

# **Mortgages**

## **CeMAP<sup>®</sup> Module 2**

### **2006/07 Update**

***This Update relates to the 2005/06 manual only.***

***The contents of this Update apply to exams on, or after, 1 September 2006.***

***This Update supersedes the Pensions Simplification Update.***

Note that, where subsections are added or deleted, all subsequent numbering within a section may be adjusted accordingly but doing so will render cross-references to the section inaccurate.

Self-assessment questions within the 2005/06 manuals have been revised and some new questions for 2006/07 added. These can now be found at the end of this update.

# Unit 3 Mortgage law, policy practice and markets

## SECTION I Borrowers

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### Page 4

The following text **replaces** the second and third paragraphs under the heading '1.1.1.2 Principles of agency':

It is vital to set out the conditions of the agency in writing before the agent begins to act on the principal's behalf because an agent should only act within the powers given to him by the principal. When dealing with property, it is vital that the seller and the estate agent have a written contract that sets out exactly what is expected from each party and the limits to the agent's remit.

In general, the *principle of agency* is that the principal is liable for the agent's actions. On occasions a statement or action by the principal might appear to give the agent wider authority. For example, where the agent carries out a number of actions that are outside his remit, with the full knowledge of the principal. Another example might be where the principal makes a statement that appears to allow or endorse actions outside the agent's remit. In these cases, the principal may be deemed responsible for the agent's actions, even though they are outside his remit, because he has given *apparent authority*. Where it is clear that the agent has acted outside his authority, the agent may be liable for any redress, unless the principal agrees after the event that his action was acceptable; this is known as *ratification*.

### Page 10

The following text **replaces** the 'Think about this' box and the final paragraphs under the heading '1.1.2.6 Attorneys':

Someone who does not have legal capacity to contract is not able to appoint someone else, who does have such capacity, to act as their attorney; for example, a twelve-year-old cannot appoint someone else as their attorney and enter into a contract that way. We will look at a specific type of Power of Attorney that applies to the mentally incapacitated later.

## **Page 15**

The following text is **added** after the third paragraph under the heading '1.1.2.9.2 The mentally incapacitated':

The Mental Capacity Act 2005, when it comes into force in 2007, will replace the EpOA with the lasting power of attorney.

## **Page 17**

Heading '1.1.3 Policy and practice matters relating to each category of borrower and giving advice' is **renamed** 'Policy and practice matters'.

## **Pages 19 & 20**

The whole of the text under, and including, heading '1.1.3.1 Mortgage regulation', '1.1.3.2 The Banking Code' and '1.1.3.3 Regulation' is **deleted**.

## **SECTION 2 Mortgage and property regulation and law**

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### **Pages 21 & 22**

The following text **replaces** the whole of the text under, and including, headings '2.1 The Mortgage Conduct of Business Rules' and '2.1.1 Introduction':

### **2.1 The Mortgage Conduct of Business Rules**

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The Financial Services Authority (FSA) took over the regulation of mortgage sales on 31 October 2004. This new regime meant that the Mortgage Code, which had provided a form of voluntary regulation since 1997, was no longer required and was replaced by the Mortgage Conduct of Business Rules (MCOB).

To be more precise, the FSA now regulates the sale and administration of those mortgages that meet the definition of a 'regulated mortgage contract'. The definition below simplifies the FSA definition of a regulated mortgage contract:

- (a) a contract which, at the time it is entered into, meets the following conditions:
  - (i) a lender provides credit to an individual or to trustees (the 'borrower'); and
  - (ii) the obligation of the borrower to repay is secured by a first legal mortgage on land (other than timeshare accommodation) in the United Kingdom. At least 40% of the land is used, or is intended to be used, as, or in connection with, a dwelling by the borrower or a relative of the borrower. In the case of credit provided to trustees, at least 40% of the land must be used as, or in connection with, a dwelling by a beneficiary of the trust or their relatives. Relatives are defined as:
    - A. that person's spouse, civil partner or cohabitant of either sex; or
    - B. that person's parent, brother, sister, child, grandparent or grandchild.

A mortgage contract will be classed as a regulated contract only if the criteria described above are satisfied at the time the contract is entered into. Contracts that were entered into before 31 October 2004 cannot be regarded afterwards as regulated mortgage contracts, even if they satisfy the required criteria.

The majority of residential mortgages will meet the above criteria, as well as some commercial mortgages where the borrower or related person occupies at least 40% of the land as a dwelling.

### **2.1.1 Lifetime mortgages**

The FSA introduced a separate mortgage category – the **lifetime mortgage**. Lifetime mortgages are subject to specific requirements outlined in MCOBs 8 and 9. Lifetime mortgages are the subject of a separate specialist examination, and, for the purposes of this text, you will need only to be aware of the definition of a lifetime mortgage:

- ◆ it is only available to borrowers over a certain age;
- ◆ no capital or interest payments are required during the life of the mortgage, although interest accrued can be rolled up and added to the debt;
- ◆ it is repaid only in the event of the borrower's death, a move into residential accommodation, the borrower moving to another property or choosing to repay the mortgage.

The following are excluded from regulation by the FSA:

- ◆ second charges;
- ◆ corporate mortgages – loans to companies.

*This does not affect subsequent section numbering.*

## Page 24

The text from the second paragraph under '2.2.1 Purpose of a mortgage' and the numbered points that follow until heading '2.2.2', is **deleted**.

## Page 26

The following text **replaces** the first bullet point under the heading '2.2.3.1 Legal mortgage':

- ◆ *mortgage by demise* (England and Wales only) – this arrangement was abolished in the Land Registration Act 2002 for new mortgages created for registered land; it was rare even prior to this change and can now only be arranged on unregistered property. It involves the transfer of the property from the seller to the lender on *completion* of the loan, and to the borrower on *redemption* (full repayment) of the loan;

Heading '2.2.3.2.1 The bond and disposition in security' and '2.2.3.2.2 The *ex facie* absolute disposition', but **NOT** including any text underneath the headings, are **deleted**.

## Page 27

The following text **replaces** the first two paragraphs under the heading '2.2.3.3 Second and subsequent mortgages':

A *second mortgage* arises where a borrower has already raised money once against a property, (giving a first mortgage over it) and then raises more against the same property. The later mortgage will be termed a 'second mortgage' and is almost invariably with a different lender; the first charge holder will usually insert a clause in the mortgage deed, allowing it to make further advances as part of the first charge, rather than on a second charge basis.

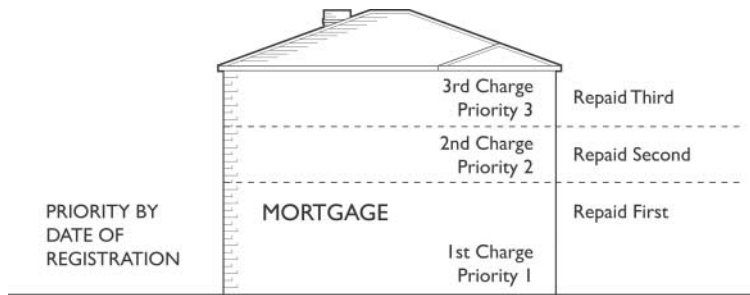
The second charge will be registered with the relevant Registry and it is the order of this registration that determines who takes priority in the event of default.

**Page 28**

The second paragraph in the first 'Think about this...' section within '2.2.3.3 Second and subsequent mortgages', is **deleted** ie the paragraph starting 'As nearly all lenders offer...'

The following diagram is **added** after the first paragraph in the first 'Think about this...' section within '2.2.3.3 Second and subsequent mortgages':

**Figure 2.1 Ranking of mortgage securities**

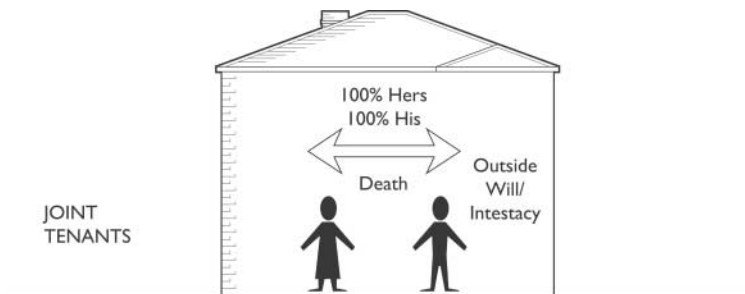


**Page 29**

Heading '2.2.4 Types of joint ownership – England and Wales' is **renamed** 'Types of joint ownership'.

The following diagram is **added** after the first paragraph under the heading '2.2.4.1 Joint tenancy':

**Figure 2.2 Joint tenancy**



The following text in bold **replaces** that on line 4 of the third paragraph under the heading '2.2.4.2 Tenancy in common':

You will be aware that the first **part** of an individual's estate on death is not subject to IHT;

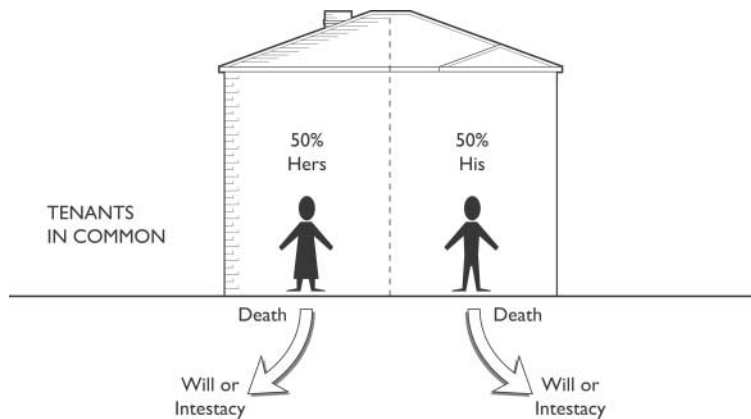
**Page 30**

The following text in bold **replaces** that on the first line of this page, under the heading '2.2.4.2 Tenancy in common':

a couple could leave **twice the nil rate band in total** to their heirs without inheritance tax.

