

Selling property to free up capital

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When you sell a property with a mortgage, you can usually keep whatever money is left after repaying the bank loan (unless, of course, you transfer the loan to another property you've bought). Things are less straightforward, however, if the mortgage acts as security over more than one loan. In that situation, banks won't automatically let you keep the entire balance. That's a source of complaints, as this guide explains.

Existing and future lending

Most mortgages are what's called an "all obligations" mortgage. This means the mortgage secures all money the property owner may owe the bank, both now and in the future. The result is that it enables the bank to require you to divert the balance on the property you've sold towards reducing the amount owed on other loans.

For example, you have two properties. Property A has borrowings of \$300,000 and Property B has borrowings of \$600,000. Property A sells for \$400,000. You want to repay the \$300,000 and keep the \$100,000. The bank, however, makes you put the \$100,000 sale proceeds towards reducing your borrowings on Property B from \$600,000 to \$500,000. Why? Because the bank must be satisfied the remaining property (property B) provides sufficient security for its remaining loan. In this example, property B might have had a market value of \$700,000, which the bank did not consider high enough in view of the \$600,000 it was owed – this would make the loan-to-value ratio 87.7 per cent. Hence the need to reduce debt with the proceeds from the sale of property A.

Other reasons

A bank may have various reasons for directing that some or all of the proceeds from the sale of one property go towards the loan on another. One, as mentioned, is that the loan-to-value ratio may not be satisfactory on the second loan. Others might be that:

- The bank's lending criteria may have changed since it approved your loans (the loan-to-value ratio requirements being a typical example).
- Your financial situation may have changed, affecting your ability to make loan repayments.
- Property values may have fallen.

How to contact us

What you should do before selling

Talk to your bank first. That way, you'll be fully informed about how much of your borrowing it wants to be repaid. Bear in mind you may have to pay an early repayment cost if the bank makes you reduce your remaining loan and you have to break a fixed-rate loan to do so. See also our guides:

[Early repayment charges on fixed-rate loans](#)

[Concerns about lending decisions](#)

[Residential loan-to-value lending restrictions](#)

Case 1: Sale affected loan-to-value ratio

Mr C borrowed money from the bank to buy two rental properties. His two loans were secured by all obligations mortgages over both properties. The properties were together worth \$560,000 and he owed the bank \$450,000 – a combined loan-to-value ratio of 80 per cent.

Mr C was later made redundant and had trouble making repayments. Without consulting the bank, he sold one property to repay one of the loans in order to free up capital. The loan was for \$150,000. Having sold the property for \$260,000, he expected to keep the balance of \$110,000.

However, the bank sent Mr C's lawyer a settlement statement instructing him to repay \$210,000, leaving him with only \$50,000.

Mr C complained to us that he was in financial difficulty and had sold the property believing he would get \$110,000 to repay other debts and cover living expenses. He said he would not have sold the property to get only \$50,000 of the proceeds.

The bank required \$210,000 to reduce his total lending because it was losing some of its security through the property sale and it was not satisfied the remaining property was sufficient security for the other loan.

To ensure a continuing loan-to-value ratio of 80 per cent over the \$300,000 property, it needed to reduce lending to \$240,000.¹ We explained that the bank was entitled to do this because it had an all obligations mortgage over the property. We did not uphold Mr C's complaint.

Case 2: No obligation to notify lending policy change

Mr L had four properties, one a leasehold apartment. Several years after the bank changed its policy on lending against leasehold properties, Mr L sold one of his other three properties for \$900,000. Once the sale went unconditional, he told the bank he wanted to pay off the \$500,000 loan on the property and put the remaining \$400,000 towards a property overseas.

¹ The figure of 80 per cent is for example purposes only. Banks have different – although roughly similar – loan-to-value ratio requirements.

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The bank said the policy change lowering the amount it would lend against leasehold properties meant it would need \$700,000 of the sale proceeds in order to keep the loan-to-value ratio of all of his lending at 80 per cent.

Mr L said the bank should have notified him of the policy change, and this news had disrupted his plans to buy an overseas property because he had based his calculations on the bank's policy on leasehold properties when he bought the apartment eight years earlier.

We noted that the banks do adjust their lending criteria from time to time, and that they are able to revise their general policies with respect to risk associated with lending, including how much they are willing to lend against various types of security. Banks are not required to advise existing customers of these types of changes.

We also noted that it would be prudent for customers with more than one property and loan to speak to their bank about their plans before selling a property. This gives the bank the opportunity to discuss its current policies.

We found that the bank did not have to tell Mr L about the policy change. As Mr L did not speak to the bank about his plans before he sold one of his properties, it did not have the opportunity to tell him about the policy change. Mr L did not respond to our finding and we closed our file.

How to contact us

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