The AFCA Approach to mortgagee sales

We have created a series of AFCA Approach documents, such as this one, to help consumers and financial firms better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and complaint types that we see at AFCA. However, it is important to understand that each complaint that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no AFCA Approach document can cover everything you might want to know about key issues.

1 At a glance

1.1 Scope

When a financial firm lends money, it may require the borrower to provide a mortgage over an asset, usually a home or investment property. If the borrower is later unable to repay the loan, the financial firm can take possession of that property to sell it and reduce or pay out the loan.

This document sets out what:

- the financial firm must do if it takes possession of a borrower's home for sale
- AFCA will take into account when considering a complaint over a mortgagee sale.

The approach has been adopted from AFCA's predecessor scheme, the Financial Ombudsman Service.

1.2 Summary

A financial firm in possession of a borrower's property must take reasonable care to sell the property for either its market value or the best possible price.

If there is a complaint over a mortgagee sale, we will look at how the financial firm:

- worked out the property's value
- marketed the property, including advertising and inspections
- repaired, maintained or improved its condition
- sold the property and set the sale price
- used the proceeds of the sale
- communicated with the borrowers.

If we believe the financial firm did not take reasonable care, we may award the borrower compensation for any difference between the sale price and the market value of the property sold.

2 In detail

2.1 Taking 'reasonable care'

What steps must the financial firm take?

A financial firm that takes possession of a borrower's property to recover a debt must take reasonable care to sell the property at its market value. If the property does not have a market value, the financial firm must get the best price it reasonably can.

To do this, the financial firm must oversee the sale and make important decisions at each stage in the process. We set out these stages in the sections below.

The financial firm can ask its marketing agent, valuer or property consultant what they suggest, and rely on their expertise to make decisions. However, it is not enough to simply:

- leave a consultant to advertise and sell the property unsupervised
- aim to recover the amount of the borrower's debt without considering whether a higher price could be reached.

Does the financial firm need to consult the borrower?

The financial firm does not need to consult the borrower about its decisions or keep the borrower informed of progress.

The borrower cannot dictate how the property is marketed or sold, or what sale price will be acceptable.

However, when the sale has been completed, the financial firm must promptly tell the borrower how it has used the sale proceeds.

What happens if the borrower complains about the sale?

If the borrower disputes the sale and involves AFCA, we will:

- ask the financial firm to supply information relating to the sale
- consider its actions and decisions.

If we believe that the financial firm did not take reasonable care when selling the property, we may award the borrower compensation for any difference between the property's sale price and its market value. We will require the financial firm to either reduce the borrower's debt (if there is any left) or compensate the borrower by that amount.

2.2 Valuing the property

How should the financial firm work out 'market value'?

The financial firm should get at least one sworn valuation from an independent registered valuer that gives an expert opinion about the property's market value.

According to the International Valuation Standards Council, the market value is the estimated amount that an asset should sell for between a willing buyer and seller on the day of the valuation. The valuer is likely to take this definition into account when giving their valuation.

If the property market is slow at the time of sale, the financial firm does not need to wait until the market improves before it sells the property.

Can the financial firm rely on a ‘forced sale value’?

The financial firm may get a valuation that includes a ‘forced sale value’, as it could be said that the financial firm is forced to sell the property. However, the financial firm should not:

- rely solely on this value
- refer to this value when setting the listing price, or auction reserve, or when considering offers.

The financial firm must still base its decisions on the market value when it sets the listing price and reserve, and considers offers.

What information will the financial firm need to supply in a complaint?

When AFCA investigates a complaint about a mortgagee sale, we will ask the financial firm to supply copies of any valuations it obtained.

We do not consider the content of a valuation is confidential and will give the complainant a copy.

If the financial firm does not agree to this, we might not be able to rely on the valuation’s content to decide whether the financial firm sold the property for the market value.

2.3 Marketing the property

How should the financial firm set a marketing strategy?