The following diagram is **added** after the last paragraph under the heading '2.2.4.2 Tenancy in common':

**Figure 2.3 Tenants in common**



Heading '2.2.6 Land tenure – freehold and leasehold estate' is **renamed** 'Land tenure'.

## Page 31

The following text **replaces** the first three paragraphs, including bullet points, under the heading '2.2.6.1 Freehold estate':

The *freehold estate* is the best and highest form of ownership of land in England and Wales, and is referred to as 'estate in fee simple absolute in possession'.

- ◆ *Fee simple* means the right for the property to be inherited on the owner's death.
- ◆ *Absolute* means that there are no limits or conditions on ownership.
- ◆ *In possession* means immediate entitlement to the land; there are no prior claims.

Although the owner of a freehold property owns it outright and with no restrictions, he is still not able to do totally as he might wish. There are a number of factors that might affect his rights:

- ◆ there is a requirement to meet local authority conditions that may be imposed – these can relate to property use and alterations;
- ◆ the owner is subject to local and national planning legislation, which may affect both the use of the property and the extent to which it can be altered;
- ◆ there may be **covenants** or **easements** that apply to the land;
- ◆ the title itself may contain restrictions imposed by an earlier owner;
- ◆ former public utilities (water, electricity, gas etc) have certain rights over the land; for example, the water companies own the rain water that falls on the property;
- ◆ the owner has obligations to those who enter or pass by the property – for example, if a tile falls off the roof and injures someone, the owner might be liable.

## Pages 31 & 32

The following text **replaces** the first three paragraphs, including bullet points, under the heading '2.2.6.2 Leasehold estate':

A less permanent form of estate than the freehold is that of a *leasehold estate* – a form of land tenure where a person has rights over the land for a specific

period only. Referred to in the Law of Property Act 1925 as a ‘term of years absolute’, leasehold is a legal estate in land and occurs where the freeholder (the *lessor*) agrees to lease the land or property to another (the *lessee*).

- ◆ *Term of years* means that the lease must be for a specified period.
- ◆ *Absolute* means that the ownership of the lease is unconditional, does not stop on death and can be passed on to the leaseholder’s heirs; it can also be sold.

The lease will require payment of ground rent to the freeholder, who retains ownership of the land.

The lease is created through a formal agreement, called a *head lease*. This agreement sets out the term of the lease, the amount of ground rent and the rights and obligations of the leaseholder. It is possible to create a sub-lease as long as the term is less than the original lease and the head lease does not prohibit it.

A freeholder can create a lease on their estate for any length of time (although if the length of the lease exceeds 21 years, the owner of the lease may gain statutory rights to buy out the freehold).

For all leasehold property, there is a freeholder. That freeholder may be bound by any of the freehold conditions described above. These obviously affect the leaseholder as well.

In addition, leases may carry additional constraints such as:

- ◆ specific conditions relating to maintenance and repairs;
- ◆ constraints on use of the property;
- ◆ restrictions on alterations or enlargement;
- ◆ duties in respect of common areas (for example, where there is a block of leasehold flats, contributions to the maintenance of spaces for communal use such as landings and stairs), although the overall responsibility for the maintenance of the common areas lies with the freeholder;
- ◆ a requirement to insure through a specified company.

## Page 32

The following example **replaces** the last two paragraphs on this page and the first paragraph on page 33 under the heading '2.2.6.2 Leasehold estate':

### Example

A borrower buys a leasehold property in 1998 for £80,000. The property is leasehold with 30 years to expiry. The purchase is funded by a 25-year mortgage.

In 2006, the borrower defaults on the mortgage and the lender takes possession. By this time, the lease has only 22 years to run and, at the end of that period, it will revert to the freeholder. Anyone buying the property will only have use of it for 22 years and no rights at all after that. It is likely that the lender will find it almost impossible to sell the property in possession for anything like its normal market value.

## Page 33

The following text is **added** after the first paragraph under the heading '2.2.6.3 The Commonhold and Leasehold Reform Act 2002':

Those with long leases on houses had certain rights to buy the freehold or extend the lease by a further 50 years under the Leasehold Reform Act of 1967; subsequent legislation, including the 2002 Act, have extended this right so that most long-term leaseholders now have the right to buy their freehold. For the purposes of this text, we will focus on the more common purchase of leasehold flats.

Heading '2.2.6.3.1 Buying the freehold' is **renamed** 'Buying the freehold of a flat'.

## Page 36

The following text in bold **replaces** the last word in the third paragraph under '2.2.7 Land tenure in Scotland':

... – these would hold land immediately under the **noble**.

## Page 37

The following text **replaces** that under the heading '2.2.7.2 Abolition of Feudal Tenure etc (Scotland) Act 2000':

The effect of the *Abolition of Feudal Tenure etc (Scotland) Act 2000* is that, in the main, the rights of superiors in land held by vassals was ended on 28 November 2004. This means that rights of superiors, such as to collect feu duty and enforce title conditions (eg approve a change of use in the land or the erection of buildings) have been abolished. The owner of the land (the vassal under the feudal system) now has ownership rights that are similar to a freeholder in England. Land owned by superiors, which has not been granted to a vassal, is not affected because in this case the superior has retained all ownership rights.

Many owners of property in Scotland are probably not aware of the existence of a 'superior' and assume that they have absolute ownership of their land (and the attached buildings). The recent reform essentially brings the law into line with that perception by removing the residual rights of a superior over land that has been granted to a vassal.

The following text **replaces** the first paragraph under the heading '2.2.7.3 The Title Conditions (Scotland) Act 2003':



*The Title Conditions (Scotland) Act 2003* operates in tandem with the *Abolition of Feudal Tenure etc (Scotland) Act 2000* (and came into effect on the same day), bringing to an end the rights of feudal superiors. These rights often relate to *burdens* in title deeds. Burdens are, in principle, any restriction on the enjoyment of land by the owner (eg obligations in title deeds to perform a particular act such as to maintain a common facility or a prohibition not to do a specific thing). Most feudal burdens (ie burdens contained in the original grant of land or in the deed creating a sub-feu) have ceased to be enforceable by superiors. The rights of enforcement of third parties – for example, other proprietors in the same housing estate or tenement whose properties are protected by the same burdens – have not been affected.

## Page 39

The Scottish flags distinguishing text under the heading '2.2.7.6 Giving advice on matters relating to property law' are **deleted**.

Heading 2.2.8.1 Purpose and origins, but NOT including any text underneath the heading, is **deleted**.

## Page 40

The following text **replaces** the last paragraph under the (now deleted )heading '2.2.8.1 Purpose and origins':

Before looking at the specific registers, we will consider a number of rights and obligations that may affect title to land. These are easements, positive covenants and restrictive covenants, all of which are said to 'run with the land'. They are passed on to all subsequent purchasers of the land, which remains subject to them.

The following text **replaces** the first two paragraphs under the heading '2.2.8.2 Easements':

An **easement** is a right that one person has over the land of another. Examples include rights of way, rights to light or prospect (ie the view), rights to ventilation, or even rights to hang a sign on another person's house. The easement attaches to, and is for the benefit of, the land, rather than its owner, and the two plots must be close to each other.

The land that enjoys the right over another site is called the *dominant tenement*, and that over which the right is held is called the *servient tenement*. The dominant and servient tenements must be owned by different people.

With one or two exceptions, the easement cannot impose a positive burden on the servient tenement – in other words, it cannot insist that the owner does something. One major exception is that the easement can demand that the servient tenement fences the land.

Easements can be *positive* or *negative*, depending on their nature. Taking a right of way as an example, many would regard the existence of a right of way over their land as an invasion of privacy: this may make the land less desirable and reduce its value. Conversely, you may need a right of way across someone else's

land in order to gain access to your own property. In this case, the right of way is essential to the maintenance of the value of your property.

*The last paragraph under the heading '2.2.8.2 Easements' is **deleted**.*

## **Page 41**

*The following text is **added** to the end of the paragraph under the heading '2.2.8.3 Positive covenants':*

Another positive covenant is that requiring owners to maintain the front garden, particularly common on new developments.

*The following text in bold is **added** to the end of the first paragraph under the heading '2.2.8.4 Restrictive covenants':*

*Restrictive covenants are similar to positive covenants, except that they specify what an owner-occupier *may not do* – for example, they may preclude him operating a business from the premises **or keeping livestock on the plot**.*

*The second, third, and fourth paragraphs under the heading '2.2.8.4 Restrictive covenants' are **deleted**.*

*Heading 2.2.8.5 England and Wales' is **renamed** 'Registering land in England and Wales'.*

*The following text is **added** before the first paragraph under the heading '2.2.8.5.1 Registered land':*

Land registration originates from 1897 and has been progressively implemented throughout England and Wales by successive statutes enacted throughout the 20th century. The main body of reforming legislation took place in 1925 with the passing of the Land Registration Act. The Land Registration Act of 2002 made further changes with effect from 2003.

## Page 42

The following text in bold **replaces** that in the line 2 of the second bullet point on this page under the heading '2.2.8.5.1 Registered land'.

- good leasehold: this can apply only in connection with leases of more than **seven** years.

