FINANCING REAL ESTATE PURCHASES IN ENFORCEMENT PROCEDURES

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Can a loan be used to buy a property at public auction?

There are many issues hindering development of the market in real estate that are being sold on public auction, including limited knowledge of how the enforcement procedure works, scant marketing, and the dominance of cash in real estate transactions.

According to the Serbian National Land Survey Agency, in the first half of 2021, most buyers (as many as 85 percent) paid cash for real estate. Nonetheless, with residential construction booming, loans were used to fund purchases of 34 percent of all units in multi-family buildings, indicating that many buyers still need loan finance.

Banks have also been endeavouring to promote housing loans by relaxing requirements, supported by borrowing incentives introduced by the National Bank of Serbia that include extending repayment periods by an additional five years, reducing the minimum mandatory deposit threshold, and cutting the minimum completion rate for homes eligible for housing loans (which also helps foster residential development).

Why, then, is repossessed real estate, which is often sold at more affordable prices, ineligible for loan financing?

First and foremost, because the rules of repossessed property auctions do not fit in well with the housing loan approval process. When a prospective buyer first contacts their bank, the buyer, seller, and price are all known, as is the property's registration status with the cadastre and the absence of any registered burdens on the title. The process begins when the parties enter into a pre-contract document and a loan is approved for the purchase of the particular property in question. The approval comes before the contract is entered into and the loan is disbursed after the contract is signed, but not before a mortgage is applied for that serves as collateral for the loan.

By contrast, when an auction begins, there is no guarantee that the prospective buyer will actually end up owning the property. The first step is depositing the bidding fee, followed by the actual bidding (which has been anonymous since online auctions were introduced in September 2020). The final purchase price at the end of the auction is also not known, but it is clear there are real burdens associated with the property that are registered in the cadastre – if nothing else, the record of enforcement proceedings in which the property is being sold will be registered. Often, there will also be a mortgage and records of other legal disputes.

The loan approval process means banks play an active part in real estate transactions. When instructed to do so by a bank, both the buyer and the seller have to take a number of actions that effectively have nothing to do with property sales other than those financed by loans. Banks are here able to vet sale and purchase contracts they are not signatories to, insist these agreements clearly stipulate that the price is financed by a loan, and require that various features of the loan are clearly spelled out. If a mortgage is to be instituted on a home, the buyer must produce and notarise a lien statement, because, at the time of notarisation (which comes before the loan is disbursed), the purchaser will still be registered with the cadastre as the owner. The contractual purchase price is irrelevant for the bank's understanding of the value of the home subject to the transaction and, potentially, posted as collateral for the loan. The value is actually determined by a professional valuer from the bank's approved roster of court-registered expert witness valuers. This is one example of how banks broaden the range of activities needed to be taken before a property can be bought and apply their own rules to these procedures.

As envisaged by the Enforcement and Security Law, auctions are organised and administered by public enforcement officers (PEOs). The enforcement creditor and enforcement debtor play active parts in the process, as do as any other persons whose status is recognised by the law, with their rights and obligations clearly laid out. Before the actual auction, the prospective buyer of a property has no impact on the enforcement procedure and their role is marginal. Moreover, the buyer is not the only person seeking to purchase the property: any interested party is able to bid in an auction provided they have paid the bidding fee, which is the same for all bidders. The sale and purchase agreement, which the buyer uses in a regular transaction to formally acquire title to the property, is here replaced by the conclusion on the award of the property, issued by the PEO in a format and with the contents prescribed by law. As such, the buyer's bank is unable to impose its authority or intervene to apply its loan approval rules in the enforcement procedure the auction is part of.

Placed in this position, the bank faces the formidable challenge of identifying, processing, and appropriately assessing the risks involved in a loan of this type, which is likely to be the largest amount borrowed by an individual in their lifetime. Risk assessment is far from easy even in the usual real estate transactions, but it becomes quite a substantial task for property purchased on public auction, where the price is unknown, there are burdens (which will be deleted once the auction is successfully completed, but not at the time the bank appraises the risk, and certainly not before the loan is disbursed), and the sale is by no means certain to actually occur regardless of how the buyer proceeds.

Many aspects of this challenge can be addressed, however. The bidding fee may also serve as part of the loan deposit, and as such may be a greater guarantee of the buyer's serious intent since it is paid before the loan is approved. The conclusion on the award of the property, which names the buyer and sets out the purchase price, may stand in for the pre-contract document, and, once it is issued, the bank will have a much clearer picture of the situation. The 15-day time limit for paying the purchase price may seem an excessively optimistic period in which to complete loan processing and disbursement, but is not necessarily unattainable.

That being said, what makes the process unfeasible is that a mortgage cannot be instituted as collateral on the property being purchased, which immediately disqualifies many first-time buyers and anyone else who does not already own a property with a value similar to the one they intend to buy. Although all burdens on the property are deleted following the sale at auction and after the conclusion on the sale is issued, this conclusion, the instruction to delete the burdens, and the application to institute a mortgage as collateral for the loan will be the last in line for processing by the cadastre, since applications there are dealt with in the order in which they are filed.

As such, if a loan is taken out to finance a purchase at auction, it may take a long time to ensure the cadastral record is brought into line with what it looks like when the loan is based on a standard sale and purchase contract (where only the mortgage is registered, or the application to institute the mortgage is first in line for processing, and an application has been made to transfer title to the buyer). The likely length of this procedure poses an alarmingly high risk, and one the bank is simply unable to manage.

Using a loan to finance a property purchase at auction, however, is not prohibited and can be done. The seemingly insurmountable difficulty posed by the inability to institute a mortgage on the property up for sale can be circumvented by mortgaging another property, and the 15-day deadline for paying the purchase price can be met. But, given all the hazards involved in approving a loan of this type, which bank would find any benefit in exposing itself to such risk?

In most cases, this option is used by the bank that initially repossessed the property. Here the bank is also the enforcement creditor, is able to utilise the property valuation it has commissioned from an authorised valuer, and may also take part in the auction itself. Apart from the bank being able to take control of the process and minimise its exposure to risk, its position as enforcement creditor may also allow it to influence or even dictate the purchase price. Ultimately, it is in the bank's interest to replace distressed assets – past-due accounts receivable undergoing enforced collection – with healthy receivables, secured by potentially safer mortgages, without having to spend any more money to do so.

A great deal of commitment and amendments to various pieces of legislation are required to induce banks other than those involved in enforcement to approve more auction finance. Banking regulations ought to permit conditional loans, which would be capped at the maximum amount a prospective buyer was prepared to bid. The Enforcement and Security Law should include additional rules for these situations and permit PEOs to issue a formal instrument, before an auction takes place, that the bank could rely on when considering whether to approve a conditional loan. If the cadastre is unable to act effectively within statutory time limits, as seems to be the case, its regulations could allow it to issue an assured opinion about whether a mortgage can be registered (primarily to clarify whether pre-existing applications could preclude a mortgage from being instituted).

Without these changes there is little likelihood of auction finance growing appreciably. Until then, the best answer to the question of whether a loan can be used to buy a property at auction is – there is nothing formally preventing it.

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