

Bridging finance pitfalls

By the Prosecution and Financial Forensic Investigation Team of the Attorneys Fidelity Fund

Law firms venture into bridging finance, especially for conveyancing matters.

What is bridging finance?

Bridging finance is essentially a short-term loan that is set up between an individual or business and a financial institution that specialises in these loans, which allows them to gain access to their money. Companies that specialise in bridging finance offer property sellers, buyers and bond 'switchers' access to a percentage of the value of the nett surplus proceeds of their transaction. Such lenders usually base their calculations on a percentage (typically 80%) of the nett future amount due to you. Actual fees may be negotiated if the size of the bridge loan is large. Bridging finance is widely used in property transactions to overcome the obstacles presented by time delays.

Bridge finance is defined by various dictionaries differently, but they all emphasise the limited timespan for which the loan is advanced.

This kind of financing has the following characteristics –

- it is available in short notice;
- it is simple to apply for; and
- it is a high-risk loan (unsecured) with relatively high interest rates.

Looking at the characteristics displayed in the foregoing, these are convenience loans. Any convenience service attracts a premium charge, purely for its convenience.

Why do attorneys use bridging finance in conveyancing matters?

Given the delays resulting from the property transfer process, many participants in property transactions require access to funds, which would otherwise only become available on the day that the transaction is registered in the relevant Deeds Office.

Bridging finance companies provide finance that creates a bridge between the participant's immediate cash flow requirement and the eventual entitlement to funds on registration in the Deeds Office. Bridging finance is typically not provided by commercial banks.

Various forms of bridging finance are available, depending on the participant in the property transactions that requires finance. Sellers of fixed property can bridge sales proceeds, estate agents bridge estate agents' commission, and mortgagors bridge the proceeds of further or switch bonds. Bridging finance is also available to settle outstanding property taxes or municipal accounts or to pay transfer duties.

What can go wrong?

When a bridge loan is taken out by an attorney's client who is involved in a conveyancing matter, the attorney is usually required to provide an undertaking or guarantee to the financier. This undertaking or guarantee is usually reduced to writing and forms a legally binding document between the attorney and the financing company.

The *Concise English Oxford Dictionary* defines an undertaking as 'a formal pledge or promise to do something'.

The *Business Dictionary of Law* defines it as 'a promise, especially in legal proceedings, that creates an obligation'.

A law definition of guarantee in the Oxford Dictionary is 'an undertaking to answer for the payment or performance of another person's debt or obligation in the event of a default by the person primarily responsible for it'.

Both the undertaking and guarantee place a burden on the attorney issuing it to become liable for the capital and any related charges.

One of the major concerns for attorneys is understanding what they are getting themselves and their firm into. Instances of attorneys misinterpreting the agreements that they enter into with the financiers have been noted. Such attorneys tend to bind firms in onerous agreements.

Examples of such instances are when an attorney fails to realise that the agreement does not make provision for in case the transaction does not succeed for whatever reason. In such instances, while there are no proceeds from the anticipated sale, as it did not pull through, the attorney is still expected to do good to the agreement by paying back the capital amount advanced by the financier and all related costs. This is as a result of the attorney signing a standard undertaking without necessarily scrutinising it in detail. The standard undertakings may include representations by the attorney to the effect that the transaction will not fail or has been concluded with all necessary requirements being met, and when it does fail, that representation holds them liable.

When financiers advance credit to the borrowers in conveyancing matters, they consider the nett proceeds to be received by the seller and usually can advance up to 80% of those nett proceeds. An illustration of how the amount that can be advanced is determined is as follows:

Selling price R 1 300 000

Balance owing in existing bond R 1 062 354,26

Nett proceeds R 237 645,74

Maximum amount that can be advanced is therefore R 190 116,59 (80% x R 237 645,74).

Should the maximum amount be advanced, the liability towards the financier is, therefore, that amount, the finance charges on the amount and any other charges stipulated in the agreement. As soon as the financier advances the finance and pays it into the attorney's trust account for the benefit of the attorney's client, specifically indicating the purpose for which the money has been advanced, and that being provision of services by the attorney in the conduct of his or her duties, the money is entrusted with the attorney.

Readers are referred to the following orders dealing with bridging finance matters:

- Attorney Fidelity Fund Board of Control v Claassens (WCC) (unreported case no A620/2011, 4-12-2012) (Allie J); and
- Honey & Partners Inc and Others v Quince Property Finance (Pty) Ltd (SCA) (unreported case no 345/11, 29-11-2011) (Ponnan JA).

How can the risk be managed?