## Page 42 & 43

The following text **replaces** the third and fourth bullet points under point 2 under the heading '2.2.8.5.1 Registered land':

- a *possessory title* may be in place where some or all of the property's title deeds are missing. The effect is that good title can be guaranteed from the point of the property's first registration but not before. Although the new owner has title to the property, this is subject to any adverse interests existing at the date of first registration. Where possessory title is held, it can be converted to absolute title once it has been held for 12 years: this is because of a long-standing principle that, where someone occupies another's land for a given period without any redress being sought, they can claim a right to the land (this is often described as *squatters' rights*).

As noted above, possessory title presents a lack of certainty to buyer and lender alike, but a bank may be prepared to lend in certain circumstances on the basis that the title may convert to absolute in time. Possessory title can apply equally to freehold and leasehold property;

- *qualified title* is very rare and occurs where there is some defect in the title as registered, and so absolute or good leasehold title cannot be guaranteed. The title is given, subject to any defect.

## Page 43

The following text **replaces** point 3 under the heading '2.2.8.5.1 Registered land':

- ◆ The *charges register* records any charges over the property, such as the rights of any mortgagee and spouse's interests notifiable under the Family Law Act 1996, negative easements and restrictive covenants.

The following text **replaces** the first paragraph under the heading '2.2.8.5.2 Unregistered land':

**Unregistered land** is that which has yet to be legally transferred since the introduction of compulsory registration. As registration was only extended to the whole of England and Wales in 1990, there remains a good deal of land in this category. When an unregistered property is transferred, or where a lease exceeding seven years is granted, it must now be registered, known as *first registration of title*; this also applies when a legal mortgage is created. An application for registration must take place within two months of the transfer; failing to do so invalidates the legal transfer, which becomes void. In effect, the title reverts to the previous owner, who will hold it on trust for the new owner.

The following text is **added** to the end of the second paragraph under the heading '2.2.8.5.2 Unregistered land':

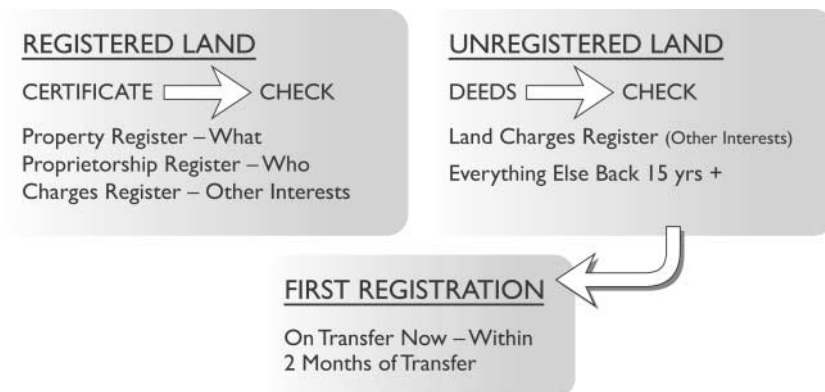
– this is known as the *root title*.

The following text is **added** to the end of the first bullet point under the heading '2.2.8.5.2 Unregistered land':

– second charges and so on;

The following diagram is **added** after the last bullet point under the heading '2.2.8.5.2 Unregistered land':

**Figure 2.4 Land registration**



**Page 45**

Heading '2.2.8.6 Scotland' is **renamed** 'Registering land in Scotland'.

The following text **replaces** the first paragraph under the heading '2.2.8.6.1 The Land Register of Scotland':



The Land Register of Scotland is a map-based computerised system of land registration that was created by the Land Registration (Scotland) Act 1979 and subsequent revisions.

The following text **replaces** the last paragraph under the heading 2.2.8.6.1 The Land Register of Scotland':



Much of the land records for Scotland are now held in digital form, although some property that has not changed hands for many years is still recorded in paper form.

## Page 46

The following text **replaces** the first paragraph under the heading '2.2.8.7 Matrimonial interests':

*Matrimonial interests* are particularly important in regard to land registration. The law applicable to these is broadly uniform throughout the UK and is set out in the Family Law Act 1996 (England and Wales), updated to include the Civil Partnership Act 2004. For ease of reading, the term 'spouse' will be used throughout; in this context spouse means husband, wife or civil partner as defined under the Civil Partnership Act 2004.

## Page 47

The following text is **added** after the sixth paragraph under the heading '2.2.8.7 Matrimonial interests':

Cohabitants can apply for protection through the courts.

## Page 50

Heading '2.3 Consumer law' is **renamed** 'Consumer legislation'.

The following text is **added** after the first paragraph under the heading '2.3.1 The Consumer Credit Act 1974':

If the loan is over £25,000, it is unregulated.

A loan is *exempt* if:

- ◆ it is for purchase, improvement, enlargement, alteration or repair of a main dwelling house; and
- ◆ the original loan is with the same lender.

The Consumer Credit Act only affects loans to personal borrowers.

Loans for mixed purposes are usually separated into regulated and non-regulated elements, because the procedures are different for each.

As a result of a long-term review of consumer credit law, the government has introduced legislation to provide better levels of protection for consumers by enhancing the Consumer Credit Act (CCA). At the time of writing, the

Consumer Credit Bill 2005 has yet to reach the statute books but the key points of the Bill are to build on the CCA by:

- ◆ establishing an independent ombudsman service through the Financial Ombudsman Service;
- ◆ making it much easier for consumers to challenge unfair lending practices and loan agreements;
- ◆ improving the quality of information lenders are required to provide;
- ◆ improving Office of Fair Trading powers to take action against rogue companies and financial penalties.

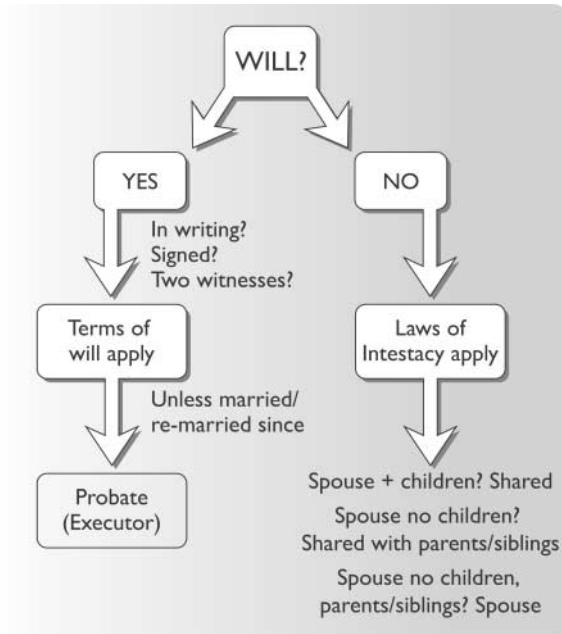
Two significant changes arise from the Bill:

- ◆ for most loans, there will no longer be a cap of £25,000 on loans covered under the legislation – the amount will be unlimited;
- ◆ In most cases, loans for business purposes will not be covered by the regulations. The exception is where the loan is for up to £25,000 and is made to a small business – defined as a sole trader, an unincorporated association or a partnership with three or fewer members.

**Page 52**

The following diagram is **added** after the last paragraph under the heading '2.4 Testacy and intestacy':

**Figure 2.5 The rules of intestacy**



Heading '2.5 Legal obligations and guarantees: lender's rights and borrower's covenants' is **renamed** 'Legal obligations and guarantees'.

## SECTION 3 The house-buying process

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### Page 55

The following text in bold is **added** to the third bullet point under the heading '3.1.1 Preliminaries':

- ◆ whether they can fund the deposit required (as **relatively** few lenders will offer 100% mortgages);

### Page 61

The following text **replaces** the second paragraph and bullet points listed under the heading '3.1.7 New proposals':

The Act requires that, from 1 June 2007, all sellers (or their agent) provide a **Home Information Pack** as part of the marketing material for the property. The pack is intended to contain all a prospective buyer needs to know before making an offer. The Act does not specify the exact contents of the pack; this will be defined before information packs become compulsory. It is, however, likely to require:

- ◆ the terms of sale;
- ◆ evidence of title;
- ◆ replies to standard preliminary inquiries;
- ◆ copies of any building regulations and planning consents and approvals;
- ◆ warranties or guarantees relating to new property;
- ◆ guarantees for work carried out;
- ◆ replies to searches made of the local authority;
- ◆ a Home Condition Report based on a professional survey of the property, including an energy efficiency rating.

## Page 62

The following text **replaces** the last paragraph under the heading '3.2.1 Investigation of title':

The various searches that will be carried out are as follows.

## Page 63

The following text **replaces** the contents of the first and last rows of the table list under the heading '3.2.1 Investigation of title':

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<b>Land Registry search</b>	Made if the land is registered and involves a search of the property, proprietorship and charges registers.
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<b>Commons registration search</b>	Checks that the land being sold is not common land. A Commons registration search usually applies where the land is in the countryside and is previously undeveloped, or is adjacent to land that has not been developed, or may have previously belonged to the Lord of the Manor or has been designated a town or village green.
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The following text **replaces** the first paragraph under the heading '3.2.2 Purchase transaction':

To complete the *purchase transaction*, the ownership of the property must be legally transferred from vendor to purchaser and the transaction must be registered. The solicitor confirms exactly what is, and is not, included (such as fittings and temporary outbuildings, eg garden sheds). A *completion date* is agreed (in Scotland, *date of entry*). The price is agreed for both the property and anything that goes with it.

In England and Wales, the solicitor then draws up contracts that are exchanged in due course. This is the point of no return – the vendor is obliged to sell and the purchaser is obliged to buy; technically, either party can withdraw from the transaction but such action would be a breach of contract and would lead to loss of the deposit and possible court action for breach of contract.



In Scotland, the final acceptance of an offer to purchase (together *the missives*), which must be in writing, is legally binding – a solicitor also deals with this.

