

A Plan for all Reasons:

How to resolve property purchase disputes in Cyprus without litigation and restore the credibility of its public, property and financial sectors

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Date Created: 27th July 2012

A discussion document

Executive Summary

1. There are thousands of disgruntled overseas buyers of Cyprus Properties.
2. As a result, there are numerous civil litigations, banks and buyers are faced with huge losses, the credibility of Cyprus as a whole is suffering, and the bad reputation is affecting new sales.
3. Neither litigation nor inaction are desirable solutions.
4. The solution is to address system deficiencies, address the abuses, provide swift resolution to disputes, ensure that loans are serviced and that potential losses are wholly or partly covered by future increases in property values.
5. The solution requires Government intervention and co-ordination

Background

Reasons for disgruntlement

There are thousands of disgruntled overseas buyers of Cyprus Properties. Some of the reasons given are:

- i) That they have been preyed on in their own country but consumer protection in Cyprus is not up to the same standard e.g. a lawyer who is purportedly acting on behalf of a buyer but also has an association with the bank and the developer is not seen as a conflict of interests.
- ii) Property developers have been exaggerating expectations e.g. one quote is that they were told "you can easily let your property for 20 weeks a year" when the property is out in the sticks and the promised shuttle service has never been provided.
- iii) Property developers have not kept promises e.g. "it overlooks the golf course" but the golf course has still not been built two years later.
- iv) Development control seems to be out of control and the property market is now saturated e.g. Paphos district seems to have a development on every hilltop.
- v) Wrong financial advice given e.g. how is it possible for someone to advise a man from Bolton who has hardly travelled outside the UK and has no understanding of currency markets to borrow in Swiss Francs? To make it worse he was actually told that "the Euro is volatile" as the reason. Surely, if the Euro is volatile and the Swiss Franc is strong, he should be borrowing in Euro
- vi) Title Deeds are still often not available upon completion of the properties making re-finance difficult if not impossible thus borrowers are trapped into the original loan.

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- vii) Properties are handed over to buyers without the planning authorities certifying satisfactory completion and lawyers hand over completion monies without demanding this certification.
- viii) Building regulations appear to be either non-existent or unenforced e.g. buyers often find they have to undertake expensive remedial work due to subsidence.
- ix) There is a general feeling that defence lawyers and courts in Cyprus have a nepotistic culture and rarely find in favour of the buyer. In any event, litigating outside one's own country is a horrendous experience for anyone.
- x) Properties have been let out without the knowledge of the owners.

The result

- i) There are numerous civil litigations and at least when UK buyers are concerned there is a move for cases to be heard in the High Court in London as a sign of no confidence in Cyprus courts.
- ii) Banks and buyers are faced by huge losses. The negative equity in a lot of these properties is clearly a consequence of the recession but the problem has been accentuated by currency exchange losses, repayment free periods, compound interest, penalties and charges and repudiation by owners so that they are no longer servicing their loans and consequently debt recovery and litigation costs are incurred on top of all the other losses.
- iii) The credibility of the Government of Cyprus, Developers and Banks is suffering. In the last round of widely-publicised protests regarding title deeds, activists were demonstrating just about anywhere where they could get attention and questions were asked even in the European Parliament. The Government of Cyprus eventually did something about it but this is generally considered too little too late. This time round, the enforcement action by banks against overseas buyers for arrears has created another furor. Again the British press, the online blogs and chat pages are full of buyer disgruntlement and photos of protesters with banners outside the High Court in London. The Government of Cyprus remains disinterested claiming that these are civil matters that need to be resolved by the civil courts. This attitude is certain to make a bad situation worse.
- iv) Bad reputation now precedes Cyprus in potential markets. This is not surprising considering the foregoing. The writer of this proposal is representing both disgruntled buyers in England and is involved in talking to buyers in China and Taiwan to invest in Cyprus. The dichotomy between the two functions is enormous but even more striking is how much foreign investors already know about Cyprus and its reputation

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as a 'banania'. This is a far cry from the aspiration of Cyprus to become the Switzerland of the Middle East. The reputation of Switzerland has been built on trust since the Middle Ages. Cyprus has managed to lose all trust within a few years.

