11 March 2015

By email: affordablehousing@treasury.gov.au

Division Head
Social Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Submission to Council on Federal Financial Relations Affordable Housing Working Group - Innovative financing models

Consumer Action Law Centre (**Consumer Action**) is pleased to make this submission to the Affordable Housing Working Group.

Consumer Action's legal service and financial counselling service assist many people facing housing stress and its consequences. Through our casework and research, we have identified a particular problem of vulnerable people being sold homes through high-risk vendor terms and rent-to-buy schemes. Acknowledging that the review is looking at market-based responses to improve housing affordability, it is Consumer Action's view that these high-risk schemes are not part of the solution to unaffordable housing.

Our comments are detailed more fully below.

About Consumer Action

Consumer Action Law Centre is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Vendor terms and rent-to-buy schemes

Vendor terms and rent-to-buy arrangements are separate, but in many ways similar, legal structures under which properties may be bought and sold. From a legal perspective, vendor terms arrangements generally involve the sale of property over a long contract term, where the purchaser takes early possession and pays the purchase price in installments. Rent-to-buy arrangements involve the purchaser entering into a lease with the vendor and generally paying above market rent, with an associated option to purchase the property at a future date.

Each arrangement generally involves a home owner, purchaser and third-party broker who facilitates the transaction (they may call themselves agents, investors or 'transaction engineers'). At times, the vendor themselves will make the deal. Brokers generally advertise to buy or sell properties online (for example, on Gumtree, Facebook and specialised real estate websites) and on handwritten posters and pamphlets. They advertise properties to the market and also seek to procure properties for sale using slogans such as ‘buy without a bank', 'for sale by owner', 'vendor finance', 'rent-to-buy’ or 'sell-your-house-fast'.[1]

The 'Australian dream' of home ownership and Australia's current housing affordability problem[2] appear to be feeding demand in this market. Brokers target purchasers who are locked out of getting a traditional mortgage due to their incomes, savings and/or credit histories. Consumer Action has also seen people who have experienced insecure housing (for example, because they find it difficult to obtain suitable rental housing) take this path to what they hope is a permanent home.

Vendors may also be vulnerable in these deals. Consumer Action has seen examples of vendors looking to sell their properties quickly to escape mortgage stress or even foreclosure. They may also be looking for quick, high returns on an investment property. Often they do not fully understand the arrangement they're entering into.

From our observations, this problem is currently centered in outer metropolitan growth areas, although a decade ago it was more common in regional and rural areas.[3]

Risks for home buyers

Although they are legally distinct, vendor terms and rent-to-buy schemes share some common and significant risks. These arrangements are high-risk for hopeful purchasers for a number of reasons.

First, because a vulnerable purchaser sees no other way to own a home, there is rarely any pre-contractual negotiation, nor does a purchaser seek independent legal advice. The sale price, interest rate, default interest and fees, option fee and other agreed costs and conditions

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[1] Chris Vedelago, 'Warning on 'risky' We Buy Houses scheme', *The Age*, 2 November 2012, http://www.theage.com.au/victoria/warning-on-risky-we-buy-houses-scheme-20121102-28ofe.html.
[2] Sydney and Melbourne were recently ranked the second and fourth least affordable major metropolitan housing markets in the world: *12th Annual Demographica International Housing Affordability Survey (2015: 3rd Quarter)*, p 12, http://www.demographia.com/dhi.pdf.
[3] Consumer Action Law Centre, *Vendor Terms: Rhetoric and Reality*, February 2007, http://consumeraction.org.au/policy-report-vendor-terms/.

can be highly disadvantageous to the purchaser. Many deals that Consumer Action has seen appear to have had virtually no chance of ever ending in home ownership.

Case study – Anna

Anna left school at 14 years of age. She was receiving Centrelink payments, had mental health issues and was a victim of family violence. Her partner, who had a bad credit rating, encouraged her to buy a house on vendor terms. They were highly unlikely to have been approved for a bank loan.