### Page 66

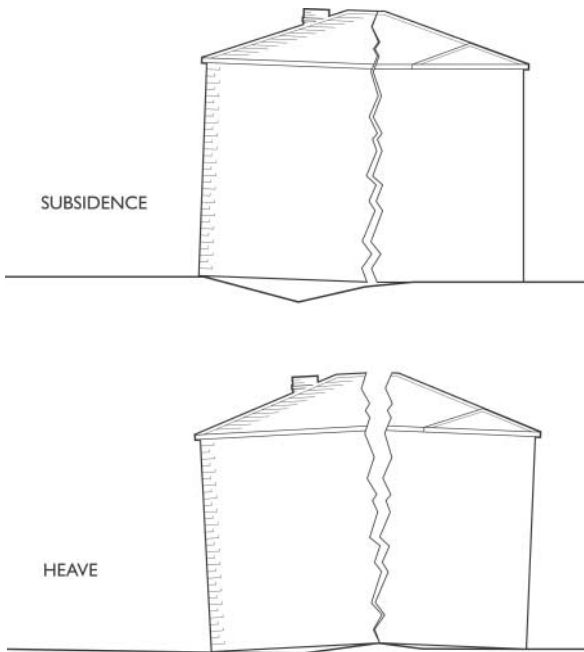
The figure in bold **replaces** that within the first bullet point under the heading ‘3.2.8 Stamp Duty Land Tax’:

- ◆ 1% is levied where the price is more than **£125,000** but no more than £250,000;

### Page 68

The following diagram is **added** after the second paragraph under the heading ‘3.3 Property defects’:

**Figure 3.1 Subsidence and heave**



*The final sentence in the last paragraph under the heading '3.3 Property defects' is **deleted**.*

**Page 70**

*The final sentence under the heading '3.4 Quality of construction' is **deleted**.*

## SECTION 4 The economic and regulatory context for giving mortgage advice

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The 2006/07 manual features this section renumbered as Section 5 of Unit 3.

Section 5 of Unit 4, 'From offer of advance to completion' is **added** and renumbered as Section 4 of Unit 3 of the 2006/07 manual.

Changes to Section 4 of Unit 3 in the 2005/06 manual are as follows.

### Page 71

Heading '4.1 The property market' is **renamed** 'The economic context'.

### Page 72

Heading '4.1.2 What affects the market?' is **renamed** 'What affects the mortgage market?'.

### Page 73

The following text is **added** to the end of the first bullet point under the heading '4.1.2 What affects the market?':

A number of factors will influence interest rates in the economy:

- *the level of government borrowing* – when the government needs to raise money for public spending it can raise taxes or borrow. Borrowing is less likely to cause political problems. Upward pressure is placed on interest rates when the government increases borrowing significantly.
- *higher levels of individual borrowing* – rates tend to move up when there is high demand for borrowing. Too much borrowing at an individual level is a worry for governments, as money floods into the economy and prices creep up. If interest rates increase dramatically, many people will be severely over-stretched financially.

- *fiscal policy* – the government will use interest rates as a way of controlling the economy.
- *foreign interest rates* – the value of Sterling against foreign currencies is affected by interest rates. When UK interest rates are higher than those abroad, the pound is popular and the exchange rate increases. This can have a negative effect on industry, because UK goods become expensive abroad and sales may be affected.

The responsibility for setting UK interest rates was passed from the government to the Monetary Policy Committee (MPC) of the Bank of England in 1997. The MPC has been given a target for inflation and must adjust interest rates as necessary to meet the target. This means that the government no longer has direct control over UK interest rates.

The MPC sets the short-term rate at which the Bank of England deals in money markets. This rate is known as the *repo rate*, and will usually influence the interest rates set by banks and other institutions.

## **Pages 75 & 76**

The text under, and including, the heading '4.2 Regulation', is **deleted**.

## **Page 84**

Heading '4.5.2 Separation of origination and administration' is **renamed** 'Separation of origin and administration'.

## Unit 4 Mortgage applications

### SECTION I The role of the mortgage adviser

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#### Pages 3 & 4

The following text **replaces** the fourth paragraph and subsequent bullet points under the heading '1.1 The role of the mortgage adviser':

#### Mortgage Conduct of Business rules

Before going into detail about the role of the adviser, it is important to understand how the Mortgage Conduct of Business (MCOB) rules 4, 5 and 11 impact on the role.

#### Page 4

The following text replaces the fifth paragraph including the bullet points and the final sentence under the heading '1.1 The role of the mortgage adviser':

### MCOB 4 – Advising and selling standards

The terms 'adviser' and 'firm' are interchangeable in relation to the advising and selling standards.

#### The scope of service

The adviser's exact role depends on the *scope of service* to be offered. The customer can be offered an *advised sale*, where the adviser asks questions about the customer's needs and circumstances, selects the most appropriate mortgage product to suit the customer's needs and then makes a personal recommendation. Alternatively, the customer can be given information about specific products that meet his requirements: no recommendation is given and the decision rests with the customer. This is often referred to as a *non-advised sale*.

There are three levels of service that the adviser can offer to customers; the service to be provided must be clearly indicated to the customer when first making contact. The three levels are:

- ◆ to select and recommend a product from the whole market, which means that a wide range of products and providers from across the entire market must be considered;
- ◆ to select and recommend a product from a limited number (a *panel*) of lenders;
- ◆ to select and recommend a product from a single lender. This would usually apply to building society advisers.

### **Initial disclosure requirements**

When first making contact with a potential client, other than by telephone, where the anticipation is that personalised information or advice will be given on a regulated mortgage contract, the firm must:

- ◆ establish with the customer whether it will provide advice or information;
- ◆ establish with the customer how much he will pay for the advice or information;
- ◆ provide the customer with an initial disclosure document (IDD).

### **The initial disclosure document (IDD)**

The adviser must give a new customer an *initial disclosure document (IDD)* at the start of the meeting. The IDD must include:

- ◆ a statement about the FSA;
- ◆ whether the mortgages on offer are:
  - from the whole market,
  - from a panel of lenders,
  - from one provider only;
- ◆ which service is provided:
  - advice and recommendations;
  - information on products but no advice or recommendation;

## Mortgages

- ◆ whether a fee will be payable or commission will be received;
- ◆ what cover is available to the customer under the Financial Services Compensation Scheme.

An IDD does not have to be given where:

- ◆ one has already been given to the customer and the information in it is still current and appropriate to that customer;
- ◆ the firm is certain that the proposed contract will not be a regulated mortgage.

### **Telephone contact**

Where the initial contact is by telephone, the adviser must provide the following information at the start of the call:

- ◆ the name of the firm and the purpose of the call;
- ◆ the scope of the service provided. Where the scope does not include the whole market, the customer must be told that a list of the providers whose mortgage contracts are offered can be provided;
- ◆ whether the company will provide advice on the regulated mortgage contracts it offers.

All of the above must be confirmed in writing. Where the call suggests that the customer is not ineligible for any of its regulated mortgage contracts, he must be sent an IDD within five working days.

### **Advised sales**

With *advised sales*, the firm must take reasonable steps to ensure that any personal recommendations are suitable for the client. This requires the adviser to gather information about the customer that will help him to assess which mortgage, if any, is suitable for the customer's needs and circumstances.

Suitability will be demonstrated where the information disclosed by the customer shows that:

- ◆ the customer can afford the contract;
- ◆ the contract is appropriate to the customer's needs and circumstances;

- ◆ the contract is the most suitable from the range offered within the firm's scope.

No personal recommendation should be made if there is no contract from within the scope offered by the firm that is appropriate to the customer's needs and circumstances.

Where the mortgage is to consolidate debts, the following should be taken into account:

- ◆ the cost of increasing the period of the debt;
- ◆ whether it is appropriate to secure a previously unsecured loan;
- ◆ if the customer has known payment difficulties, whether it would be better for him to negotiate an arrangement with his creditors.

*When assessing affordability*, considerations include:

- ◆ information about the customer's income and expenditure;
- ◆ any likely changes to income and expenditure;
- ◆ costs after the end of any discount period.

*When assessing suitability*, considerations include whether the customer:

- ◆ meets the lender's eligibility criteria – income, loan-to-value ratio, etc;
- ◆ should have a repayment or interest-only mortgage, or a combination of the two;
- ◆ has a preference for a particular mortgage term;
- ◆ has a preference or need for stability of monthly payments (fixed or capped);
- ◆ has a preference or need for reduced initial payments – discount etc;
- ◆ intends to make early repayments;
- ◆ has a preference or need for any other mortgage features – payment holidays, overpayments etc.

Remember if the adviser does not have access to a suitable mortgage product from within the range that he deals with, it is not acceptable to recommend the closest fit from those available. A good example is where the adviser is a sub-prime specialist – only offering mortgage products designed for those with poor credit records. If a customer with a good credit record were to ask for

advice, the adviser must not recommend a sub-prime mortgage. The one exception will be if the adviser can demonstrate that the costs, terms and conditions of the contract will not disadvantage the customer when compared to suitable standard mortgages.

### **Records**

The firm must keep records of all information provided by the customer and the reasons for the recommendation.

### **Non-advised sales**

In some situations, a customer may ask for information on a particular type of product or products, rather than seek advice and a recommendation from the adviser. In some cases, the adviser might present the customer with a shortlist of products that appear to meet his requirements, leaving the customer to decide which one, if any, best suits his needs. If the customer decides to apply for a contract on this basis, it will be a *non-advised sale*.

MCOB 4 sets out basic requirements for non-advised sales:

- ◆ all questions the adviser asks the customer about his needs and circumstances should be scripted in advance;
- ◆ information given to the customer should be clear, fair and not misleading.
- ◆ if it becomes clear during the conversation that the customer is considering an unsuitable product, he should be encouraged to seek advice;
- ◆ staff who use the scripted questions should be trained in their use and should understand the difference between making and not making a personal recommendation;
- ◆ the firm must make a record of all scripted questions on the date they are first used. The records must be kept for one year after the last date on which they were replaced by new questions.