- v) The Cyprus property market is suffering from the general recession. Its chances of recovery are hampered by its bad reputation. Despite the recession, Cyprus has a lot to offer to potential investors. Low Corporation Tax, 0% on dividends paid to foreigners, a well educated workforce, a service economy geared to foreign investors, new oil and natural gas exploration and in particular the new Government measures to attract investors through Permanent Residency and Citizenship programmes including the temporary lifting of the Property Transfer Tax. Nevertheless, despite the attractions, buyers remain cautious and only a trickle is materialising into actual applications.

Undesirable Solutions

Whoever wins these cases in court, the damage Cyprus is suffering is immense. If banks or developers lose, good money will never be recovered and this will hurt the Cypriot economy. Potentially, the Government of Cyprus may have to refund millions in VAT refunds and stamp duties. If buyers lose, judgments will need to be enforced and Cypriot enterprises will have to push people in the UK as far as bankruptcy in an effort to recover the debts due. The media are already having a field day. This would be an amazing anticlimax to a holiday romance: "I was flown over to Cyprus, bought a holiday home and found myself bankrupt as a result". Are the authorities in Cyprus serious about allowing a reputation that has taken years and huge expenditure to build to be lost by allowing this flow of events?

The other alternative is for banks to take no action, accept the surrender of these properties and write-off the debts. Such a solution would increase the shortfall by further depressing property prices with such huge stock of unwanted properties coming back into the market. It will not only kill any prospects of selling new properties but will also turn the existing developments into ghost towns.

Cyprus cannot afford any of these alternatives. Property is a sizeable portion of the economy and its continuing recession is affecting recovery in other sectors. Recovery of the property sector, on the other hand, would encourage growth of the whole economy. Trying to stimulate new property sales, however, while burying the problems created by the old, is a recipe that will haunt the stimulus and make it ineffective.

The Proposal

The proposal is in two parts:

1. Implement long overdue measures that relate to the property market generally and need to be taken in any event; and
2. Proposals to resolve the mortgage defaults and negative equity

Implement measures relating to the property market generally

I will not elaborate on these as they have already been highlighted in this document and in reports previously submitted to the Government of Cyprus by pressure groups. The main points are:

1. That the building regulations, planning and development control mechanisms in place are not working and the Government needs to intervene to ensure that they are.
2. That system abuses are commonplace and even when breaches are reported, the regulatory bodies are apathetic so action must be taken by the Government to ensure that such abuses are eradicated.
3. That a 'Property Complaints Ombudsman' service is required to quickly resolve the backlog of complaints regarding Building Regulations and Planning, Sales Agents, Developers, Financial Advisers and Lawyers. Such an integrated service could work more effectively in the case of property than the separate complaints procedures that currently exist (or are distinctly absent) and are obviously not working.

If the service is to be considered credible, the Ombudsman needs to be given powers to mediate and decide (not simply to make recommendations), needs to have sufficient manpower to resolve cases within 3 months at the most and once a decision has been made, the Ombudsman must have strict powers of enforcement.

The service could be financed by fees payable by both complainant and the respondents and if this measure is implemented effectively, the first two measures may become less urgent.

Anyone involved with these issues finds it surprising that the Government of Cyprus has not already acted swiftly to protect its reputation and the industry from itself. The only conclusion is that the lack of political will comes from a failure to explain at least to the major developers and to the professional bodies involved that these measures are in their own best interests and that the whole industry is suffering due to these abuses.

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Proposals to resolve the mortgage defaults and negative equity

One explanation for Government inaction in the areas just discussed is that these are ongoing complaints that have been going on for years and have become an acceptable part of the infrastructure. In any event, addressing these issues alone will not resolve the vast majority of the current cases which have to do with a drop in property prices, income that never materialised, mortgages taken in strong currencies and negative equity.