The financial firm should also get at least one marketing proposal from a reputable property agent. This proposal will usually include recommendations on the:

- market value
- way to sell the property, such as by auction, private sale or tender
- marketing and advertising strategy
- work needed to prepare the property for sale, such as maintenance and repairs.

The proposal might also refer to potential problems the agent has identified, such as uncooperative tenants who will not give access for inspections.

What might an advertising campaign cover?

Advertising is a vital step to generate interest and competition. If potential purchasers are not made aware that the property is for sale, the financial firm might struggle to show that it has achieved market value at sale.

While the financial firm must advertise the property for sale, how that is done and to what extent will depend on the location and type of property. It will also be influenced by the recommendations of the financial firm’s valuer, property agent or property consultant.

An advertising campaign might include:

- print ads, such as in newspapers, property agent’s brochures and window displays, or real estate magazines
- online ads on sites such as domain.com.au and realestate.com.au
- billboards at the property
- handbills or flyers
- contact with potential purchasers
- inspections for the public or by appointment.

The financial firm should ensure that the advertising accurately describes the property and its location. It should also detail any planning permissions and redevelopment opportunities that the financial firm is aware of.

Which elements are appropriate for an auction?

More often than not, the financial firm will sell the property at an auction. We consider that a four-week advertising campaign with inspections each week and on the auction day is generally appropriate.

As potential purchasers often search for properties online, the financial firm should advertise on commercial real estate websites for at least four weeks. We will usually consider the financial firm has met its obligation if it has done so.

If the property is in a regional area, advertising a couple of times in a local newspaper will generally also be necessary. If a property is commercial or unusual, the financial firm should also advertise it in appropriate specialist publications.

Should the financial firm advertise the property as a ‘mortgagee sale’?

Sometimes the financial firm will advertise its sale of the property as mortgagee. While a potential purchaser can easily find out who is selling the property, ads referring to a mortgagee sale might suggest that it will be sold for a cheap price.

However, reference to a ‘mortgagee sale’, particularly for an auction, can be positive as it might attract more purchasers. The auctioneer will then need to ensure that the auction generates competition between the bidders to achieve a sale at market value.

Whether advertising a property as a mortgagee sale impacts on the sale price will depend on the individual circumstances of the sale.

What information will the financial firm need to supply in a complaint?

When considering a complaint, we will ask the financial firm to supply copies of the marketing proposal. We will look at whether the financial firm's campaign was reasonable in light of the proposal's recommendations.

We will also expect the financial firm to prove that it regularly received updates from its property agent about the campaign.

The financial firm will need to supply the agent's file showing:

- the advertising schedule
- actual copies of the print and online ads as they were published
- confirmation the ads were published in line with the advertising schedule
- details of inspections, including the number of parties, comments from interested parties, and the agent's suggestions on any offers received or opportunities to promote offers.

We will also ask the financial firm to supply any reports it received from its property agent about feedback from potential purchasers. We will use this information to confirm that the property was adequately described and marketed. This lets us test the market and get the market value at sale.

2.4 Maintaining or improving the property

Does the financial firm need to look after the property before sale?

The financial firm generally does not need to spend money to improve the property, even if an owner might take that risk to get a higher price. Nor does it need to find new tenants or let existing tenants stay to make money before the sale.

However, the financial firm might need to pay for common maintenance issues such as:

- repairing broken windows or door locks to secure the property
- cleaning, gardening or lawn mowing
- repairing pool equipment
- fencing the pool if it is required by law before the property can be sold.

Whether other expenses are reasonable will depend on the circumstances. For example, the financial firm might need to rent furniture to market a high value property in an affluent area, but not for an average home.

Should the financial firm insure the property?

Usually the financial firm will insure the property when it takes possession of it.

If there is a risk of vandals or squatters gaining access, the financial firm might also hire a security service so it can market the property in a presentable condition.

What information will the financial firm need to supply in a complaint?

When we are investigating a complaint, we will ask the financial firm to provide receipts for all expenses it incurred to maintain or improve the property, where it took payment out of the sale proceeds.

