Vendor terms “intermediaries” - see note (a)

We have become aware of a system being used by a number of operators, which appears to be being taught at investment type seminars or “boot camps”. We don’t know exactly what is being taught, because we haven’t been to one of these seminars. However, this diagram illustrates, to the best of our knowledge, how the system seems to operate, based on a number of transactions we have seen, and some web research. While there is no evidence to show that these transactions are necessarily linked in any way, a number of similarities suggest that there is a common source for the system, contracts etc. The system and contracts can differ between transactions, so the following is only an overview of how the system works in some cases.

The operator attends one or more seminars.

Operator note 1) attends seminar. Learns the system, and is probably provided with some example contracts, and perhaps names of lawyers or other advisors. May hold Real Estate Agents Licence (note 2).

With techniques he has learned at the seminar , he advertises to two specific groups:

- Sellers, including those desperate to sell (note 3) ; and
- I can help you buy a house if you can’t get finance.

See for example: http://www.webuyhouses.com.au/

* This is Version 4

In this example we assume that the vendor is desperate to sell his home , as we believe this group is sometimes specifically targeted.

Operator enters into agreement with vendor, whereby operator helps the vendor to sell the property, in exchange for the benefits in the table below. We suspect that the more desperate the seller is, the more likely that the seller will receive less, or none, of any profit.

"Vendor" who is desperate to sell his home (eg facing forclosure).

Operator sets up an agreement between the vendor and purchaser providing the documentation. The vendor agrees to move out (and live with friends/relatives?)
The sale price is higher than the price agreed with the purchaser, to allow for a "profit" (if the sale settles).
The purchaser's deposit may cover any mortgage arrears to prevent immediate foreclosure.
The contract may allow for settlement to take place in 25 years, but the operator may represent that settlement is likely to take place in only a few years.
The purchaser pays a monthly amount which more than covers mortgage payments, rates and maintenance, until the purchaser can obtain finance to pay amount required to purchase home outright (in reality the purchaser may never be able to finalise the purchase).

"Purchaser" is desperate to buy a home but can't get finance. Attracted to an ad placed by the operator (possibly on a website where other similar "operators" place similar ads) which says you can buy a home even if you can't get finance. Agreement may be a "rent to buy" or "vendor terms purchase". Vendor terms may be chosen by operator if purchaser is eligible for FHOG.

Money received	**Expenses paid**	**Paid to seller**	**Paid to operator**
Deposit paid by purchaser	Mortgage arrears may be paid from this if necessary.	Seller may keep 50%, or may get nothing	Operator may keep 50% or all of the deposit
Monthly payments made by purchaser	Mortgage payments, rates, maintenance and other expenses	Seller may receive anywhere between 50% and 0% of the balance.	Operator may receive between 50% or 100% of the balance
Final payment (if sale ever settles)	Mortgage repaid	Seller receives agreed value less mortgage owing Seller may receive 50% or 0% of the difference between the initial agreed value and the sale price.	Operator may receive between 50% and 100% of the difference between the initial agreed value and the sale price

Note (a) This document has been developed as the basis for discussion within Consumer Action, and with limited outside parties. It outlines how we believe this system might work, however this is based on viewing some contracts, speaking to some consumers, and some web research. Further, we believe that there is a range of variations of types of contracts, so the process outlined here may will not necessarily apply to all similar transactions.

Note 1: We use the term "operator" here. The individual isn't an investor because he or she doesn't appear to put any money into the deal.

Note 2: It appears that what the "operator" is doing, may require an Estate Agents Licence (at leased based on Victorian legislation). However, the Victorian legislation prohibits an Estate Agent from obtaining a beneficial interest in any property he is commissioned to sell. It appears that in these cases, the "operator" is doing more than taking a commission for selling.

Note 3. It is possible that as well as advertising on the web or in newspapers, the operators may be obtaining details of sellers who are in desperate circumstances by contacts with liquidators, Part IX administrators etc (this is suggested in a web video .)   While we have seen evidence to suggest that sellers in trouble may be targeted, the operator may also look for those who want to sell (but aren't in trouble) or to those who want to purchase the property and then hope to sell via vendor terms and make a profit.

<u>Risks</u>

There are clear risks for the vendor and the purchaser, which could vary depending on the actual agreement . The system is complex, and it would be surprising if the vendor or purchaser (who are both likely to be under some form of financial stress) would clearly understand the risks.

Purchaser: As the purchase is someone who has been unable to get credit, it is likely that even after a few years, the purchaser may be unable to get credit. This may be further exacerbated by the sale price of the house being overpriced (for the operator's profit). Depending on the type of agreement between the seller and purchaser, if the purchaser has difficulty in paying the high payments (which are usually well in excess of market rental), he could be evicted as a tenant for non-payment and lose all money which has been paid. Even a vendor terms purchaser can find himself in a similar position. Interestingly, a NSW court case in 2005, ordered a vendor terms seller to pay compensation to the purchasers (of about $28,000, which was the difference between the amount paid under the contract and notional rent payable during the occupancy [(Lewis v Ormes (Commercial) [2005] NSWCTTT 481 (18 July 2005)]. However, in the system outlined in this document, the seller is likely to be an individual in financial difficulty himself—and unable to pay any amount of compensation even if ordered by a court.

It is likely that there is little, or no, incentive for the operator to ensure that the purchaser is able to afford the payments. If the First Home Owners Grant is received once the vendor terms contract is signed, the "operator" is not at any financial risk if payments can't be maintained. Therefore while the operator may claim to ensure that the purchaser can afford the payments, it is difficult to see why the operator would bother to take significant steps to assess the purchaser's ability to pay.

We don't know at this stage what, if any, protections are built into the agreement with the purchaser. Depending on who is responsible for payment of mortgage payments, the house could be sold by the 'bank' and the purchaser evicted if these are not passed on (eg by the operator).

Further, as the vendor is likely to be in financial difficulty, other creditors of the vendor could take legal action and sell the home—even if they don't hold a mortgage. For example, a credit card company could sue in Court for payment, and then enforce the debt by forcing sale of the home to pay the debt. Therefore, the fact that the purchasers payments may be used to cover mortgage payments would not prevent the house being sold by another creditor of the vendor. In this case it is likely that the purchaser would have no rights, and could only take action against the vendor (who is likely to have no money and be unable to provide any compensation even if the purchaser won a case in a court or tribunal).

Vendor: Given that the purchaser is someone who is unable to obtain finance, it is likely that there could be a significant delay (possibly of many years) before the purchaser can obtain finance. The vendor is not living in the home and, we assume, in many cases is living with friends or relatives. Any equity in the home is probably required by the vendor (for example to pay other debts). The vendor may not be aware of the time it will take to settle the sale. In many cases it is likely that the sale will "fall through", and the purchaser will move out (or be evicted for non-payment). The vendor could, ideally, be in a situation where the value of the home has increased and he can simply put it up for sale again —but depending on the agreements, the operator may still have a financial claim on the vendor—and if the vendor has any funds, may find that the purchaser could have a legal claim (as above) which has to be paid as well.

Additional issues/questions

Estate Agents Licence

- Not all these operators appear to hold an Estate Agents Licence.

First Home Owners Grant

- Purchasers who use a FHOG as a deposit are using their one chance to access a FHOG. If they are unable to afford the payments, and don't proceed to settlement, they may find that they are in debt to the State Revenue Office.