The problems with the way these cases are progressing are the following:

1. The defence to defaulting on one's mortgage is unfulfilled promises by developers, wrong advice by financial advisers and failure to protect interests by lawyers. This defence would not have been there if the measures proposed earlier were in place and the sooner they are the better for the industry.
2. The borrowers are attempting to establish a conspiratorial connection between the various parties involved and the bank and thus demonstrate that abuses by any one of them invalidates the sales contract and the mortgage. If this argument succeeds (and there is strong evidence to show that they all collaborated to trap these borrowers into these mortgages), they will rightfully be able to claim a refund of their deposit, all expenses incurred, interest and damages. Apart from the damage to the economy of Cyprus from such an outcome there will also be collateral damage in the form of the long-term consequences of even more properties coming back into the market for sale, and rebate of the VAT and stamp duties paid which must be well over one hundred million Euros.
3. The Government does not have any control over what happens because it cannot dictate to any of the litigants how to act in their respective litigations. The Government, therefore, feels that there is nothing it can do other than to allow these cases to be settled in court.

This is a real predicament for the Government because allowing the current flow of events will bring about all the 'Undesirable Solutions' outlined above. This predicament, however, can be resolved if the Government was to introduce and was to co-ordinate a voluntary scheme that addresses the two main issues:

- Servicing the loans; and
- Covering the losses

Servicing the loans

Most buyers appear to have relied on rental income to maintain repayments. In one example I quoted above, they were told that the whole development was being let out to Thomson's and Thomas Cook, that the bar area in the development would be open and that a shuttle service to the beach would be available. None of these happened.

These properties are sitting empty. They need to be assessed for required facilities and agree who would provide property management services, airport transfers and meet and greet at the properties so that they can be let as holiday accommodation.

They need to be marketed correctly but if the effort is centralised with Government assistance, it should be possible to market them through tour operators and airlines to ensure a high degree of occupancy. The Cyprus tourist offices in Europe, Russia and the Middle East could facilitate this and a well search engine optimised and advertised web site may do the trick and perhaps even create additional tourist traffic to Cyprus.

Cyprus has been very successful in the past in marketing premium products e.g. the success of the Cyprus Potato Marketing Board. There is no reason, given political will, it should not succeed in this, which can in turn become a permanent attraction of the Cyprus property sector.

If rental income is restored then mortgage default can be eliminated.

Covering the losses

Whether or not rental income is restored, some of these loans are impossible to service. They were given in a strong currency and currency losses have taken their toll. They were given with a two-year moratorium which has added to the shortfall.

To make these mortgages serviceable, it is proposed that:

1. They should be turned into Euro loans;
2. A percentage sufficient to allow the borrower to service the loan should be 'conditionally' written off and an equivalent percentage in the property should be taken by the bank by way of shared ownership.
3. From time to time over the next, say, ten years the owner can buy-back shares of ownership from the bank. At the end of the period, if the owner has not re-acquired 100% of the property, the property can be sold and the proceeds shared in their respective percentages.

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I will not elaborate on this further at this stage, as what we are trying to establish as a workable proposal, is the basic principle. Once the principle is established the figures can be discussed in more detail.

The Benefits of taking action

This is indeed a win-win proposal. From the moment the Government of Cyprus is seen to be proactive, the climate and the bad press will change. Most disgruntled buyers I spoke to, do not support the belligerence displayed by some pressure groups and if they have an alternative, they would flock to it. Furthermore, the single voice of belligerence that is currently being heard will suddenly have a counterpart: it will be the voice of reason, the voice of resolve and the voice of justice.

The Government of Cyprus will not only be seen to have acted decisively but will have acted in its own best interest and that of its property sector and all those connected with it. It would have acted in the best interest of all these overseas buyers that have been expecting the Government of Cyprus to protect them from abuses.

If the Cyprus property sector succeeds in resolving the current crisis, it will acquire a taste for taking a lead in upholding standards and providing facilities to buyers which will become major marketing points for new property sales abroad.