

LOAN CLAUSE

LEAVES PROPERTY SELLERS
IN VULNERABLE POSITION

Lisney





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In 2009, the Law Society advised its member solicitors that when acting for purchasers using mortgage finance to buy a property, a special condition should be included in the contract for sale. This condition provides that the completion of the contract is subject to the purchaser's loan approval being in place at the date of completion, at a sum sufficient to complete the purchase. In essence, it means that if the full mortgage amount is not available from the bank on the day that the sale is to close, the buyer can pull-out of the transaction.

The loan clause is recommended to protect buyers from losing their deposit if the bank were to withdraw their loan offer for reasons outside of the client's control and to protect against the client potentially facing legal proceedings by the seller in the absence of a loan clause. This special condition was designed at a time in the market where prices were falling and was prudent at that time. However, almost 12 years on, it is causing difficulty, leaving the other party to the transaction, the seller, in a vulnerable position. Even if the contract is signed and exchanged, it can be deemed null and void if the mortgage provider decides to rescind the loan offer.

Prior to the introduction of the loan clause, sellers could rest easy in the knowledge that once a contract was signed, they could make arrangements to proceed with their own moving plans. However, because of this clause, until the sale has completed, the contract can be overturned at any time. This poses major logistical difficulties for sellers. Those buying another home on foot of selling their existing home can be precluded from signing a contract to purchase until their existing home is completed and vacated because they do not want a situation where the loan clause is invoked on the sale of their own home, leaving them open to the risk of action being taken for breach of contract or specific performance on their purchase.

As a result, sellers often must arrange a short-term rental to mitigate against this. It adds in another step and pinch point in the process. It is not uncommon for sellers to book into hotels for a few weeks in between homes as sourcing a short-term rental can be difficult and expensive.

Loan clauses have become even more problematic since the arrival of the pandemic. Many borrowers have been impacted by it since last March, where banks refused to advance funds as borrowers found themselves on Covid-19 supports eg, the Pandemic Unemployment Payment or the Wage Subsidy Scheme. The loss of a job immediately prior to drawdown would be another reason for invoking the loan clause.

Additionally, this clause can be invoked where issues are discovered during a medical examination for life insurance cover. Life cover is one of the final items to be put in place prior to drawdown. If it cannot be put in place due to health concerns, loan funds will not be released by the bank. Once again, we are experiencing cases such as these more frequently since Covid-19 darkened all of our doors. It seems that anything respiratory related has become a red flag for life insurance in the Covid world. For example, a minor and entirely benign chest infection in an otherwise healthy young borrower in the months prior to drawdown can preclude a bank from releasing the funds. These types of scenarios cause major headaches for sellers as houses are usually cleared out fully for completion and sellers' forward plans are subsequently kiboshed.

Another recent victim to a loan clause involved a client who was downsizing. They proceeded to dispose of all of their furniture, in anticipation that the sale would conclude because the contract was signed, however, the special condition clause was summoned at the last moment and our client found themselves living in a house with nothing other than garden furniture and a mattress until the property was sold to another party several months later.

One might believe that once Covid-19 is firmly in the rear-view mirror that this will no longer be an issue, but the continued existence of the loan clause in transactions means none of the parties can enjoy certainty until the sale completes. The pandemic aside, and as is prudent, banks usually run a last-minute credit check on borrowers prior to drawdown to check that they, for example, have not splashed out on an expensive new car on hire purchase, or splurged on a world tour. This would be another reason for banks to refuse to advance funds and for the seller to be left high and dry at the last minute.

Unfortunately, health issues and job losses are a fact of life that occur with or without Covid-19. One solution that would be fairer to all consumers would be to make the loan offer unconditional. The bank could insist on life cover being activated prior to loan offer issuing to protect against that concern. The banks take a long-term risk on a borrower as part of the underwriting decision in any event. Borrowers could lose a job or find themselves on a Covid-19 or equivalent support at any stage during the loan. The fact that it happens between loan offer and draw down should be irrelevant as it could happen the day after drawing down. Their underwriters have factored all of this into their decision to lend already.

The length of time the grant of probate takes can also be an issue. When there is a loan clause in place and a contract is exchanged but the completion is subject to the grant of probate, it is possible that the buyer's loan offer may expire as many lenders have revised their loan offer periods from 12 months to six months.

If loan offers were unconditional borrowers would be able to rely on them fully and loan clauses would not be required for transactions to complete. Both buyer and seller could rely fully on the contract at the point of signing as opposed to sellers having to vacate properties, find temporary accommodation and still wait for transactions to complete before being able to move on. It appears that we are simply making an already fraught system unnecessarily more convoluted & stressful for all concerned.



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