We will consider whether those expenses were reasonable for the financial firm to obtain a market value.

For more on using the sale proceeds, please see section **2.6**.

2.5 Selling the property

Should the financial firm sell by auction or private sale?

The financial firm may decide how to sell the property. However, we consider that an auction is the most appropriate option, unless the financial firm's experts have recommended another approach.

An auction effectively shows how much interest there is from potential purchasers on the day of sale. It can create competition between bidders, which will likely result in a fair price.

If the financial firm's experts recommend a private sale, the financial firm must take particular care with marketing and advertising. It must be able to show that it brought the property to the attention of potential purchasers, thus creating competition and achieving market value.

If the financial firm does not sell by auction, it must give us written proof the selling agent recommended that the property be sold by private treaty or another way, and include the reasons why.

How should the financial firm set the reserve or sale price?

The financial firm will need to set a reserve price for an auction. It should consider all the available information, such as valuations, marketing reports and previous offers.

A low reserve will not always mean that the property sells for a low price. The level of interest and number of bidders can push the price well beyond the reserve. However, if there is little interest or a specific price range is disclosed before the auction, a low reserve might limit the sale to below the true market value.

Often, particularly for private sales, the advertising will specify a price. The financial firm will need to be satisfied, based on its valuation and property agent's advice, that this price is appropriate. If the reserve price is too low, it will be difficult to promote higher offers. If it is too high, the property might be overlooked.

2.6 Using the proceeds of the sale

What can the financial firm use sale proceeds for?

The financial firm must explain to the borrower what it has used the sale proceeds for. It should do this after the sale has been completed and, if there is a shortfall debt, before it starts any collection activity.

The financial firm can use the money to:

- reduce or pay out the debt the borrower owes to it and any other creditor with a mortgage over the property
- pay reasonable costs it incurs in taking possession of, maintaining and selling the property.

If there is any money left over from the sale and the borrower has no other loans, the financial firm should pay the surplus to the borrower. This is good industry practice.

The financial firm should not keep the surplus, even if the borrower has threatened to take legal action and the loan contract or mortgage says it can hold money in case of legal costs.

Can the financial firm use surplus money to reduce other loans?

If the borrower has loans from the financial firm for more than one property, the financial firm may use any surplus money from the sale to reduce the balance on other loans.

Borrowers often mistakenly believe that one loan applies to one property, and the property's mortgage will only apply to that loan. However, the financial firm can require all the borrower's properties to secure all the borrower's loans.

Which costs are reasonable for taking possession and selling the property?

The financial firm should only do what is necessary to get possession of the property. It should start by contacting the borrower to discuss whether the borrower will 'deliver up possession' by handing over the keys or, for vacant land, agreeing to the sale.

If the financial firm does not try to contact the borrower, it might take unnecessary action and will not be entitled to pay its costs from the sale proceeds. For example, there would be little need for a court order if the borrower has already left the property. The financial firm will generally only need to put a notice at the gate on a vacant block.

Once the financial firm has possession, it can usually reimburse itself for costs relating to:

- security, insurance and maintenance (such as changing the locks, cleaning, gardening and mowing)

- advertising and sale, including the property agent’s fee.

The financial firm may even outsource the sale to a property consultant and recover the consultant’s reasonable costs. However, that person must add value to the process. If he or she merely acts as an intermediary between the financial firm and service providers, such as property agents or repairers, the financial firm may not recover costs.

Which legal costs are reasonable?

The financial firm, under the loan contract or mortgage, will usually be allowed to recover reasonable and proper legal costs for serving default notices, demands or other notices, and taking court proceedings. It does not matter if there has been a court order for the costs of a default judgment.

However, the financial firm may not recover any more than it has paid to its lawyers. Sometimes a financial firm’s agreement with its lawyers will include a discount or rebate if the financial firm gives them a certain amount of work. The financial firm should apply that discount or rebate to bills for the borrower’s loans, even if the lawyers have not.

