

Under the hammer

Brokers need to fully inform clients of the terms and conditions and the risks involved in the auction process.

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Picture this scenario: your clients call you on Wednesday and let you know they are going to an auction on Saturday.

Great news, you think, because you know this means you could close another deal shortly. They ask you what they need to do to be prepared for Saturday's auction, do they just need a pre-approval?

Sound familiar? This scenario and the inherent risks involved are all about a level of knowledge and education, both yours and your clients. There are two main pitfalls that brokers fall into when faced with these circumstances.

Firstly, it's easy for a broker to underestimate the role they have to play in this process because, quite simply, the amount of educational material available on this topic for brokers is severely lacking. Secondly, brokers will often overestimate what clients really understand about the auction process and the implications of being the successful bidder.

COVER ALL BASES

Most brokers know generally how the process works, but many also lack sufficient training or experience to understand the full implications of this process for their clients. Where do you think your responsibility resides?

With so much information available about the auction process, we all assume everyone understands it inside out and rarely are the intricacies actually explained. This has far reaching effects, because most clients would rather not look foolish or uninformed, than simply plead ignorance and ask for guidance.

The aspect of the auction process we are going to concentrate on is not tips or techniques for clients on how to bid or win at auction, or how the process unfolds, but rather the implications of what happens if they actually win.

When it comes to risk and the implications of winning, the auction process can be broken down quite simply. If your client is successful at an auction, they will have to do the following as soon as practicable after the hammer has fallen:

- Enter into a legally binding and unconditional contract
- Pay their deposit for the property.

Thankfully, most clients have had this explained to them at some point and most brokers are also aware of these requirements. However, it is the risks involved with these actions that cause a concern for brokers.

BUYER RISKS AT AUCTION

If these are the two main actions completed simultaneously straight after the auction has finished, then let's drill down further and analyse the risk for the buyer at this point. The key to the

assessment of risk for the buyer is in relation to the unconditional nature of the contract that the successful bidder must enter into straight after auction. These risks can be explained as follows:

- There is no 'cooling-off' period when buying at auction
- There is no further opportunity to inspect the property
- There is no further opportunity to review and negotiate the Contract for Sale
- There is a risk of obtaining a low property valuation.

In all Australian states, some form of 'cooling-off' rights are usually built into contracts for the sale of land in order to protect the buyer. These rights usually allow the buyer an unconditional right to get out of the contract for a limited time – sometimes for a small fee. They are designed to protect the buyer who has entered into the contract without proper inspection of the property or legal advice.

These cooling-off rights are not available at auction sales and this can have significant consequences because the successful bidder at auction cannot simply change their mind and pull out of the contract without losing (in most cases) the full deposit for the property.

If the buyer has not already had the property inspected by a qualified property inspector prior to auction, then (if any significant defects are found with the property after auction, eg. structural damage, termite infestation, water penetration, etc.) they will have to accept the property in this state and will potentially need to cover thousands of dollars of damage or defects themselves (sometimes tens of thousands!).

TERMS AND CONDITIONS

Also, buyers cannot negotiate any terms in the Contract for Sale once the auction has commenced, so if they have not had a solicitor or legally qualified conveyancer

review the contract prior to auction, they may subsequently find numerous legal reasons not to buy this property (eg. different form of legal title than they expected, their property encroaches onto neighbouring land, etc.).

Of course, as broker for the buyer, your role is not to advise your client as to these risks. That is clearly the role of the legal adviser. However, the prudent broker is normally very aware of these risks and always ensures that their client has been advised by their legal representative before auction day.

There are legal risks for a client buying at auction and they should always seek prior legal advice before attending at auction day. That's fine; you are experienced enough and you have already told your client to see their legal adviser – all that is left now is for you to obtain a conditional loan approval, right?

The broker who only obtains a conditional loan approval for their client prior to auction may be subjecting their client to significant risks without really knowing it. "But they only gave me two days notice. There is no way I can get an unconditional approval in this time!" – is the common response from brokers. I agree, and this is where the risk arises for the broker.

