Aussie Bonds Australia

… we help to make property dreams happen!

Thanks for downloading. After reading, I trust we've lifted the mystery about Deposit Bonds for those who haven't considered using them before and for those that have, provided a greater awareness of how broadly Deposit Bonds can be used and their many benefits.

A word of caution.

If you or your adviser haven't obtained a quote from Aussie Bonds, it's highly likely you'll pay too much.

If your adviser tells you that they can't obtain a Deposit Bond for your proposed purchase, it's highly likely that they haven't spoken to us.

Best to work on the basis that 'if we can't do it, no one can'. So try us first and save time.

From the thousands of clients we've quoted over the years, we seem to be the most flexible and price competitive. Plus, we have a 'can do - want to do' attitude!

So, if you receive a Deposit Bond quote and it's not using Aussie Bonds, email me direct at khenry@aussiebonds.com.au or phone and I'll give you our comparison quote.

You'll be both surprised and happy with the savings and the service, including after-hours!

Before we jump into Deposit Bonds, hopefully the first topic below will give you an insight into how changes to lending policies being forced onto or being adopted by some of Australian lenders.

Good luck with your property purchase. Give us feedback on Facebook and Twitter.

Sincerely,
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(About Aussie Bonds Australia. One of our directors was part of the team that developed the Deposit Bond product, way back in 1989. For me, I've been involved with various sorts of Insurance Bonds for 35+ years and also have a banking background with Citibank. That's why we're seen as the 'go to guys' for all things, Deposit Bonds. We're one of two Authorised Representatives of QBE Insurance (Australia) limited (rated A+), which is very important, especially for 'longer term settlements'. Plus, we're 100% Australia owned & not part of Aussie Home Loans.)

Changes to bank's lending policies

The Reserve Bank of Australia (RBA) and the Australian Prudential Regulation Authority (APRA) have been making noise and changing banking policies to rein in the level of lending and potential risk exposure of the regulated banks, the Big Four as they are known. It's also an attempt to take some 'heat' out of the level of increases in property prices, especially key capital cities, witnessed over the last few years.

The lending policies don't apply to non-bank lenders, although some of these are also tightening their lending practices.

Whilst the initial primary focus has been on 'investors' versus 'owner occupiers', both sectors will be impacted.

Another area of impact is the imposition of increased capital adequacy/weighting requirements (this is the % of funds the Big Four must hold with the RBA for their total mortgage exposure), currently at 16% and rising to 25% from 1 July 2016.

Industry commentators are suggesting that if banks are to maintain their current levels of profit and dividend to shareholders (and of course the executives' performance bonuses), they will need to find additional income from elsewhere or if they pass the additional costs of the increased RBA requirements onto borrowers, it represents a .65% increase in interest costs.

Ignoring what the RBA may do with general interest rate levels, the combination of recent interest rate increases and the potential .65% impact from 1 July 2016, equates to a near 1% increase in interest rates over the next 12 months.

Amongst the changes being introduced by lenders are increases in 'lender floor rates' and reductions in the proportion of rental and other investment income that can be attributed to loan servicing.

The reality is that these changes will have a negative impact on buyer's borrowing capacity.

Re increased 'floor rates' (FR), some lenders have significantly lifted the FR they use when determining whether or not the borrower can service their loan. While the current mortgage interest rate may be just 4.5%, most lenders use an FR of at least 7% and above. They will then use this FR as a benchmark and check to see whether or not the borrower can easily make their mortgage repayments, if interest rates shift back to 7% and above. They do this to make sure the borrower won't default on their loan if interest rates were to rise. *(Given that current interest rates are at historical low levels for many decades, higher interest rates over the medium to long term are most likely.)*

Some borrowers may find it difficult to prove they can service their loan at a higher FR and, as a result, their borrowing capacity will be impacted.

Re 'loan to value ratios' (LVR), some lenders have recently reduced their maximum LVR to 80% for investors, which may negatively impact many investors, particularly those looking to purchase 'off the plan' properties.

Investors who are in the process of purchasing 'off the plan' properties may find that while they may have received a pre-approval from their lender when they started the proposed property purchase, that lender has recently changed their lending policy and will no longer be able to approve the loan, because they have reduced their LVR.

While this issue certainly won't affect all investors purchasing 'off the plan', if you are going through the process currently, it will certainly pay to speak with your lender or a mortgage broker to see if your proposed home loan will be impacted.

