

## **What are Bank Guarantees and how do they work?**

When thinking about purchasing a property off plan it worth understanding that Spanish law has several good provisions that protect you as the consumer. In this article I want to focus on the most important protection available: bank guarantees or insurance policies that protect your deposit (normally held in an escrow account) while your property is being built.

Developing is an economically risky activity and most developers borrow heavily to finance their operation. They then rely on the deposits from properties sold to finance the stages of construction until completion of a project. Consider a worst case scenario: a particular developer might have sold most of the units of one of their projects and none of another. They lack the proper finance on the second project and cannot stall the construction phase. Eventually, monies of purchasers destined to finance the first development are re-routed to the second development, since creditors for the second development are impatient. Sales drop, debts creep up and creditors begin to take legal action. Privileged creditors will queue up for salaries, and the bank or private lender who gave the loan forecloses on the mortgage for payment default, forcing the developer to close before either project is finished.

To prevent loss to the buyer in this scenario, the 57/1968 Act was drafted to guarantee advanced payments paid over to building developers. These guarantees may be in the form of bank guarantees or insurance policies, which the developers should have ready at the purchase contract phase.

It is your right as a purchaser to demand this cover, and your lawyer can make this request at the time of paying the reservation. It costs the developer around 1% of the purchase price of the property to initiate the policy or guarantee and that is a fee they must pay. There are two guarantees involved in your protection, first is the general guarantee on the building, and second is the specific guarantee for your property which ties in with the 'The Law Horizontal Property' (Law 49/1960 and amended by Law 8/1999) and is the most relevant to your protection. Get your lawyer to check that both are in place, that they are in accordance with each other and that you are not being charged.

A standard purchase contract should include the following clauses to incorporate the protection imposed by the guarantee or policy:

- The obligation of the developer to refund any of the payments paid in advance, plus 6% annual interest in case:
  1. the developer does not commence the works of the proposed property on schedule as per the contract signed with the consumer,
  2. the developer does not complete the construction of the proposed property on time,
  3. the license allowing occupation of the property is not granted.
- Reference to the type of guarantee and indication of the guarantor (bank or insurance company).
- Reference to the bank where advanced payments are to be paid in, and account number.

On signing of the contract (coincides with payment of funds), the developer will be obliged to hand over the relevant guarantee documentation: insurance policy or bank guarantee.

Should the developer default on the terms of the purchase contract the buyer has two choices:

1. Demand refund of the monies added with an annual 6% interest increase
2. Grant the developer an extension to fulfill their commitments as per the contract.

Documentary evidence of the occurrence of any of the events mentioned, together with the original guarantee enables the consumer to execute the policy. Failure by the developer to adhere to any of the terms of the guarantee and refuse to refund monies will be deemed as criminal misappropriation, by the Spanish Courts. It is your right to demand a guarantee from a developer. In today's buyers market and the maturing of the Costa del Sol property market, this important security measure should always be in place to protect your money.