FOREWARNED IS FOREARMED

If any broker reading this article has not had a purchase valuation come back at a value under the contract price, then they are either extremely lucky or haven't been around long enough to have lived through this scenario, especially with the current property market conditions.

Failure to advise your client prior to auction of the risk of a possible low valuation report leaves you wide open to legal action or a claim on your professional indemnity (PI) insurance, should the worst happen. The damage to your hard earned reputation could be even greater and this also has a crushing effect on your clients. ►

BEST PRACTICE APPROACH

Auctions are a risky business for everyone involved. Clients assume you will tell them what they need to know, but they do not tell you this, they simply rely on your expertise and experience to guide them. Here is a handy set of tips to get you on the right track:

- Learn about the risks involved at auction, for you and your client
- Don't assume your clients know about the risks involved with auctions
- Develop your own auction checklist and educate your clients from the first interview about the requirements for your clients going to auction
- Tell your client to always get legal advice before auction
- Explain the risk of a low valuation – try working through a low valuation scenario with your client and explain the effects it may have
- Always recommend obtaining an unconditional loan approval before auction
- If the client does not want an 'unconditional', still explain the risk of low valuation and make a file note of your conversation and their instructions
- Establish a close relationship with solicitors who understand and value brokers.

► Yes, it is possible in some cases to get out of low valuation situations through obtaining a higher loan approval or a different type of loan. However, the damage can be irreversible for a client who is already approved at the maximum LVR and has no further serviceability capacity or access to extra deposit funds.

The prudent broker will advise their client of the risks they face by only obtaining a conditional approval before auction. They tell their clients about the minimum amount of time required to obtain an unconditional loan approval prior to auction and they know the lenders' policy and procedures in obtaining pre-auction valuations.

All brokers should strive to establish a close relationship with solicitors who understand and respect the role of the mortgage broker and who are proactive in assisting the broker to obtain an unconditional loan approval.

Timing is often crucial and a pre-auction valuation cannot be ordered by a broker without a completed contract for sale, which includes your clients' full names and addresses, and the purchase price and deposit amount.

So, how do you get a purchase price on a contract for a property that has not yet gone to auction? Quite simply, you ask your client for

the maximum price they are willing to go to at auction and then ask their solicitor to complete the contract for sale with the relevant details at this maximum price. Obtaining this completed front page of the contract quickly from the solicitor is very important for the broker.

Solicitors can sometimes be unhelpful, viewing brokers as a painful addition to the process, not a helpful one. Unfortunately, you will have to deal with this from time to time. That is why you should try to establish relationships with solicitors

who are proactive and helpful. Then, when your clients ask you for a referral to a solicitor, you can refer them to someone and know that you and your clients will be in good hands. **MFB**

Aaron Upcroft, principal solicitor, MORE Legal, the in-house conveyancing service for MORE Finance. Aaron is a member of the MFAA Member Panel, which is made up of members who volunteer their time and expertise to shape *Mortgage & Finance Brief* by suggesting article ideas, writing content and acting as subject matter experts or reference points for articles.

IN THE FIRING LINE

Jesse and Barbara are first home buyers in New South Wales with a \$25,000 deposit (which includes their \$7000 First Home Owner's Grant) and serviceability for a \$485,000 loan. Just enough serviceability to cover a 95% loan with capitalised LMI on a \$500,000 purchase. They go to auction and are successful at buying the property at \$500,000.

You only have a conditional approval on their loan so you order the valuation on Monday using the copy of the contract. On Thursday, the valuation comes in at \$475,000. Jesse and Barbara's LVR has gone from 95% to 100% – and their LMI premium has just gone up about \$3000!

At 100% LVR they can also only get a \$475,000 loan, but now need to come up with a further \$12,000 for LMI as it now cannot be capitalised. They call you in a panic asking why there is a problem – weren't they approved for a \$500,000 purchase before auction?

Learn about the auction process and then tell your clients about your requirements to obtain an unconditional loan approval prior to auction. Always get your client's approval for any action you take and stay close to a good, proactive solicitor.

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