## **MCOB 5 – Pre-application disclosure**

*Pre-application disclosure* is the information that must be provided *before the customer completes an application* for a regulated mortgage contract. The principle is that the customer should make an informed decision to apply for a regulated mortgage contract. This means that he must be given sufficient information, specific to his case, to be able to make that decision.

The information includes:

- ◆ the features of the proposed mortgage;
- ◆ the price the customer will pay;
- ◆ any linked borrowing or products required as a condition of the contract.

### **Illustration**

A customer-specific *illustration* must be given to the customer at the point when any recommendation is made and before an application is made. It must also be given where the firm provides written information that is specific to the amount the customer wishes to borrow. If the recommendation is made over the telephone, the illustration must be sent to the customer within five business days.

The customer must be given an illustration if the adviser or firm:

- ◆ makes personal recommendation to the customer;
- ◆ provides information to the customer that is specific to the amount he wishes to borrow;
- ◆ provides the means for the customer to make an application.

The illustration must be clear, fair and not misleading, and an accurate reflection of the costs of the contract. The content is prescribed by the FSA; the firm is not permitted to add information other than that prescribed. The headings of the prescribed content are as follows:

- ◆ *date produced*;
- ◆ *about this illustration* – what it is and what it does;
- ◆ *the level of service provided* – advice and recommendation or information only;

## Mortgages

- ◆ *what you have told us* – the amount of loan required; the price of the property; the desired term; interest-only or repayment basis;
- ◆ *description of this mortgage* – lender; interest rate option chosen; period of any special rate;
- ◆ *the overall cost of this mortgage* – the amount to be repaid in total; the amount repaid for each £1 borrowed; the APR;
- ◆ *what you will need to pay* – the amount of each regular payment at the rate quoted; the total number of payments; whether the payments are fixed or variable. With an interest-only mortgage, the illustration must state that separate arrangements should be made to repay the capital at the end;
- ◆ *are you happy with the risks?*
- ◆ *what fees you must pay* – itemising all fees included in the APR calculation. A description of each fee – amount, when payable, recipient if not the lender, whether refundable; a statement to confirm if a fee is to be added to the loan; higher lending charge statement (if applicable);
- ◆ *insurance* – insurance that must be taken out through the lender/adviser; insurance required as a condition of the mortgage (but not necessarily through the lender/adviser); amounts;
- ◆ *what happens if you do not want this mortgage any more* – early repayment charges; moving house;
- ◆ *what happens if you want to make overpayments?*
- ◆ *additional features* – underpayments; payment holidays; borrow-back facility; incentives; linked savings accounts, etc;
- ◆ *using a mortgage intermediary* – deleted if arranged directly through the lender.

The key part of this section is that the fee payable by the lender to the intermediary must be stated:

- if the fee is £250 or less, the illustrator can state that the fee payable will be no more than £250;
  - If the fee is more than £250, the exact amount must be stated;
- ◆ *where can you get more information about mortgages?*

The adviser/firm must explain the importance of the customer reading and understanding the illustration before making an application.

The firm must keep an adequate record of each illustration it issues for a year from the date of the customer's application.

## **MCOB 11 – Responsible lending**

MCOB 11 is aimed particularly at the lender but it does place responsibility on the adviser to gather the information required for the lender to support its decision.

Before entering into the mortgage contract, the lender must be able to show that account has been taken of the borrower's ability to repay the mortgage. A record must be made of the information used in reaching the decision and kept for at least one year from the start of the contract.

The lender must establish and operate a written policy outlining the factors it will take into account in assessing the borrower's ability to repay the mortgage.

### **The advice process**

The adviser should first interview the customer to find out as much relevant information as possible. In most cases the adviser will need to explain terminology, products and procedures so that the customer can give reasoned and informed answers.

Among other things, the interview will include establishing:

- ◆ the customer's intended purchase price or price range;
- ◆ the type of property to be purchased;
- ◆ the customer's feelings about the term of the mortgage;
- ◆ the customer's income and outgoings;
- ◆ the amount of deposit available and other cash available to meet expenses;
- ◆ the customer's current employment status and employment history;

- ◆ the customer's budget for mortgage repayment and whether this is vulnerable to rate increases: whether he needs the stability of a fixed or capped rate; whether he needs to start at the lowest possible cost via a discounted mortgage;
- ◆ the customer's attitude to fixed and variable rates, and to potential rate rises in the future;
- ◆ the potential/intention for the customer to make early repayments – partial or total;
- ◆ protection needs that will arise when the mortgage is arranged – life cover, mortgage payment protection and so on, assuming the adviser has the appropriate authorisation to advise on these products;
- ◆ the fees, charges and costs involved in the mortgage products, including early redemption charges.

**Figure 1.1 The advice process**



## **Page 7**

The following text is **added** after the second bullet under the heading '1.4 Risk' and before the third bullet point:

- ◆ those who do not wish to take a risk that the mortgage will be repaid at, or by, the end of the term should be advised to select a repayment rather than interest-only;

## SECTION 2 Assessment of status

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### Page 13

Heading '2.1.1 Information gathering – significance of information required on the application form is **renamed** 'Information gathering'.

### Page 25

The following text in bold **replaces** that cited in the second and third bullet points on this page above the heading '2.1.3 Corroborating income' (but still under heading '2.1.2.1 The self-employed sole trader'):

- ◆ a self-assessment tax computation – this is produced by **Her Majesty's Revenue and Customs (HMRC)** and will confirm the figure for taxable profit as shown in the business tax computation and show the calculation of the income tax liability;
- ◆ a self-assessment statement of account – this is also produced by **HMRC** and confirms whether there is any outstanding tax liability carried forward from a previous year.

### Page 27

The last three paragraphs under the heading '2.1.3.2 Bank statements' (not including the 'Think about this...' box are **deleted**.

### Page 34

The 'Think about this...' heading on this page under the heading '2.1.5 Credit assessment', including the paragraph underneath it starting 'Regular income may be more...', is **deleted**.

**Pages 39–42**

The text under, and including, headings '2.1.5.5 The mortgage interview' to '2.1.5.5.3 After the interview' (inclusive) is **deleted**.

**Page 46**

Heading '2.1.7 Sub-prime and non-status mortgages' is **renamed** 'Non-status mortgages'.

The text under, and including, heading '2.1.7.1 Sub-prime' is **deleted**.

**Page 47**

Heading '2.1.7.2 Non-status (or self-certified)', but NOT including any text underneath this heading, is **deleted**.

## SECTION 3 Assessment of security

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### Page 51

The following text in bold **replaces** that cited in the last two bullet points on this page ie directly before the paragraph beginning ‘In any event, it is clear...’:

- ◆ **external valuers** may be better able to accommodate ebbs and flows in business volumes, which can be harder to deal with as the department of a single lender;
- ◆ **external valuers** may also have wider experience because they are dealing with other lenders and types of property.

### Pages 55 & 56

The following text **replaces** the third to sixth paragraphs under the heading ‘3.1.3.1 Tenure’:

Some land has rights attached for the benefit of others. In England and Wales these are usually easements (such as rights of way, rights of light and the right to hang a sign on someone else’s building).



In Scots law, the technical term for these is *jura in re aliena* (rights in a thing belonging to another, or servitudes). A creditor might, for example, have some right over his debtor’s property pending settlement.

The value of freehold property can be affected by easements and covenants: a property with a right of way through its garden, for example, is likely to be valued lower than a similar property without such as easement. A restrictive covenant may also affect the value.

Properties on long leases sell at significantly higher prices than those on short leases. Most lenders insist that leasehold properties have a specified minimum unexpired period on the lease beyond the end of the mortgage term. If the remaining term of the lease, after the end of the mortgage, is less than 30–40 years, the lender will be reluctant to lend because in the event of default, it may be left with a property to sell with a short lease. In addition, problems can arise in respect of ‘common areas’ of freehold flats (ie one person’s ceiling is another person’s floor). As a consequence, many lenders will not consider freehold flats for mortgage. Many lenders will also not lend on ex-local authority flats.

In some parts of Scotland, property has to be *decrofted* before a title can be created for a new purchaser. This often occurs when a farmer sells off a portion of agricultural land so that a purchaser can build a dwelling on it. This action can be time-consuming and is quite technical.

## Page 58

Heading '3.1.3.6 Quality of construction' is **renamed** 'Quality of construction and contract guarantees'.

The second 'Think about this...' heading on this page under the heading '3.1.3.6 Quality of construction', including the paragraph underneath it starting 'The mortgage adviser should...', is **deleted**.

## Page 59

Heading '3.1.3.7 Condition' is **renamed** 'Condition of the property'.

## Page 60

Heading '3.1.3.11 Planning and building regulations' is **renamed** 'Planning consent and regulations'.

The following text **replaces** the text under the heading '3.1.3.11 Planning and building regulations':

When a property owner builds, extends or undertakes other building work on a property, he may be required to seek *planning permission* or follow specific *building regulations*. Failure to do so can result in a compulsory order to reinstate the property to its original state; permission is rarely given retrospectively. In terms of property values, failure to obtain the necessary consents will seriously devalue the property and is likely to result in lenders choosing not to lend on the property. Unfortunately, the failure of a previous owner to gain planning consent or satisfy building regulations will not prevent the new owner from suffering the consequences.

