

Lending law changes perfect for spruikers

DAVID HUGGINS

The Federal Government recently announced it would scrap responsible lending laws, which prevent a bank from making a loan that you can't repay and prevent a mortgage broker from assisting you to enter into such a loan.

The repeal of these laws will make it much easier for real estate scammers to operate. They work like this:

A property developer subdivides land, usually in some semi-rural location. They engage a property spruiking firm to sell house and land packages. The firm will be paid a substantial commission for each house and land package that it sells.

The firm finds investors by cold calling or advertising. The investor meets with the firm and goes through a sham process that appears like the investor is getting proper financial advice from a financial planner.

The investor is then referred to a mortgage broker who manipulates the investor's living expenses and the rent that is going to be received from the house so as to make it look like the investor can pay back the loan. When the loan is approved the mortgage broker gets an up-front commission and a trailing

commission from the lender. Often the builder of the house is part of the same organisation, as is the real estate agent who is engaged to find tenants. Incredibly, I know of one organisation in this line of business that consists of a property development company, a builder, a financial planner, a mortgage broker and a real estate agent.

Inevitably, what happens is that a shoddy house is built in an undesirable area that is full of houses that are much the same, all of which are being rented out. The investor can't find a tenant or receives a much lower rent than was expected.

On top of this, the investor has to pay all of the costs associated with owning an investment property. The investor defaults on the loan and has to sell and makes a huge capital loss. The bank then seizes the investor's family home that was used as security for the loan.

The part about the family home is key. Banks don't look closely at these loans because they have security over the investor's family home. They know that if the investor defaults they can sell the investment property and the family home and get their money back.

All of this has been going on under the current laws. The

scrapping of these laws is only going to make things much worse. To protect yourself from these types of scams, I propose my own laws to live by.

Know the area

Don't buy an investment property in some place that you have never been to and know nothing about, and don't respond to advertisements or cold calls about these types of investments.

Don't buy the hype

Accept that advice about property investments and loans that are used to make them is unregulated. There is a vast and very strict legal framework that applies to advice about financial products such as shares that does not apply to advice about property. Advisers can pretty much say what they like and they can accept commission payments that have been outlawed for many years with respect to financial advice.

Don't believe statements that are made about future matters such as the rent that will be received and how much the property will appreciate in value over time. Predictions about what the value of a property will be in 10 years time are nonsense.

Keep it real

Do not let a mortgage broker submit false information about your living expenses or income to a bank on your behalf.

Mortgage brokers receive up-front and trailing commissions every time a loan is approved. It will be your problem, not theirs, if you can't pay back the loan and lose your family home.

Spot the fakes

Avoid advisers who go through a sham process that is designed to look like you are getting financial advice. When you receive financial advice you must be given a financial services guide and a statement of advice. Scammers will provide you with documents that have similar names but this is all made up.

They are designed to trick you into believing that you are receiving regulated financial advice when what you are actually receiving is an unregulated sales pitch.

Protect your castle

Fifth, understand that if you put your home up as security for an investment loan you will lose it if you default on the investment loan.

David Huggins is a lawyer specialising in financial disputes