

# Finance Market Update

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**Changes to the Offer & Acceptance means it's more important than ever to get finance sorted with your finance specialist before placing an offer**

On 15 June 2011, the Court of Appeal of the WA Supreme Court in Dodds -v- Kennedy [No 2] [2011] WASCA 131 made a ruling in relation to the finance clause in the Standard REIWA Contract for Sale of Land by Offer and Acceptance. The case in question involved a Buyer who, after signing the Offer & Acceptance (which was subject to finance), was advised by his Mortgage Broker that he would not qualify for a loan. The Broker then provided a letter stating his client's inability to achieve finance to the Selling Agent. The Seller did not accept this and took the matter to court and the Buyer lost his deposit and damages (due to a subsequent lower resale price on the property) to the tune of approximately \$80,000.

In response to this, the industry standard Offer & Acceptance document has been updated to remove any confusion. Buyers who sign an Offer & Acceptance subject to finance MUST place a formal loan application to the lender stated on the Offer (either directly or through a broker to that lender), and only a decline letter from the lender will suffice as non-approval. This means that the Seller can insist under the contract that the Buyer apply to that particular lender. This could have significant impact on the Buyer. Credit applications made now (even if they are declined) can have a major impact on a clients' ability to borrow in the future as all credit enquiries are entered into the clients credit file and affect their credit rating.

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**For Buyers who have misunderstood or not researched their ability to get finance, the "worst case scenario" could be worse than missing out on the property!** It's crucial that all Buyers have their finance formally assessed by a Mortgage Broker before even considering placing an offer on a property. Before the offer is placed, a Mortgage Broker can make an assessment whether or not a client will be able to get the loan without making a formal loan application to a lender, giving the client confidence when placing an offer and also protecting their credit rating should they not qualify for a loan.

### **National Consumer Credit Protection (NCCP) Legislation Update**

Since the introduction of NCCP, Lenders have naturally become more stringent with their lending requirements, particularly with small business owners.

Changes that seem inconsequential to the business owner, such as a change to their tax structure (e.g. sole trader to Discretionary Trust), can cause a delay or decline to an otherwise strong finance application. A minimum of 2 years' financials are still required for new businesses by the vast majority of lenders. Based on Lender policies, some business owners who previously accessed finance on a low-documentation basis might find that they don't qualify this time around. However, there are still some good low documentation loans at lower Loan to Value Ratios or with reduced documentation (such as BAS).

It's more important than ever to assess finance capacity well in advance of a transaction taking place. This is especially

important for borrowers who are changing their income in any way (e.g. changing business structures or planning a family).

## **Loan Structures and Nasty Surprises – Make sure your clients are not caught out!**

A common strategy employed by Lenders and some Mortgage Brokers is to Cross-Collateralise loans. Effectively, one loan (e.g. an investment property loan) is secured against multiple properties (e.g. the family home and the investment property). In the past, the consequence of this strategy has generally only been a limited borrowing capacity for the property owner. We've helped many investors when their current lender has refused to lend further by "un-tangling" their loans and allowing them to access more finance by diversifying their lending.

However, several changes to the market have made this a much more risky strategy which has in some cases forced borrowers to sell down their assets unplanned. The main reason for this is that when loans are cross-collateralised, every property is re-valued, and every loan is re-assessed based on current Lenders' criteria, each time a transaction takes place. Most borrowers would only think of considering this when they are buying a new property. However, the sale of a property will also trigger this re-assessment. If a borrower wants to sell one property (for example as part of a structured sell-down strategy in preparation for retirement) they would reasonably expect to receive the proceeds from the sale (less costs). If the loans are cross-collateralised, however, and the Lender's required Loan to Value Ratio has changed, the borrower might find that they lose the proceeds to help pay down the other loans.

In one extreme scenario, a borrower came to us for help when they had already committed to a Contract of Sale on one of their properties. On seeking a loan discharge amount from their Lender, they were advised that they no longer qualify for their existing loans and that they would be required to sell a second property to bring their total loan amount to a level that would satisfy the

lender! This obviously had grave implications for the borrowers, not only for their overall asset position, but for their tax position as well.

With the right strategy and planning, borrowers can often avoid these nasty surprises – but once the property is under offer, it's too late to do the restructuring required to satisfy the lender and meet the client's requirements. We would strongly urge any borrowers with more than one loan to contact us to review their loan structure 6-12 months before selling, buying or building on any of their properties.

## **Interest Rate outlook**

The November 1<sup>st</sup> interest rate drop of 0.25% has certainly been welcome by home owners and investors. The Reserve Bank indicated that while some sectors of the economy were strong, others were less so and with core inflation within the target range, that an interest rate decrease was warranted.

The futures market is predicting that interest rates will decline further over the next 12 months. We have seen fixed rate 3 year residential rates offered as low as 6.25%, which is substantially less than the current variable rates. For our commercial investor clients we have been able to lock in rates around 7% for two and three years. Now may be a prudent time for your clients to reassess their loans.

## **Free property appraisals for Momentum Wealth Referral Partners**

We have now secured access to instant property appraisal reports from Australian Property Monitors and can provide these to our referral partners free of charge. If you have clients considering applying for a loan or making their next purchase, this quick and easy report is a good starting point to assess their current position and potential available equity for borrowing.

***Need more information? Contact me and one of our Finance Specialists can provide advice specific to your situation.***