Indeed, with so many lenders making so many changes to their lending policies, the home loan market has become far more complex, so do seek professional help and be alert to those who might be looking after their interests and not yours!

Deposit Bonds, the smarter option

Buying real estate can be a stressful experience, however, there's one aspect of the process that makes the buying process much easier, and helps save buyers time and money.

That's the use of Deposit Bonds, versus cash or bank guarantees, as the deposit required to secure a Contract of Sale.

With short-term real estate settlements (typically 4 to 26 weeks), in some States and Territories, the deposit amount can be a minimum amount of several thousand dollars, which means many buyers can simply pay cash.

Elsewhere, the deposit amount can be upwards of 10% of the purchase price.

In the majority of cases Australia wide, 10% is required for longer-term settlements, predominately for 'off the plan' purchases, where settlement may not take place for a number of years.

Different % amounts and settlement periods apply to commercial real estate purchases.

Deposit Bonds explained

It's best to explain how Deposit Bonds work, before we venture further.

Two insurance companies currently issue deposit Deposit Bonds. In our case, we're one of two Authorised Representatives of QBE Insurance (Australia) Limited, rated A+.

Let's take a $500,000 real estate purchase, albeit a short-term or long-term settlement, as the process is the same and a 10% deposit is required.

If using 'cash', you pay $50,000 upfront and the remaining $450,000 at settlement. If you fail to settle on the Contract of Sale, the vendor has the right to withhold your $50,000 'cash'.

If using a 'bank guarantee' or a 'Deposit Bond', you pay 'zero cash' upfront and pay $500,000 at settlement. At settlement, the 'bank guarantee' and the 'Deposit Bond' are no longer required and become 'null & void'.

If you fail to settle, with a 'bank guarantee', the vendor presents the 'bank guarantee' to the bank that issued the 'bank guarantee' and is paid the amount of the 'bank guarantee', in this case $50,000.

With a 'Deposit Bond', the vendor presents the 'Deposit Bond' to the insurance company that issued the 'Deposit Bond'; they are paid the $50,000 amount of the 'Deposit Bond'; and then the insurance company comes after you to recover the $50,000.

As you can see from the above, irrespective of using cash, bank guarantee or Deposit Bond, if you fail to settle on a Contract of Sale, you'll be out of pocket by $50,000.

We'll further comment below on the upsides and downsides of each, however, your options are to use 'cash', 'bank guarantee' or a 'Deposit Bond'.

Who can use Deposit Bonds?

Individuals, including First Home Buyers*, Super Funds, Trusts, Partnerships, Companies, Builders and Developers buying established or 'off the plan' Residential or Commercial Real Estate, including or Vacant Land. *(*First Home Buyers will need a family member to act as Personal Guarantor for the amount of the deposit.)*

The term of the Contract of Sale can be as long as 60 months on all bond types (66 months in QLD for Residential).

Pricing?

The cost depends on the $ amount of the Deposit Bond and the number of months required.

Using $70,000 as the deposit amount, for a short-term Deposit Bond, $805; and for longer periods (say) 18 months, $3,006; 30 months, $5,546; and 60 months, $10,385.

The above amounts are paid in full upfront, with no further payments required.

Payment can be made by credit card or EFT. As Deposit Bonds can't be released without 'cleared funds', so if using a credit card, it can be same day release. If paying by EFT, it can take one or two business days for funds to clear into our bank account.

What's the application process & how long can it take?

For short-term settlements, where the funder is providing 'unconditional finance' (can be a pre-approval subject to valuation), there's a 2 page online or offline application with 3 support documents.

For longer-term settlements, there's a 7 page online or offline application with additional support documents similar to applying for a home loan.

So long as we receive the fully completed and correct documents, Deposit Bonds can be issued within an hour or so for short-term bonds and several hours for long-term bonds. If lodged late in the day, next business morning and if super urgent, overnight or on weekends for an additional issue fee.

What are the upsides and downsides for each of the deposit options?

Once you've considered the following, we're sure you'll see why Deposit Bonds are a very popular option, a strong favourite in terms of ease to obtain, turnaround time and the risk management of longer term settlements.

◆ Cash

If you have idle cash available, the upside is it can be a quick process to access and secure the Contract of Sale.