While no measure can completely eliminate risk, there are benefits to be derived from putting sound measures in place. The following are possible measures:

- The consent of the practitioner’s client to obtain finance should always be obtained and filed.
- Conveyancers and/or staff dealing with conveyancing matters should be adequately supervised.
- Ensure that your client’s tax affairs are in order before signing an undertaking.
- Practitioners, especially directors in law firms, should always know what undertakings or guarantees have been issued. An internal arrangement at the law firm should exist and always be adhered to, and can bind the law firm in any kind of agreement or arrangement.
- Undertakings and/or guarantees issued must be properly read and interpreted with care to guard against the risk of not being able to get out of them should circumstances dictate or should it become extremely difficult and/or expensive to exit the agreement.
- The finance should be closely monitored throughout its life to ensure no new charges not agreed to are accumulating and that there will be sufficient funds on registration to cover the balance due. Statements should be received from the financier in this regard and scrutinised.
- On receipt of proceeds from the sale, ensure that all obligations are properly discharged in terms of the agreement.
- As far as possible, background checks should be conducted on the possible financiers. There is an association for bridging financiers known as the Bridging Finance Association of South Africa (BFASA) (www.bfasa.org.za), although not a statutory body, which bridging financiers can become members of. This association has a Code of Good Conduct for BFASA members effective from 1 February 2010, which members are expected to uphold. The code governs the relationship between the BFASA members and its clients; other members as well as the association. Each bridging finance company (BFC) by accepting the code is committed to the promotion of good practices and the formalisation of the bridging industry. The code is as follows:

Code	Interpretation
Conduct	Each member shall conduct themselves and their business to avoid doubt being cast on their professional integrity. A member shall ensure that they provide a financial service that is proper, efficient and in the interest of good business practices.
Rules for practice	Only members with a valid Certificate of Good Standing are permitted to display the BFASA logo and their membership to BFASA on their website or corporate publications/stationary.
Ethical practice	Members shall at all times act honestly, ethical and fairly in their dealings with members of the public. They will refrain from activities that can bring BFASA or the bridging industry into disrepute.
Regulatory compliance	All members will abide by all applicable laws and regulations.
Accountability	To enhance consumer confidence in the bridging industry, members making their services available agree to make their systems, practices and records available for inspection and review by any industry relevant legitimate authority.

Consumer privacy and data protection	Members will design and operate their services to afford consumers privacy and confidentiality. Each member will institute controls to detect and eliminate fraud and to protect data from breaches. A member must treat all facts and information concerning their client obtained as confidential and must not make any unauthorised use of such facts or information. Information exchanged between members and/or BFASA must be treated as confidential by all members.
Entity listings	BFASA's entity listings (available at www.bfasa.org.za) are intended to combat fraud. The listings should be considered as confidential and only for internal use by the members. Each member must independently decide on the applicability of the listing to their business. BFASA does not accept any responsibility or liability for inaccurate information displayed on the website or the listings thereon. As cited in 'responsibilities of members under this code' below, each member hereby accepts their duty to actively contribute to this entity listings on a continuous basis. An entity or individual must be listed on the BFASA website at such an early stage where the BFC suspects or is aware of any fraud, negligence, high risk or bad payment behaviour.
Truth in advertising	Members shall be truthful in promotions and publish only accurate information about their operations
Consumer interest	The interests of the consumer are always foremost for members. Such conduct is to assure sustainable development of the bridging industry and in order to procure desirable and acceptable business practices.
Complaints from the public	Even though BFASA is not a regulatory body, its objective is to enhance, improve and develop the bridging finance industry. If the association receives complaints from the public, the board of directors will have the right to further investigate the complaint in their sole discretion and to assist the complainant in referring the matter to the appropriate authority.
Professionalism	Members commit themselves to the goal of continuously improving themselves, their business and their employees in the chosen profession.
Responsibilities of members under this code	Each member has the explicit responsibility to: 1 Be actively involved in and contribute to the activities of BFASA.

	<p>2 Attend a minimum of 75% of BFASA meetings per annum.</p> <p>3 To actively list entities and/or individuals on the internal BFASA entity listing</p> <p>4 Ensure that they do not have any outstanding fees due to the association or their associates.</p> <p>5 Ensure that their employees are familiar with the contents of this code and adheres thereto. Responsibilities pertaining to business conduct:</p> <p>6 A member must make available his fees before concluding an agreement with a consumer including:</p> <p>6.1.1 The way in which the fees are calculated;</p> <p>6.1.2. Cancellation or default charges;</p> <p>6.1.3. Adverse information he has obtained about the consumer.</p> <p>7 The BFC will provide the client with a copy of the agreement.</p> <p>8 The BFC will provide the client with a statement of account.</p> <p>9 The BFC will keep records of all their financing activities.</p> <p>10 The BFC will at all times strive to enhance the wellbeing of their clients.</p>
Certificate of Good Standing	BFASA will issue each member annually with a Certificate of Good Standing provided that the member is in compliance with this Code of Conduct. This certificate should be displayed at the Member's place of business. The certificate (and subsequently the BFC's membership) may be retracted by the Board of the Association in their sole discretion and with immediate effect.
Membership Fees	Membership fees payable will be determined annually at the first official members meeting for that year.

Law firms and practitioners should therefore take extreme care when dealing in bridging finance as it can become a nightmare for them.