Town and country planning legislation is complex but much more far-reaching than a buyer might think. Anything that changes the external appearance of a

property substantially is likely to require approval. Typical work that will require planning permission would include:

- ◆ building a new property;
- ◆ converting an existing building – a barn, for example;
- ◆ additions and extensions that:
  - mean the property will be closer to a road, lane or footpath than before, unless there is at least 20 metres between the extended house and the ‘highway’;
  - are higher than the roof of the original building;
  - are more than four metres high and within two metres of a boundary;
  - mean more than half the land surrounding the original building is covered by buildings;
  - extend terraced houses by more than the greater of 10% of the original house or 50 cubic metres,
  - extend other houses by more than the greater of 15% of the original house or 75 cubic metres,
  - in all cases where the increase is more than 115 cubic metres;
- ◆ dividing a single property into separate homes;
- ◆ work that would contravene original planning permissions – building a two-metre wall where the original permission was for a one-metre wall, for example.

The examples given are by no means exhaustive.

The general procedure for seeking planning permission is as follows.

- ◆ Contact the local authority/council planning department and tell them the plan in outline.
- ◆ If they think planning permission might be needed, an application form should be completed.
- ◆ Submit an outline plan or detailed plan: an outline plan saves money and will enable the council to give an idea of acceptability; detailed plans are more costly.

- ◆ The application is placed on the application register for public inspection. Notices will be posted on, or near, the site to inform neighbours.
- ◆ The planning committee will make the decision.

A serious situation will arise if planning consent has not been granted on a property that is subject to a mortgage because the local authority is unlikely to accept the work and may force the borrower to change the property back to how it was. To make matters worse, if the borrower defaults in the meantime, the lender can be left with a property that is not saleable because it does not comply with planning laws and is subject to an enforcement order. This can result in heavy expenditure by the lender, which it may not be able to recoup from the borrower.

### Listed buildings

**Listed buildings** are subject to restrictions on changes to the fabric of the building. This means that permission must be sought when changes are planned. This can affect the value of a property in two ways:

- ◆ the limitations placed on listed buildings means that a new buyer may not be able to make changes to the exterior or even the interior, in some cases. While this might preserve the heritage of the building and the area, it can be restrictive and potential buyers who see potential in a property may be put off by the requirements. Repairs may also be expensive, in that they have to be carried out according to strict rules and often have to use expensive original materials;
- ◆ if a listed building has been changed during a previous ownership, the potential buyer must ensure that any work carried out in the past has been the subject of relevant permission. If this is not the case, the property may need to be reinstated or the work carried out again, on the same basis that applies to planning permission.

*Listed building consent* is required where the owner wants to demolish a listed building or change or extend it in a way that will affect its character as a building of special architectural or historical interest. Such work is covered by statutory legislation – primarily the Listed Building and Conservation Area Act 1990.

The procedure for seeking permission to alter or demolish a listed building is similar to obtaining planning permission. The listing applies to the building and anything attached to it, and any buildings in its grounds. It should be recognised, however, that some of the requirements may be very detailed.

- ◆ Grade 1 buildings are of exceptional interest and represent 2% of all listed buildings.
- ◆ Grade 2 buildings are of particular importance and represent 4% of all listed buildings.
- ◆ Grade 3 buildings are of special interest and represent 94% of the total number of listed buildings.

Proposed changes to Grade 1 and 2 buildings will involve National Heritage and various historical societies. The Secretary of State will be informed once a local authority has reached a decision relating to the proposed demolition of a listed building and any alteration to a Grade 1 or 2 building.

Owners should also be aware that they may be required to carry out repairs on listed buildings as dictated by the local authority.

## **Page 62**

*Heading '3.1.3.14 Property defects', and any text underneath this heading, is **deleted**.*

## **Page 64**

*The 'Think about this...' heading on this page under the heading '3.1.3.16 Contents of the report', including any text underneath it starting 'Subsidence occurs when land...', is **deleted** as further coverage of subsidence rendered it redundant.*

*The paragraph on this page starting 'In the UK, these problems...', under the heading '3.1.3.16 Contents of the report' is **deleted**. The bullet points on this page form part of the bullet point list on page 63.*

## Page 66

The following text **replaces** all paragraphs (except the last paragraph) on this page under the heading '3.1.3.17 The valuer's recommendations':

- an *undertaking* to repair or make alterations is recommended when the property is basically good security but certain work needs to be done.
- a *retention* is more serious. This is where the lender holds back a sum of money from the advance, pending repairs being carried out to the lender's satisfaction.

## Page 68

The following text **replaces** the first paragraph under the heading '3.1.6 Reinstatement value':

Although it does not directly impact on the value of the property, the **reinstatement value** is a vital part of the insurance cover. The reinstatement value will be the valuer's estimate of the cost of rebuilding the property from scratch in the event of destruction by fire or another catastrophe. The value will be based on the size of the property and building costs for the area. The amount is usually increased in line with inflation each year to ensure that the insurance remains adequate. With properties of standard construction, the reinstatement value will be considerably less than the market value; in the main, this is due to the fact that the market value includes the price of the land, which is not a cost when rebuilding.

## Page 71

Heading '3.5 Due diligence enquiries' is **renamed** 'Disputes'.

Heading '3.6 Covenants' is **renamed** 'Covenants and easements'.

The following text **replaces** that under 3.6 Covenants:

Covenants and easements were covered in detail in Unit 3. Both could impact on the value of a property where they are seen to be a hindrance to the owner, or where they imposed a burden on him. For example, the existence of a right of way over a property could reduce its value.

## **SECTION 4 Guarantees and additional security**

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### **Page 73**

Heading '4.1.1 Guarantees is **renamed** 'Guarantees and sureties'.

### **Page 76**

Heading '4.2.1 Other types of security', but **NOT** including any text underneath this heading, is **deleted**.

### **Page 77**

The following text is **added** after the last paragraph under the heading '4.2.1.2 Collateral deposits':

### **Mortgage indemnity guarantee premium**

The mortgage indemnity guarantee (MIG) is payable by the borrower through a single premium. The premium protects the lender against losses caused by the borrower defaulting and the lender having to take possession and sell the property. Although the charge is paid by the borrower, the mortgage indemnity guarantee does not actually benefit him, except that, without it, he would not be able to borrow such a high amount.

Some lenders do not buy an insurance policy but take the charge as a way of offsetting the potential risk.

In recent years, more and more lenders have either dispensed with higher lending charges or paid the mortgage indemnity guarantee themselves.

If a claim is made by a lender on a MIG policy, the insurer will pay out the shortfall, up to the limit insured less an excess, which is usually 20% of the amount claimed. The insurer is entitled to exercise its *right of subrogation*, which means it can sue the borrower for recovery of the amount paid to the lender. The insurer is able to insist that the lender exercises prudent underwriting methods.

**Example**

If a lender sells a property in possession for £120,000 but the total owed by the former borrower is £130,000, then the claim made by the lender on any MIG would be for £10,000, less the £2,000 excess.

The insurer will probably sue the borrower under its right of subrogation for the £8,000 that it has paid to the lender.

*Heading '4.2.2 Fees', but NOT including any text underneath this heading, is **deleted**.*

**Page 78**

*The following text **replaces** the last two bullet points under the heading '4.2.2.1.2 Mortgage fees':*

- ◆ Where the loan-to-value ratio exceeds a certain level, the lender may charge a **higher lending charge** that, in many cases can be added to the loan. The charge threshold varies from lender to lender but is usually between 75% and 90%. The lender may use the higher lending charge to buy a mortgage indemnity guarantee.

### Example

A mortgage applicant is hoping to borrow £72,000 to purchase a property priced at £84,000 but valued at £80,000. The lender requires a higher lending charge if the loan-to-value ratio exceeds 80%.

The higher lending charge threshold is  $£80,000 \times 80\% = £64,000$ .

The amount of the advance to be covered by the charge is therefore:

$$£72,000 - £64,000 = £8,000.$$

If the higher lending charge rate is 4.5%, the premium will be:

$$\frac{£8,000}{100} \times 4.5 = £360$$

- ◆ *The mortgage indemnity guarantee premium* is used by some lenders where the loan-to-value ratio exceeds a stated amount and is paid for by the higher lending charge. It is payable on completion as a single premium and is often added to the loan; it cannot be refunded or taken to another property.
- ◆ The existing lender may charge a small *lender's reference fee*, typically £20–50, to supply the new lender with a reference in relation to the conduct of the existing account.
- ◆ If the borrower uses a mortgage broker to arrange the mortgage, the broker is able to charge a *broker's fee*, which must be stated clearly in the broker's initial disclosure document. The fee is most commonly a fixed charge, although some brokers charge a percentage of the mortgage advance, for example 0.5%, especially for non-standard cases. In addition, the broker may receive a *procurator (finder's) fee* from the lender.

**Page 80**

The figure in bold **replaces** that in the first bullet point under the heading '4.2.2.2 Stamp Duty Land Tax':

- ◆ 1% is levied where the price is more than **£125,000** but no more than £250,000;

**Page 80–82**

The whole of the text and headings from '4.2.2.3 The higher lending charge' until the end of this section, is **deleted**.

## **SECTION 5 From offer of advance to completion**

*The 2006/07 manual features this section relocated and renumbered as Section 4 of Unit 3.*

### **Page 83**

*The following text is **added** after the second paragraph under the heading '5.1 Offer of advance':*

Before we look at details of the offer, we must consider the Mortgage Conduct of Business Rules in relation to this part of the process. The appropriate rules are contained in *MCOB 6*.

### **MCOB 6 – disclosure at the offer stage**

MCOB 6 applies to lenders only, where the offer has been made to a customer with a view to:

- ◆ starting a regulated mortgage contract;
- ◆ varying the terms of an existing mortgage contract by:
  - adding or removing a party;
  - making a further advance;
  - switching some or all of the mortgage to a different interest rate option.