The downside is that you may need to break a fixed-term investment to generate the required cash, which is more painful during periods where interest rates are higher. In addition, you are using 'working capital' that may give you a better return if utilised elsewhere, especially during periods of low interest rates.

For the majority of buyers, they simply don't have idle cash available and perceive they will miss out on opportunities to upgrade their existing property or buy a longer-term investment opportunity.

A number of considerations and cautions if using 'cash'.

1. Make sure you don't allow the vendor to use your cash deposit as their cash deposit on a new purchase. This typically relates to sell/buy situations. If the contract becomes null & void for some reason (something discovered after contracts have been exchanged), you want the cash deposit sitting in their solicitors trust account, so you can get your cash back quickly.
2. Some real estate agents will deliberately steer you towards a 'cash deposit', although this may not suit you, because they want to get their commission paid early.
3. If buying 'off the plan', you need to consider what might happen to your 'cash deposit' if the developer goes into administration during construction. The receivers will freeze all funds whilst they unravel the operations and your cash will be locked away for an indefinite period. You'll also want to be extremely confident that your 'cash deposit' has been held safely in a third party trust account and not used by the developer. We recently saw promotion (April 2015)

about a property seminar being held in Melbourne, where the presenter was going to show how developers can use 'cash deposit' to fund project legal fees. Over the years, we've also seen solicitors holding cash in their 'trust account' use the cash illegally to fund their lifestyle or vanish overseas. Experienced investors prefer to use bank guarantees or Deposit Bonds to remove this risk.

4. In addition, with 'off the plan' purchases, you'll need to ensure you have sufficient cash in reserve to pay for Property Stamp Duty. The timing varies in each State/Territory, however, it is payable well before the actual settlement date.
5. First home buyers need to demonstrate to funders an extended savings pattern, so retaining cash and building up the required equity may be a more prudent priority.

◆ Bank guarantees

Bank guarantees are issued on a 'secured' basis.

This isn't a favoured option these days by banks and buyers for short-term settlements due to the extra paperwork to extend your existing home loan or take out a personal loan if you don't have the ready cash; takes extra time; and incurs costs. For long-term settlements, there are ongoing costs & fees.

In addition, this can be a stressful period as there are normally tight 'cooling off' periods with Contracts of Sale, so your finance provider may struggle to sort the paperwork and provide the finance in time.

Deposit Bonds are the most favoured option for short-term settlements.

For longer-term settlements, even if you have the necessary cash, but want to avoid the pitfalls listed above, the bank will require that you place the cash in a 'term deposit' and they will secure this 'term deposit' to issue the bank guarantee. You will earn interest on the 'term deposit', which is subject to tax. You will incur set-up and ongoing fees, typically charged upfront on a quarterly or half yearly basis. Sadly, the banks won't offset the interest earned on the 'term deposit' and the costs of the bank guarantee.

Otherwise, the bank will require you to offer your existing occupied property to secure the amount of the bank guarantee.

One upside, versus Deposit Bonds, is that the bank guarantee can be rolled over to align with the settlement date of the property, which is most often in advance of the Sunset, Registration or Scheme Date, defined in the Contract of Sale. *(This date is set some 6+ months after the anticipated project completion date to allow a buffer in the event of bad weather, site access, damage occurring during construction, a shortage of materials, etc. To protect buyers, Deposit Bonds are always issued to this date.)*

However, as an offset, it's recognised that most projects go beyond the anticipated completion date, but mostly complete before the Sunset, Registration or Scheme Date by approximately 6 months. Aussie Bonds pricing has been adjusted to allow for this average early completion.

The downsides include:

1. Increases your debt leverage, which limits your ability to further refinance should you need, i.e., getting extra funds to renovate your existing property to ready for sale.
2. Ties up your leveraging, possibly for long periods, especially if buying 'off the plan'.

◆ Deposit Bonds

As you've probably picked up from above, Deposit Bonds are like an insurance policy where you pay a once-only upfront fee that buys you a Deposit Bond; which is held by the vendor as your substitute deposit (let's say using our example above of $50,000); and they will claim if you fail to settle.