Anna paid a very high price and high interest on the house, When her partner left seven years later, Anna could not afford to stay. She tried to sell the property but discovered that its market value was less than the price she had agreed to seven years ago. The owner is now seeking to evict Anna and her children. Anna stands to lose $238,000 in repayments and $20,000 spent on improvements to the property.

Second, because a purchaser does not have legal title to a property, that purchaser generally will not have the legal rights and protections offered to traditional home buyers with mainstream mortgages.

Third, there are additional complexities where a vendor has a mortgage on the property (this arrangement is referred to by some in the vendor finance industry as 'wrapping'). If a vendor who has 'wrapped' a property defaults on their own mortgage, or fails to pay certain other debts secured by the mortgage, and a mortgagee foreclosures, the buyer may be left with no equity in the property and limited legal rights.

Case study – Nina

Nina was a refugee from East Africa who became a single mother to six children in late-2014. She was earning good money running her own business. In mid-2014 a friend had put her in contact with a man who would help her design and buy a new home for her family. She was told that it would be ready in about six months. She agreed to buy the property and paid a $40,000 deposit plus further payments totalling about $17,000.

Nina realised after several months that no construction work was happening. She enquired about progress but the company representatives continually evaded her. In mid-2015 she asked for her money back. In late-2015, Nina saw a 'Sold' sign on the block of land. She later found out that the land was mortgaged to a bank after she had agreed to buy it. An external controller was appointed on behalf of the bank to sell the land to recover the amount owed to the bank. The bank alleges that they had no knowledge of Nina’s agreement to purchase the property prior to mortgaging the property. Nina’s legal claims in relation to the property is uncertain.

These schemes can have significant impacts for our clients including:

- inability to pay other debts due to high housing costs,
- inability to pay bills, including for essential services, and
- stress, mental health issues and family and other difficulties.

Addressing the risks

There is doubt as to whether all brokers (including in some cases vendors) in vendor terms and rent-to-buy deals must be bound by the National Credit Code[4] and hold credit licences, which would afford purchasers responsible lending protections and dispute resolution options. Clear coverage of private lending would go some way to addressing this aggravated risk. In 2012, Federal Treasury consulted on draft legislation that would extend the National Credit Code to contracts where a credit provider is a private individual who is not in the business of providing credit, and where the contract is arranged by an intermediary (rather than directly between the credit provider and the consumer).[5] This legislation did not procced following the 2013 Federal Election. While these schemes continue to operate in Australia, every person with home finance, including through a private lender, should be protected by the National Credit Code.

In addition, high-profile property spruikers who provide coaching in how to make money through brokering vendor finance and rent-to-buy deals must be held accountable for their advice. Consumer Action supports the recent recommendation of the Senate Economics References Committee that property investment advice be regulated as financial advice.[6] This reform would go a long way to protecting vulnerable consumers from high-risk vendor finance, rent-to-buy and other property schemes.

It is Consumer Action's view that private vendor terms and rent-to-buy schemes are a symptom of the problem of unaffordable housing, and not part of the solution.

While we do not endorse any particular model, there are examples of not-for-profit and government-funded housing schemes in Australia and overseas which appear to be more genuine attempts to assist people to own their own homes.

Please contact Susan Quinn on 03 9670 5088 or at susan@consumeraction.org.au if you have any questions about this submission.

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[4] See *Weerasinghe v Jamaly* [2015] VSC 45 (23 February 2015).

[5] National Consumer Credit Protection Amendment (Credit Reform Phase 2) Bill 2012, 21 December 2012, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2012/Credit-Reform-Phase-2-Bill-2012.

[6] Senate Economics References Committee, *Scrutiny of Financial Advice Part 1 – Land banking: a ticking time bomb*, 24 February 2016, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Scrutiny_of_Financial_Advice/Report.

Yours sincerely,

CONSUMER ACTION LAW CENTRE

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