BORROWING MONEY – A LAWYERS GUIDE

As we are all aware, banks are in the business of making money. Whilst this fact is neither new nor surprising, there are some tactics which banks use to make money and ensure you remain a “loyal borrower”. This article sets out to provide some observed bank behaviours and tips and tricks for borrowers and guarantors in dealing with banks.

We use the term banks in the broad sense to include all providers of finance. We also note that the observations here certainly do not apply to all banks or bankers.

Left Arm, Right Arm Syndrome

Banks like most large organisations are compartmentalised. The customer service (sales) department who you may have dealings with, assuming you are dealing directly with the bank and not with a broker which adds another layer of distance and complexity, will be instructing the credit department who approves the provision of finance who may then instruct a documentation team to produce the documents. It would be unusual for the customer service people to occupy the same building as the credit department who may be in different States and time zones.

It is little wonder then that the terms of your specific loan, the details of which you painstakingly specified with your broker or customer service representative, are often incorrect in the documentation you are initially provided with. It is often at this point that the finger-pointing starts within the bank. Re-documentation invariably leads to delays which brings us to our second observance.

Tip - When you have had a discussion with your bank customer service representative follow this up with an email clearly setting out the details agreed upon including loan amount, draw down date, interest rate, fees, security and so on.

Delay until there is no time for you to arrange finance elsewhere

A common complaint of clients is that loan documents are often produced at the final hour shortly before drawdown of funds is required. Not only does this make it difficult for clients to obtain proper legal and financial advice, it also makes it impossible, in many cases, to arrange alternative funding from a different bank or financier or to negotiate or amend the loan terms if the contents of the loan documents are not what was expected or agreed upon. Whether this

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is a tactic of the banks or simply a result of a lack of coordination between the various departments is unclear.

Tip – Try to clarify in writing the date on which the banks representative has promised to get the documentation back to you and request that they inform you well prior to this date if there is going to be a delay.

Guarantors – are they necessary?

For many clients, both individuals and companies, whose financial affairs are structured towards asset protection, often using a trust or having a spouse or partner owning assets, guarantees from the asset owners can put these assets at risk. In situations where the assets to be provided as security are owned by someone other than the primary borrower, the bank may have a valid reason for requiring a guarantee or even requesting that the asset owner becomes a primary borrower.

Banks work on the basic economic premise that risk requires return so if they can lower their risk by increasing the security provided for a loan whilst keeping the interest rate and fees that you pay the same then they make more profit. Clients sometimes forget that, like most contracts, bank loan documents are negotiable and too often we see banks asking for more security than required without offering a corresponding discount in lending rates.

When a client approaches us to review their loan documentation and advise a guarantor we often enquire whether the client has asked the bank if the loan can proceed without the guarantee. On a number of occasions the guarantee requirement has been waived when the bank reviewed the transaction.

Another important issue with guarantees is their removal. It is vital when refinancing or paying out a loan to ensure that the guarantees are released particularly where the guarantee is unlimited and covers all present and future borrowings of the borrower. An unreleased guarantee could potentially make a guarantor liable for borrowings of an entity which they no longer have any association with and over which they have no control.

Tip – Get the loan documents as early as possible. If the security required is more than what was expected or if you think the loan to value ratio (LVR) is sufficient request some of the security to be removed or a discount be provided on the interest rate for the loan. See what other lenders are able to offer for the same security. Check the guarantee release provisions and ensure that you understand the extent of liability.

Cross Securitisation

Cross securitisation often occurs when related borrowers have multiple loans with the same institution. With a cross securitisation provision, the security provided for one loan, for example a residential mortgage, may be used to secure the borrowings for a completely separate entity, for example the business overdraft, through the use of guarantors and cross securitisation

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provisions. These provisions are sometimes difficult to interpret and may not appear to put assets at risk on first reading.

The potential risk is that assets which clients thought were ring fenced and protected may be available to the bank to cover the borrowings of different entities.

One of the simplest ways to ensure that personal assets are not at risk from other entity borrowings is to have the loans with separate institutions. It is also pertinent to ensure that the owners of the personal assets, be it individuals or a trust, do not provide guarantees or take any loans in their personal capacities with banks other than their primary mortgage provider.

Tip – Getting quality legal advice by experienced finance lawyers may serve to help protect assets which may otherwise have been put at risk.

Loan to Value Ratio (LVR) breaches following (de)valuations

The LVR is a primary consideration for lenders both in providing initial finance and deciding when to stop providing it. It is a large box that bankers are required to tick when having loans approved or rolled over. The required ratio depends greatly on the type of property or asset and its use. Typically, stand-alone residential properties have a higher required LVR (less equity required) than commercial property, apartments, or company assets other than real property where the market is more volatile.

Where inflated property or asset values decline, as has happened in speculative beachside and apartment property markets or the used yellow goods (machinery) market in recent times, the LVR on loans for highly geared (low equity) properties or other assets may fall below the threshold required by the bank and trigger a default.

Tip – For highly geared loans, communication with the bank and having a clear understanding of bank expectations and required value ratios is vital. A plan to deal with a drop in the value of security assets such as providing other assets is often preferable to selling assets at the bottom of the market.

Summary

Not all banks are alike and certainly not all customer service representatives are equal. The level of product knowledge and understanding of the credit department procedures are important qualities in a banker. As this is hard to judge, your lawyer or accountant may be able to give you suggestions regarding who they recommend.

Finding the right financial institution and the right banker for you is as valuable as finding a quality lawyer, accountant or doctor. It will potentially save you hours of frustration in re-documenting and enable you to get the best finance deal and a quality of service that suits your needs.

For further information contact Murfett Legal by telephone on +61 8 9388 3100, via our website at www.murfett.com.au or email one of the following directors:

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