There are several significant upsides to using Deposit Bonds:

1. You don't need cash; or if you have cash, you don't need to disturb if it's on term

deposit; or look to sell other assets, such as shares, to secure a new property purchase.
2. By preserving your cash and retaining the level of net equity in your existing property, it's likely you can have more than one 'off the plan' purchases happening at the same time. Those buyers with idle cash typically only have sufficient cash for one 'off the plan' purchase.
3. If the purchase is an investment, we've observed that the cost of the Deposit Bond can be claimed in the first year of ownership (i.e., year 1 of rental income) or added to the capital base of the purchase for future Capital Gains Tax calculations.
4. Easy, flexible and fast approval – approval & issue within a matter of a few hours.
5. Issued on an 'unsecured' basis, in difference to 'bank guarantees' that are secured by a 'term deposit' or increasing your registered mortgage.
6. As Deposit Bonds can be issued in advance, you have increased confidence in attending one or more auctions or negotiating a treaty sale, as you know you already have the deposit ready.

There are some downsides, mainly driven by others:

1. Despite Deposit Bonds being around since 1989 and issued as white label products by Australia's leading banks, some vendors or their advising solicitors are steeped in tradition and insist on cash or bank guarantees. We find it amazing that a small suburban developer or solicitor will adopt this stance when the large developers and legal firms, repeatedly use Deposit Bonds. Our advice is to find another vendor or solicitor who is up with the times.
2. Vendors who want an early release of the deposit so as to be able to pay a cash deposit on another purchase may be reluctant to accept a Deposit Bond. Unless the Contract has gone 'unconditional', this is rather dangerous, so seek careful legal advice. Indeed, not allowing early release, is the smarter option.
3. Estate agents are paid their commission from the deposit. Some have been known to refuse to receive an offer using a Deposit Bond as that means their commission payment will be delayed.
4. A purchaser using a Deposit Bond can be trapped if the Contract of Sale does not specifically state that the deposit can be paid by way of a Deposit Bond, so best to check first.
5. With large developments, the project funders may limit the % of deposit types, i.e., 25% bank guarantees; 25% deposit bonds; and 50% cash. Our advice is to get in early, if planning to use a Deposit Bond, before the 25% cap is reached.

Sunset, Registration, Scheme or Latest Dates in 'off the plan' Contracts of Sale explained

Depending on the type of purchase (building or land) and in which State/Territory, you'll find one of these or similar dates, typically in the 'Definitions' section, however, a few comments.

1. The 'specified date' is essentially the date at which either party can walk away from the Contract, unless there's mutual agreement to extend to a revised date.
2. The 'specified date' is a date beyond the 'anticipated completion date', which provides the vendor a buffer in the event of bad weather, difficulties in sourcing supplies, damage happening to the project during construction, etc.
3. This 'buffer' has been increased from the norm of 6 to 9 months a few years ago to 12 to 24 months now. This 'buffer' is influenced by supply & demand factors. At present, demand is high, so vendors are dictating, however, as supply increases, purchasers can dictate and we'll again see these higher 'buffer' periods will reduce.
4. In recognition that most projects complete sometime between the 'anticipated completion date' and the 'specified date', this has been taken into account in our bond pricing.
5. The Contract may have an additional clause hidden in the Contract stating that, if using a bank Guarantee or Deposit Bond as the deposit, the Sunset Date needs to

be extended by a further 3 months or so.

6. Sometimes the vendor will indicate a preparedness to accept a Deposit Bond for less than the 'specified date', however, to protect the purchaser, we can only issue to the 'specified date'. If the vendor agrees to accept a Deposit Bond for a lesser period either the 'specified date' must be amended in the Contract or the vendor or their legal representative sends a letter or email that refers to the 'specified date' in the Contract and amends to 'revised specified date'.
7. If buying late into an 'off the plan' project, the Contract may stipulate a 'specified date' that is well beyond the 'soon to complete date'. Again, the vendor will have to agree to amend as in 4. above.

A final comment about Deposit Bonds from experienced investors

Because of the various factors I have outlined above, many repeat investors want to limit their risk exposure and maximise the return on their assets and investments.

Even if they have the ready cash, they prefer to be in a position where, if the developer goes into receivership during construction, all they have lost is the Deposit Bond fee, versus their cash being locked away for prolonged periods whilst the project is sorted.

Given the large deposit amounts required these days, using 'cash' has to be cautiously considered.

These same repeat investors will also walk away from a particular new 'off the plan' development, if the vendors won't accept a Deposit Bond. It's not as if there are limited investment opportunities.

For more information, contact us.

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