

Finance Brokers Association of Australia
Response to the “Consumer Property Law Review:
Sale of land and business: options for reform” paper

28th April 2017

Dear Madam/Sir,

The Finance Brokers Association of Australia Limited (“FBAA”) as the leading professional industry association to finance and mortgage brokers nationally, would like to thank Consumer Affairs Victoria for this opportunity to respond to the “Consumer Property Law Review: Sale of land and business: options for reform” paper.

The FBAA was established in 1992 and 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.

Background

The FBAA made a submission to the previous round of consultation against Issues Paper No3 in May 2016 focussing on Part C, sections 12 and 13 of the paper. In that submission we supported terms contracts and put forward eight essential attributes we believe need to be present for terms contracts to strike the right balance with consumer protection. We reiterate our view that terms contracts are an essential alternative to consumers who fall outside of typical lending criteria (insufficient deposit or poor credit history) but who otherwise demonstrate capacity to service a loan (i.e. good current finances). Any move to prohibit terms contracts will be a significant step backwards for many consumers.

Our previous submission also supported rent to buy arrangements provided substantial additional consumer protections could be introduced in short time.

We confine this submission to respond to Part C, Section 7, Option 8 – Prohibit all rent-to-buy arrangements, and the use of terms contracts for residential home ownership sales. The focus of our response is on residential property. All references to ‘property’ in this submission should therefore be read as references to ‘residential property’. As such we have left answering Question 11 to other interested stakeholders.

Vendor Finance Industry Overview

Terms Contracts have been used in Australia since the 1870’s. They are a form of Vendor Finance, i.e. the Seller (Vendor) helps the Buyer to purchase the property by allowing a proportion of the price to be paid off over time.

They were initially used by land developers who subdivided land and sold the resulting blocks, with a small deposit and a payment plan over a number of years. Large parts of well known suburbs countrywide were sold in the early 1900's using Terms Contracts. The legality of the Terms Contract was established by the High Court of Australia in 1927 in the case of *The Federal Commissioner of Taxation versus Thorogood*.

They became particularly popular in the post World War 2 era, when banks remained reluctant to lend on housing blocks. During this period it was common for people to buy their land with a Terms Contract, pay it off over time and then get the bank to lend to build their home. At different times since the 1970's, the NSW Dept. of Housing has used Terms Contracts to sell properties to its tenants. All Australian States, except South Australia, make the First Home Owner Grant available to first home owners, buying an eligible first home with a Terms Contract.

The Australian Government recognised Vendor Finance when the 2006 Census established that 2.1% of homes in Australia were being bought with Vendor Finance.

An Industry Setback

We recognise that the reputation of Vendor Finance in the residential real estate marketplace was damaged between 2002 to 2012 by the arrival of a number of 'property spruikers'. Seminars run by these property spruikers were promoted as get rich quick schemes and aimed at vendors. Attendees were lured with promises of making "wads of cash" with almost no consideration of the buyer's interests. This activity, which is relatively recent in the context of how long terms contracts have been around, has tainted the reputation of vendor finance in residential real estate. We strongly encourage Government to keep this perspective front of mind during this consultation process. Prohibition is not the right answer. Terms contracts are no more or less susceptible to mischief than any other financial and consumer credit product. Effective regulation and enforcement is all that is needed to preserve the right to use terms contracts.

Key Challenges

It's our belief that the greater majority of the example problem transactions advanced by stakeholders in support of prohibiting terms contracts, would have common deficiencies which can be addressed. The examples advanced as evidence of terms contracts not working would not have been:

- (a) structured so the buyers 'loan balance' was calculated to be zero at the end of the term of the vendor finance arrangement; or
- (b) assessed against the requirements and standards imposed by the National Consumer Credit legislation – in particular, buyers would not have been qualified against responsible lending requirements.

National Credit Code Has Brought Significant Improvement

Regulators appear to have had some success against property spruikers, leading to their departure from the marketplace. We have observed a dramatic improvement in the quality of 'regulated' vendor finance arrangements which we attribute to the impact the NCCP Act has had on the attitudes and behaviours of those involved in the finance industry.