Where MCOB 6 applies, the lender must provide an offer document containing an illustration. The offer must be based on the information contained in the illustration. Most of the requirements apply directly to the lender rather than the adviser but some elements do impact on the adviser, in that best practice suggests he should explain these factors to the customer.

- ◆ The customer will have been given an illustration at the application stage, and the lender's final offer may be different. The illustration contained in the offer document must be adapted to reflect the actual offer the lender is making.

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- ◆ The offer document must contain the statement: ‘You are not bound by the terms of this offer document until you have signed the legal charge.’
- ◆ Where an interest-only mortgage has been selected, the illustration must:
  - clearly state that payments only cover interest and not a repayment of capital;
  - confirm the repayment vehicle that the customer intends to use if the details are known, or a warning that a repayment vehicle should be arranged;
  - remind the customer to check the performance of the repayment vehicle regularly to see if it is likely to repay the capital at the end of the term.
- ◆ The offer document must contain a prominent statement:
  - of the period for which the offer remains valid;
  - explaining that there will not be a right of withdrawal once the mortgage has been completed;
  - explaining that the customer will have a right to repay the mortgage in line with the terms of the contract;
  - explaining the consequences of the customer not entering into the contract – non-refunding of fees etc.

### Page 87

Heading ‘5.1.1 Report on title (also known as Certificate of Title) is **renamed** ‘Report on Title’.

### Page 88

The ‘Look at this...’ heading on this page under the heading ‘5.2 Legal charge, standard security and mortgage conditions’, and the paragraph underneath it starting ‘You should have your own company’s...’, is **deleted**.

## Page 94

The following text is **added** after the last paragraph under the heading '5.2.2.2 Giving advice on the contractual relationship':

### **MCOB 7 – disclosure at the start of the contract**

MCOB 7 covers the disclosure requirements at the start of the contract and after it has started. This section will cover the requirements at the start of the contract. The ongoing requirements for mortgages in place are covered in Unit 6 Section 1.

The lender is required to provide information to the borrower before the first payment is made on a new mortgage. This requirement also applies to variations to the terms of a mortgage and further advances. The lender is required to state:

- ◆ the amount of the first payment;
- ◆ the amount of subsequent payments if they will be different to the first;
- ◆ how the payments will be collected – direct debit, standing order etc;
- ◆ the date of collection of the payments;
- ◆ confirmation of any insurance or investment products that may have been arranged through the firm and whether the payments will be collected with the mortgage or separately;
- ◆ whether the mortgage contracts allows underpayments or overpayments;
- ◆ confirmation of whether the mortgage is interest-only, repayment or a combination;
- ◆ if the mortgage is interest only, a reminder that the customer should check that any repayment vehicle is in place if it has not been provided by the firm;
- ◆ what the customer should do if he falls into arrears and draw attention to the tariff of charges.

## Unit 5

# Mortgage payment methods and products

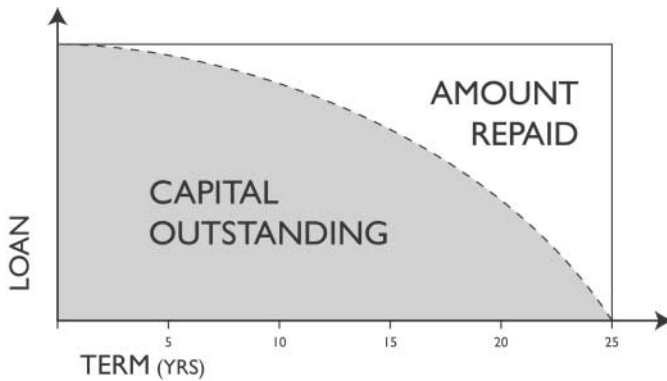
### SECTION I Mortgage repayment methods

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#### Page 3

The following diagram is **added** after the fourth paragraph under the heading '1.1 The capital repayment method':

**Figure 1.1 The capital repayment mortgage**



**Page 4**

The following text and table are **added** after the last paragraph under the heading '1.1.1 Example':

The following table shows the capital outstanding at points in the term of a 25-year £100,000 repayment mortgage. The figures assume interest rates will not change over the term.

**Figure 1.2 Debt reduction table**

Interest rate	Monthly	Capital outstanding at years into term (£)				
		5	10	15	20	22
3%	479	85,400	68,600	49,000	26,300	16,200
5%	591	88,400	73,600	54,800	30,700	19,300
7%	715	90,900	78,200	60,300	35,200	22,500
9%	848	92,900	82,100	65,300	39,600	25,800
11%	990	94,600	85,400	69,900	43,900	29,000

**Page 5**

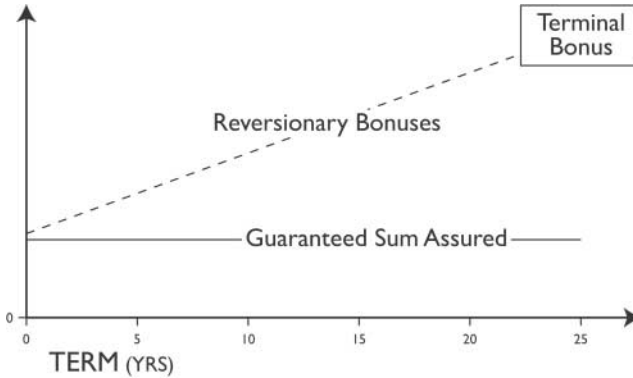
The last two paragraphs (including bullet points) under the heading '1.1.2 Example' are **deleted**.

Heading '1.1.3 Advantages' is **renamed** 'Advantages and disadvantages'.

**Page 10**

The following diagram is **added** after the last paragraph under the heading '1.3.1 With-profit endowment policies':

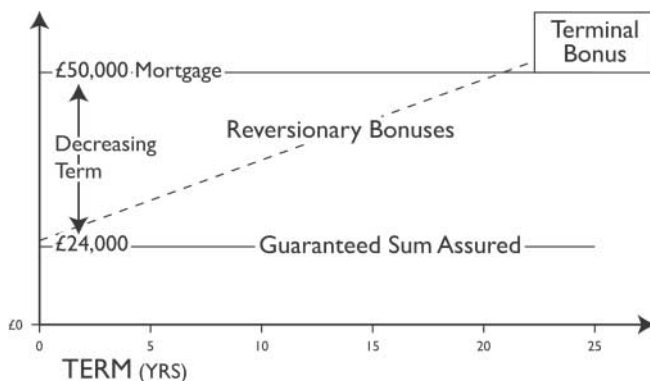
**Figure 1.3 With-profits endowment**



Heading '1.3.1.1 Examples of reversionary bonuses' is **renamed** 'Calculation of reversionary bonuses'.

**Page 13**

The following diagram is **added** after the last paragraph under the heading '1.3.1.3 Low-cost with-profits endowment':

**Figure 1.4 Low-cost with-profits endowment**

Heading '1.3.1.3.2 Advantages' is **renamed** 'Advantages and disadvantages'.

**Page 14**

The following bullet point is **added** after the last bullet point under 1.3.1.3.2 Advantages':

- ◆ no tax is payable on the maturity value.

The following text is **added** after the fifth paragraph under the heading '1.3.2 Unit-linked endowment policies' ie the paragraph starting 'The only guarantee offered...':

A unit-linked policy may include either a level term or decreasing term policy; this decision rests with the policyholder.

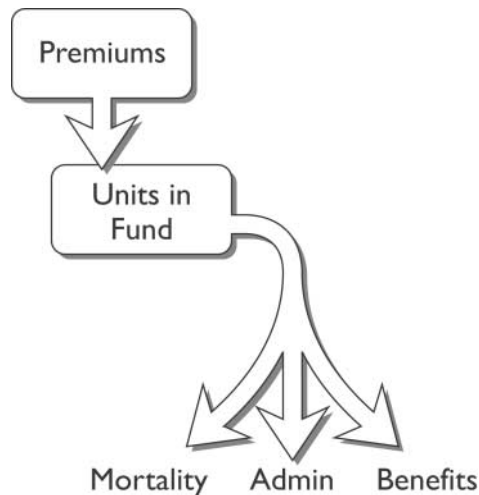
**Page 15**

The following text in bold is **added** to the last sentence in the fifth paragraph under the heading '1.3.2 Unit-linked endowment policies':

Units are deducted from the fund each month to pay for the cost of the life cover (**a mortality charge**), which will always be the difference between the sum assured and the fund value. **A unit linked policy may include either a level term or decreasing term policy; this decision rests with the policy holder.**

The following diagram is **added** after the fifth paragraph under the heading '1.3.2 Unit-linked endowment policies ie the paragraph starting 'The only guarantee offered...':

**Figure 1.5 Unit-linked endowment**



## Page 16

Heading '1.3.2.1 Advantages is **renamed** 'Advantages and disadvantages'.

The following bullet point is **added** after the last bullet point under '1.3.2.1 Advantages':

- ◆ no tax is payable on the maturity value.

## Page 20

The following text is **added** after the last bullet point under the heading '1.3.4 Endowment shortfalls':

## **Unit trusts and open-ended investment companies (OEICs)**

Although relatively uncommon, it is possible to use unit trusts and OEICs as mortgage repayment vehicles. As both these vehicles can be held within an ISA, it is more tax efficient, and more common, for them to be used as part of an ISA repayment 'package'.

### **Unit trusts**

A **unit trust** is a pooled (or collective) investment created under trust deed. The term *pooled* is used because money from a large number of investors is pooled together and then invested. An investor can invest in a unit trust through a lump sum, regular contributions or both.

The unit trust is divided into units, with each unit representing a fraction of the trust's total assets. In simple terms, the value of each unit is the value of all of the trust's assets divided by the number of units issued. A unit trust is *open-ended* in the sense that a manager can, in response to demand, create more units. He is also obliged to buy units back from investors wishing to sell.

