

Understanding deposit bonds in real estate transactions

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During the sale or purchase of real estate in NSW, the payment of a deposit at the time of exchange is a necessary condition. As a prospective buyer or vendor in NSW, you may come across the term "deposit bond." This blog aims to demystify the concept, shedding light on what it entails, and providing valuable insights for clients considering its use in real estate transactions.

What is a deposit bond?

A deposit bond is an alternative to the traditional cash deposit paid when entering into a real estate contract. Instead of providing a lump sum in cash, a buyer obtains a deposit bond from a financial institution or an insurance company.

The deposit bond serves as a guarantee to the vendor that if the purchaser defaults under the contract, then the vendor can call upon the deposit bond. The sum guaranteed is typically the equivalent deposit amount, so 10% of the purchase price.

If the vendor claims upon the deposit bond, the financial institution or insurance company that provided the bond will typically pay the guaranteed amount to the vendor and will then pursue the purchaser for repayment of the guaranteed sum.

How do property transaction deposits work generally?

For the sale or purchase of property, the typical deposit that needs to be paid is 10% of the purchase price, so it is a significant sum of money. The deposit is usually cash paid to the vendor’s agent or solicitor’s trust account.

If a purchaser does not have access to 10% of the purchase price in cash (including if they need to sell their existing property to purchase a replacement property), then alternative options may need to be considered. Often this may be requesting that a 5% deposit be paid instead of the usual 10% deposit, seeking the release of the deposit received on their sale of another property, or that a deposit bond be provided in lieu of a cash deposit.

Further reading

- "What if I accept less than 10% deposit when selling my property?"
- "Buying or selling property in NSW – when to involve your lawyer"

Benefits of deposit bonds when buying or selling property

Financial flexibility

Deposit bonds enable purchasers to preserve their cash for other investment opportunities or to cover additional costs associated with property purchases. The cost of obtaining a deposit bond is much less than the value of a deposit.

Simultaneous transactions

For purchasers who do not have access to a cash deposit (e.g. if it is tied up in the sale of another property or other assets), then it can be an option for a purchaser to be able to enter a contract to purchase a replacement property before the settlement of their existing property.

Potential risks with deposit bonds

If a purchaser defaults under the contract in a manner that enables the vendor to terminate the contract and claim the deposit, it can be more complicated for the vendor if they are claiming a deposit bond as opposed to a cash deposit.

This can include the following:

1. If there are any errors in the deposit bond (including incorrect names, addresses or terms) or if the bond has expired, then the vendor may be prevented from claiming the deposit bond.
2. The vendor, when submitting their claim to the financial institution or insurance company, usually becomes a creditor of the financial institution or insurance company. If the financial institution or insurance company that issued the deposit bond is in liquidation or is unable to meet its liabilities, then the vendor may be one of many unsecured creditors. The deposit bond is only as good as the financial institution or insurance company that provides or underwrites it. So, when accepting a deposit bond, it is essential to ensure that the provider is reputable, well-established, and accepted by the vendor.

Before accepting a deposit bond, the vendor should undertake their own due diligence on the finance provider and ensure that the deposit bond provided by the buyer is valid and meets the requirements specified in the sale contract.

Cost and timing of deposit bonds

While a deposit bond may enable a purchaser, who does not have immediate access to a 10% deposit an alternative option to purchase a property, the bond does come at a cost. A purchaser should factor this cost into the decision of whether or not to obtain a bond.

The financial institution and insurer will also require that the purchaser pass financial checks before they will issue a deposit bond. Depending on the risk profile of the purchaser, it may take time before the financial institution and insurer approve the deposit bond for the purchaser.

Vendor must agree to accept the deposit bond

Some vendors have an aversion to deposit bonds and will not agree to accept one. Before obtaining a bond, it is best for a purchaser to confirm with the vendor that they will accept a deposit bond. If the vendor refuses, then the purchaser may need to consider other alternatives, or they may not be able to purchase that particular property from that vendor.

In summary

Deposit bonds have become a common alternative to a cash deposit in real estate transactions in NSW. Before using a deposit bond, both vendors and purchasers should consider how these deposit bonds differ from a typical cash deposit.

Always consult with legal and financial professionals for personalised advice tailored to your specific situation.

How can a property lawyer help?

At E&A Lawyers, our property team has extensive experience in matters concerning deposit bonds and can help you understand the potential consequences of accepting one.

Contacting E&A Lawyers

For more information or to arrange a consultation with a lawyer, you can call or email us.

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