Anecdotally, this is confirmed by a quote from the Director of Vendor Finance Management Pty Ltd ("VFM") who, when asked what type of vendor finance transactions cause VFM the most problems, quickly answered, "The top 3 are Rent To Buys, short term Terms Contracts and transactions that commenced before the National Credit Code started."

While 2002 to 2012 is seen as a negative period for the vendor finance industry, information supplied by VFM shows that 'regulated' vendor finance transactions, structured since approximately 2012 have improved greatly. VFM tells us that, with the advent of Responsible Lending requirements, the percentage of 'regulated', nonperforming transactions it administers is approximately 5% to 6%, i.e. approximately the same percentage as traditional home loans.

Prior Responses to Finance Industry Challenges

The Mortgage Broking industry has come under fire on various occasions throughout the 1990s and 2000s. Western Australia introduced its own licensing regime in response to broker misconduct that was the subject of several Inquiries during the 1990s. The remainder of the country adopted the Uniform Consumer Credit Code however it lacked meaningful enforcement and penalty powers and was adopted with differing levels of engagement by various States. Further control over credit providers and broker conduct was deemed necessary. The response was not to prohibit activities and products. The response was the National Consumer Credit Protection Act 2009 ("NCCP Act").

Concerns were raised about the injurious effects of some reverse mortgage products offered in the early 2000's. Additional requirements were introduced on 18 September 2012 to address the egregious features of older reverse mortgages (such as negative equity and the loss of the right to occupy the property). It wasn't necessary to ban the product, only remove the harmful elements.

General Recommendations

Terms contracts can be extremely effective. Consumer protection concerns are capable of being addressed through adopting the NCCP Act or mirroring those provisions in other legislation.

As such, the FBAA believe that, at a minimum, all vendor finance arrangements for the purchase of residential property should be regulated credit contracts.

Specific Response to Option 8 – Prohibit all rent-to-buy arrangements, and the use of terms contracts for residential home ownership sales

We are extremely concerned that terms contracts have been included with a general recommendation to prohibit rent to buy contracts for residential property. Our previous submission provided a significant amount of information in relation to each product and we acknowledged the challenges with each. Terms contracts are not rent to buy. Nor are they 'like' rent to buy. Each must be assessed on their merits and it should not automatically follow that a decision to prohibit one is any justification to support prohibiting the other.

Our first submission recognised that rent to buy contracts needed significant reform, and recommended that if such reform could not be achieved quickly, then rent to buy should be prohibited.

The FBAA can see no place in the consumer home buying space for a purchasing technique that is not regulated by the National Credit Code.

Against the information that rent to buy arrangements offer too many opportunities for law avoidance, the FBAA supports recommends that rent to buy arrangements be prohibited from the residential property marketplace.

Answer to Questions 10

10 Are there potential risks with prohibiting all rent-to-buy arrangements and the use of terms contracts for residential property sales, and how might they be mitigated?

We reiterate our concern that this question is framed to cover both rent to buy and terms contracts when the products and attributes are significantly different.

The FBAA contends that the significant risks with prohibiting terms contracts for residential property include:

1. **Exclusion.** Consumers who could otherwise comfortably service a commitment towards their own home ownership but who have a poor credit history, insufficient deposit or some other issue precluding them from eligibility with mainstream finance will lose a valid and viable option for home ownership if terms contracts are prohibited.
2. **Unregulated Alternatives.** There is no alternative product consumers can move on to if terms contracts are taken away from them. This will force them to look for unregulated sources of credit which place them at greater risk than if terms contracts are subjected to better regulatory oversight.

These risks can be mitigated by allowing terms contracts, requiring that they be handled only by a licensed broker and introducing the measures around key steps in the transaction proposed in our first submission namely:

- **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.

Alternately, further research needs to be conducted, involving consumers who have benefitted from terms contracts arrangements, e.g. VFM informed us they assisted 12 families successfully 'complete' their terms contracts over the last 13 months and VFM is only one of a number of businesses that administer terms contracts. This would allow the Government to hear the success stories and not base a decision as significant as prohibiting a product on account of where there have been problems.

The FBAA believes there is a genuine place for vendor finance for residential property buyers provided it is offered in compliance with the Credit legislation.

Finance Brokers Association of Australia (FBAA)
On behalf of the FBAA Vendor Finance Steering committee



Peter J White CPFB FMDI MAICD
Executive Director