The financial firm will also be entitled to a tax credit for 75% of the GST charged by the lawyers when seeking possession of the property. The financial firm should make sure the benefit of this tax credit is taken into account when it deducts its legal costs from the sale proceeds, even if it chooses not to claim the credit from the Australian Taxation Office.

The financial firm cannot recover its AFCA complaint costs from a borrower.

What information will the financial firm need to supply in a complaint?

In a complaint, the financial firm must provide invoices for all the costs it has taken from the sale proceeds, such as its property agent’s fee and costs for advertising and maintenance.

This includes the financial firm’s lawyers’ bills. We do not consider these bills confidential, even if the financial firm claims legal professional privilege.

3 Context

3.1 Case studies

The case studies below are based on determinations by one of AFCA’s predecessor schemes, the Financial Ombudsman Service. While previous determinations (by AFCA or by its predecessor schemes) are not binding precedents, where relevant they will inform AFCA’s approach to an issue.

Case 1: Inadequate advertising did not mean the property was undersold

In 2012, the financial firm took possession of the complainant's house and sold it for a much lower price than he had paid for it three years earlier. He said it had been undersold.

Loan	Purchase price	financial firm valuations	Sale price
$540,000 (2008)	$750,000 (2008)	$445,000 (early 2012) $385,000 (Apr 2012)	Passed in (Apr 2012) $325,000 (Sept 2012)

When we investigated, the financial firm gave us information showing that its agent had advertised by:

- putting up a display notice at the agent's office on 16 March 2012
- installed a billboard at the property on 16 March 2012
- advertised on realestate.com.au and domain.com.au on 16 March 2012
- advertised in the local newspaper on three consecutive Saturdays
- accurately described the property in the newspaper ads.

The financial firm did not keep a copy of the internet advertising and could not show how long the property was advertised online, or how the ads described it. The financial firm also could not show that the property was advertised in the newspaper for any longer than three weeks.

We concluded that the financial firm did not adequately advertise the property.

However, this did not mean the property had been sold for less than it was worth. The valuation the complainant relied on was two years old and raised possible difficulties in selling the property.

The financial firm:

- had obtained two valuations
- received and rejected lower offers
- received an offer for $325,000, which was later withdrawn
- accepted another offer for $325,000.

Given the financial firm's conduct and the declining market, we were not satisfied that its failure to adequately advertise the property led to a sale at less than market value.

Case 2: Disparate valuations complicated a sale at shortfall

In 2010, the financial firm took possession of the complainants' block of land and sold it at auction. The financial firm then sought to recover a residual debt of around

$30,000. The complainants said that the financial firm sold the land for less than its market value.

Loan	Purchase price	financial firm valuations	Sale price
$80,000 (2004)	$60,000 (2003)	$150,000 $60,000	$50,000 (Dec 2010)

The complainants told us:

- the land's value was around $110,000 in 2007
- they did not know why the financial firm's valuations differed so much
- shortly before the auction, they had an offer of $160,000 and their financial counsellor told the financial firm that they had offers between $150,000 and $160,000.

We reviewed the financial firm's two valuations. While its $60,000 valuation referred to the limited market for the land and difficulties in building on it, the financial firm's $150,000 valuation did not. This might have accounted for some difference in the assessments, but did not explain the size of the gap.

It was not clear from the financial firm's information whether it looked into the discrepancy. It appeared to have disregarded the $150,000 valuation, which we considered as unacceptable without the financial firm looking into the discrepancy. Therefore, we were not satisfied it had met its obligations to take reasonable steps to determine the value of the property.

The financial firm did not take reasonable care in setting the auction reserve price at $60,000, because it relied solely on:

- a property agent's valuation in April 2010 of $70,000
- a drive-by valuation in May 2010 of $70,000
- a property agent's property report valuing the land between $50,000 and $60,000
- the small number of enquiries in the four-week marketing campaign.

