure rate are;

1. There is no requirement to carry out responsible lending;
2. The absence of a requirement for a zero balance at the end of the term, and
3. The consumer Purchaser is not afforded all of the protective provisions of the National Credit Code, as a rent-to-buy contracts often fall outside of the ambit of the Code.

Our initial response to the lack of successful outcomes with these rent-to-buy contracts was to suggest the National Credit Code be amended, with a view to ensuring all rent-to-buy arrangements for real property be caught by the Code. The Code currently addresses rent to buy contracts (Section 9 of the Code) and also

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recognises Sale of Land by instalment arrangements (Section 10 of the Code) however there are shortcomings with both sections that see rent to buy contracts not covered.

FBAA supports an amendment to Section 9 of the National Credit Code extending the current application beyond goods leases to also include real property. The reach of section 9 could be expanded by changing the reference from 'goods' to 'goods and residential property'.

One difficulty is that the Code only applies to entities that are in the business of providing credit (s5(1)(d)) therefore ad hoc or one-off arrangements between individuals or between a business and individuals are unlikely to be caught.

A further difficulty is that determining the application of the Code to particular business activities can become a highly technical exercise and a number of operators rely on artificial constructs to avoid the application of the Code. It is an inferior consumer outcome if a regime requires the consumer to have to establish the applicability of the Code prior to seeking to rely on any protections provided by it.

The Committee supports the suggestion that the Victorian legislation be amended to specifically include rent-to-buy contracts and further supports the adoption of provisions from other jurisdictions that provide consumers with effective remedies (noting the reference to the South Australian provisions provided in the consultation paper as one such example). Careful consideration needs to be given to the ambit of such provisions to avoid a repeat of practices still going on in South Australia where entities continue to structure their rent-to-buy contracts in ways that fall outside of South Australia's regulations on such contracts.

The Committee recommends that any legislative changes also impose specific obligations on parties to a rent-to-buy contract that mirror the NCCP Act and Code obligations with regard to responsible lending inquiries, balloon payments, hardship provisions and access to External Dispute Resolution.

If it is considered that consumers cannot obtain sufficient protection through legislative amendments, the Committee submits that the establishment or continuation of a residential property Lease be prohibited where a Put and/or Call Option is placed on the property.

The Committee believe this course of action is warranted, after taking into account:

- the probable lengthy time frame to get the NCCP Act amended, and

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- the need to close down as soon as possible, the unscrupulous, often unlicensed, operators using artificial constructs to circumvent the application of the Code.

The Committee believes all residential property buyers deserve the protections provided by the National Credit Code.



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On behalf of the FBAA Vendor Finance Steering Committee