ACTING FOR PRIVATE LENDERS CAN BE HIGH RISK

Short-term, high-risk, urgent private lending is a recipe for disaster and even diligent solicitors can be at risk.

The enormous financial pressure many people and businesses are under in this pandemic is likely to lead to increased high-risk lending. Our claims history shows that acting for private lenders in short term, high interest urgent loans is fraught with risk.

The following claim scenario is a good example of the risks.

Urgent short-term loan done well

A practitioner received an email at 2.30pm from a broker asking for a meeting with a new lender client at 3pm the same day. The client wanted to execute loan documents and finalise an urgent loan.

The practitioner was instructed the loan was for $170,000 for 30 days at 25 per cent interest, supported by a caveat and an unregistered second mortgage over a residential unit in suburban Melbourne. The first mortgage secured a debt of $590,000.

Before the meeting the practitioner did title searches and confirmed the details the broker gave him. He also prepared the loan documents.

The lender's director (the client) and the borrower's husband attended the meeting at 3pm. The practitioner convinced them that the loan could not go ahead until the documents were signed by the borrower. The borrower's husband took the documents away to be signed.

The practitioner discussed with the client there was not enough time to do the necessary checks, the shortcomings of a caveat and that a registered mortgage would be better. The client was insistent the matter proceed and instructed that the mortgage be registered if the money was not paid in 30 days.

The client declined to accept the practitioner's advice to delay settlement until they obtained:

- an independent valuation of the property
- a letter from the bank to show how much was secured against the property as that could take a few weeks.

The practitioner gave the client a letter of advice at the meeting he had prepared beforehand and made a detailed file note. In both the advice was this was a risky loan.

The next day the client confirmed he had read and understood the letter. The signed loan documents were returned from the borrower, the money was paid and a caveat was lodged that day.

The loan was not repaid within the month. After many conversations between the practitioner, the broker, the client and the borrower's lawyers and several scheduled settlements to repay the money over the following six weeks, the loan remained unpaid.

After a further six week delay the first mortgagee was asked to make the title available for registration of the second mortgage. It took two and half months before the mortgagee finally made the title available.

The outcome

In the end the second mortgage was of no use as the first mortgagee held an all monies mortgaged over the property that was cross collateralised with another loan that meant there was not equity left in the property.

The client issued proceedings against the practitioner alleging he had received no advice about the risks of taking a second mortgage. The practitioner conceded he had not given that express advice – but said this was because the lender was an experienced accountant and property developer and he assumed the client understood what a second mortgage was. He had, however, warned the client to get advice about the amount secured by the first mortgage and that the client had rejected that advice. It was implicit in the practitioner's advice that a second mortgage was risky.

Allegations were also made about the practitioner's delay in registering the second mortgage. The delay occurred because it looked like the loan would be repaid. In hindsight, he should have sought to register the mortgage anyway although no loss flowed from this.

In the end the claim was resolved prior to trial for a nuisance sum to avoid the cost, angst and uncertainty of a hearing.

Lessons

The lender's claim was not a strong one and may well have failed had the matter proceeded to trial and judgment, but litigation carries inherent unpredictability as the practitioner found himself embroiled in a dispute that presented some risk.

There are some clients who will try to find a crack to pursue their claim if enough is at risk.

You should not take for granted that sophisticated business people understand the nuances of the law. Always tell them the consequences.

Where clients are blindsided by the quick gains or trying to do the right thing by someone and help them out, tell them forcefully more than once via more than one media – spoken, written, diagrams – to try to have them understand the risks and give them time to absorb it.

There are some clients and situations that you should just say no to.

TIPS

- Keep good records of your advice.
- Don't take for granted what sophisticated business people understand about legal issues.
- Forcefully advise clients in multiple ways about risks.
- Give clients time to absorb advice.
- Sometimes you should say no.

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