We sought an independent, retrospective valuation of the land as at December 2010. It gave a market value of $65,000, which was closer to the financial firm's lower valuation. However, the higher valuation was supported by information from the complainants' agents. This confirmed an offer of $160,000 was made a week after the land sold. We considered that a fair way to determine the land's value was to average the three valuations ($60,000, $65,000 and $150,000) resulting in a value of $91,666.

The balance of the complainants' loan at the time of the sale was around $87,500. After accounting for the financial firm's sale costs of $6,500, the net proceeds would have been $85,166. The complainants therefore remained in debt to the financial firm, but only for $2,334.

Case 3: financial firm had adequate advertising and made a fair commercial decision

In May 2011, the financial firm sold the complainant's property for $360,000. He said it was undersold and the financial firm should have delayed the sale until it could achieve the true value. He based this view on several valuations (see below) and the fact the property was resold in December 2012 for $595,000.

2010	Source	Method	Amount
–	Local council	Valuation	$483,000
–	Property agent 1	Valuation	$700,000 to $800,000
May	Smaller neighbouring property	Sale	$300,000
Nov	Property agent 2	Valuation	$580,000 to $630,000

We reviewed the financial firm's information on its sale process. The financial firm:

- advertised the property in a local newspaper for five consecutive weeks and on the internet, and provided copies of the ads that accurately described the property
- had a billboard at the property and window displays in its two town offices for six weeks before the auction
- obtained two independent valuations of the property, setting a range between $360,000 and $420,000
- spent money on lawn mowing and pumping water away from a space below the house (in line with the valuers' recommendations)
- set the reserve price at $420,000 based on the valuations.

The information also showed that around 10 people attended the auction, but only one bid at $360,000 was made. The financial firm decided to accept this bid because:

- its property agent advised that this was the best offer available
- the market was 'soft'
- it would otherwise incur holding costs, including further interest charged to the complainant's loan.

We concluded that the financial firm adequately advertised the property and was entitled to make its commercial decision to accept the bid. The complainant remained liable for the rest of his debt.

Case 4: Court order was unreasonable

The complainants had a mortgage over their home and two vacant blocks of land more than 2,000 kilometres away. When they did not make their loan repayments, the financial firm served default notices on all three properties.

The complainants tried to sell the vacant blocks and supplied the financial firm with an offer of $270,000 for one, but the financial firm obtained a court order to take possession of both. The complainants then told the financial firm about other offers they had received, including a written offer for $225,000.

The financial firm later sold the blocks for $200,000 and $185,000. The complainants complained that the financial firm had not obtained the market value for them.

We considered that the financial firm did not respond appropriately to the complainants' request for consent to sell one block. It waited to hear from its lender's mortgage insurer before it considering the offer, which on its own valuations was good. It also waited for financial information on the complainants to determine how they might pay any shortfall.

We also considered that the financial firm:

- did not need a court order to take possession of the vacant blocks
- failed to adequately work with the complainants when it considered it was legally entitled to take possession. If it had done so, it would have found that they had a signed contract for one block at $225,000 and it should have allowed that contract to be completed.

The financial firm was required to reduce the complainants' remaining debt by the difference between the sale prices and the written offers the complainants had. The financial firm was not allowed to use any sale proceeds to pay its court costs.

3.2 References

Definitions

Term	Definition
Complainant	individual or small business that has lodged a complaint with AFCA
Borrower	individual or small business who has taken out a loan from a financial firm
Financial firm	An organisation or individual that is a Member of AFCA
Market value	estimated amount that an asset should exchange for, on the valuation date, in an arm's length transaction between a willing buyer and seller where the parties have acted knowledgeably, prudently and without compulsion

Term	Definition
Mortgage	encumbrance on land or property owned by a borrower to secure a loan from a financial firm

Useful links

Document	Link
Rules	www.afca.org.au/rules
FOS Bulletin	Bulletin 38: Special Bulletin – Mortgagee Sales