The unit trust is set up under a *trust deed*, which means that the assets are separate from the company that runs it. The deed specifies the types of investment the manager can use, the broad principles on which it can operate and whether it pays income or aims for growth: this is referred to as the

*mandate*. For example, a typical Japanese unit trust's deed might specify that at least 85% of the fund must be invested in Japanese shares.

The main role of the unit trust *trustee* is to hold the fund assets on behalf of investors and to ensure that the trust runs in line with its deed.

The role of the *unit trust manager* is to manage the investments, value units and buy and sell units on demand. Most unit trusts are *actively managed*, which means that the manager carries out research on suitable investments and buys and sells investments to achieve the required fund objective.

There are over 2,000 unit trust and OEIC funds available in the UK. The Investment Management Association (IMA) has defined three broad categories.

- ◆ *Income funds* – funds that aim principally to provide income, although many also aim to produce some capital growth in order to provide a growing income;
- ◆ *Growth funds* – funds that aim principally to provide capital growth;
- ◆ *Specialist funds* – funds that do not really fit into the other sectors due to the nature of their underlying investments.

### **Growth (accumulation) unit trusts**

The objective of *growth unit trusts* is capital growth. The underlying investment is in shares and other assets likely to benefit from growth, while not likely to produce significant income. Any income received from underlying assets is automatically reinvested into the fund, thus increasing the value of each unit – hence the term *accumulation*.

### **Income (distribution) unit trusts**

*Distribution unit trusts* have a different investment objective. They are geared to produce a degree of capital growth, but primarily to produce a high level of income (relative to other unit trusts) that is distributed to unit-holders as dividends.

Typically a distribution unit trust's underlying investments will feature high-yielding shares, gilts, bonds and cash.

The individual investor can choose to take the dividends or reinvest them by purchasing new units, as opposed to increasing the value of existing units.

### **Tracker funds**

*Tracker funds* aim to track (match) the performance of a stock market index, eg FTSE100. The manager attempts to buy the shares appearing in the index, in the proportion (weighting) in which they appear.

The fund is not actively managed as such; the manager only needs to make sure the index is replicated in the shares held. This keeps the fund charges down compared to actively managed funds.

### **Prices and charges**

Units are purchased at the *offer price*. An *initial charge* is taken from the units when they are purchased, typically 3–5% of the purchase value. The charge is taken to cover, among other things, the cost of purchasing assets and paying commission to advisers.

Once units have been purchased and the initial charge taken, they are valued at the *bid price*, which is the price at which they can be sold back to the manager. The difference between the bid price and the offer price is known as the *bid-offer spread*.

To give a simplified example, an investor invests £1,000 pounds in a unit trust with a unit offer price of £1 and an initial charge of 5%. Once the initial charge has been taken he will still own 1,000 units, but the bid price will be £0.95, leaving him with a holding worth £950.

Unit trusts are subject to a *fund management charge* – the fee paid for the services of the professional investment manager. The charge will vary but is typically in the region of 0.5% and 1.5% of fund value.

### **Taxation**

Dividends from a unit trust are taxable as non-savings income, depending on the source of the underlying income.

- ◆ *Share based unit trusts* – dividends are paid with a tax credit of 10%. This settles the basic rate tax liability, although lower (10%) rate and non-taxpayers are not able to reclaim the tax credit. Higher rate taxpayers will be required to pay a further 22.5% of the gross dividend. This gives a total tax charge of 32.5% of the gross dividend.

- ◆ *Cash and fixed interest trusts* – where more than 60% of the fund's assets are held in cash or fixed interest securities, the position is different. 20% tax is deducted at source. This settles the basic rate liability, but non-taxpayers can reclaim the tax deducted and lower rate taxpayers can reclaim 10%. Higher rate taxpayers have to pay a further 20%.

Gains made on disposal of a unit trust holding are subject to capital gains tax.

### **Open-ended investment companies (OEIC)**

**OEICs** have been popular in mainland Europe for a number of years and have become increasingly popular in the UK since their introduction in 1997. They share a number of characteristics with unit trusts. The similarity with unit trusts is not surprising, because there is much commonality between the Financial Services Authority's two sets of regulations on OEICs and unit trusts.

OEICs are pooled investments that operate in a similar way to unit trusts. However, their legal status is different – they are set up as *limited companies*. This means that investors buy and sell shares in the OEIC. As with a unit trust, the share price represents the value of the fund assets divided by the number of shares in issue. The OEIC manager is obliged to buy back shares from investors who wish to sell, and is able to create more shares on demand. This makes the OEIC an open-ended fund, in line with unit trusts.

As OEICs are similar to unit trusts, the Investment Management Association (IMA) uses the same categories as for unit trusts. Most investment performance-rating organisations combine unit trusts and OEICs in the same tables.

The *depository* carries out a similar role to the unit trust trustee.

Day-to-day management of the OEIC funds is the responsibility of the *director*.

### **Pricing and charges**

OEIC shares are *single-priced* – which means that the buying and selling prices are the same.

**Initial charge** – OEICs are usually subject to an *initial charge*, usually between 3–6%. However, the charge is taken directly from the investor's capital rather than through an adjustment in the share price.

To give a simplified example, an investor invests £1,000 in an OEIC with a share price of £1 and an initial charge of 5%. He will actually receive 950 shares valued at £1 each, giving him a holding worth £950.

An OEIC is subject to a *fund management charge* – the fee paid for the services of the professional investment manager. The charge will vary but is typically in the region of 0.5% and 1.5% of fund value.

### **Taxation**

Dividends from an OEIC are taxable as non-savings income, depending on the source of the underlying income.

- ◆ Share-based OEICs – dividends are paid with a tax credit of 10%. This settles the basic rate tax liability, although lower (10%) rate and non-taxpayers are not able to reclaim the tax credit. Higher rate taxpayers will be required to pay a further 22.5% of the gross dividend. This gives a total tax charge of 32.5% of the gross dividend.
- ◆ Cash and fixed-interest OEICs – where more than 60% of the fund's assets are held in cash or fixed-interest securities, the position is different. 20% tax is deducted at source. This settles the basic rate liability, but non-taxpayers can reclaim the tax deducted and lower rate taxpayers can reclaim 10%. Higher rate taxpayers have to pay a further 20%.

Gains made on disposal of an OEIC holding are subject to capital gains tax.

### **Advantages and disadvantages**

The advantages of unit trusts and OEICs are that:

- ◆ they are flexible investment products; there is no contractual term, which means contributions can be varied and made either regularly or infrequently, and with no penalties for early closure or encashment;
- ◆ they offer a wide choice of funds and investment types;
- ◆ charges are generally lower than those of endowments;
- ◆ they offer the potential for capital growth over the medium to long term.

The disadvantages of unit trusts and OEICs are that:

- ◆ no guarantee is given that the fund will be sufficient to fully repay the mortgage at the end of the term;
- ◆ no life cover is included – this must be arranged separately, usually as level term assurance.

The following text is **added** to the end of the first paragraph under the heading '1.3.5 Individual savings accounts (ISAs)':

Essentially, an ISA is another, well established investment product in a tax-free wrapper. It is important to realise that the underlying investment risk depends on the underlying product and fund.

## Pages 23 & 24

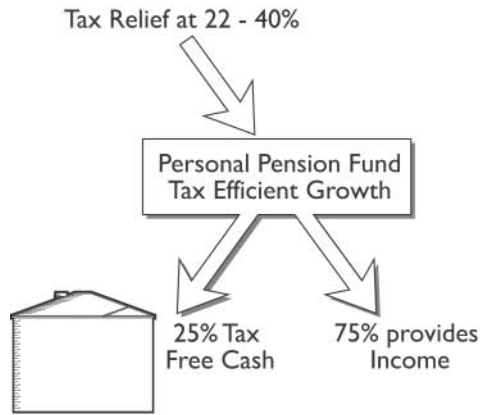
The following text **replaces** the third paragraph (including bullet points) under the heading '1.3.6 Personal pension plans':

Pension simplification brought in a new set of rules from 6 April 2006. In summary, the rules are:

- ◆ it is now possible to contribute any amount to a pension. However, tax relief is only available up to specified limits as shown below;
- ◆ individual annual contributions are limited to the greater of £3,600 or the individual's earned income for the year. There is an overall maximum contribution, referred to as the *annual allowance*, which is £215,000 for the 2006/07 tax year. The allowance will increase each year. Some examples:
  - James earns £45,000 a year from his job in marketing. He will be able to pay £45,000 a year into a pension and receive tax relief on his contributions;
  - Jane earns £350,000 as a successful lawyer. She will only be able to pay in £215,000 a year and receive tax relief on her contributions, because the annual allowance will apply;
  - Judy does not work. She would be able to pay in £3,600 a year and receive tax relief on her contributions.

- ◆ there is a *lifetime allowance* – a maximum amount that can be held in pension funds by an individual. For 2006/07 the allowance is £1.5 million; again, the allowance will be increased each year. If the fund exceeds the lifetime allowance on taking the benefits, the amount over the allowance will be taxed at 55% if it is taken as a lump sum, or 25% if it is used to provide an income;
- ◆ benefits can be taken at any time from the age of 50 to the 75th birthday. It is not necessary to retire in order to take the benefits. The minimum age increases to 55 in 2010;
- ◆ up to 25% of all pension funds can be taken as a tax-free lump sum, with the balance used to provide an income. With a pension mortgage the tax-free cash is used to repay the mortgage. This means that the projected fund must be at least four times the mortgage amount;
- ◆ eligible contributions qualify for income tax relief at the individual's highest marginal rate;
- ◆ contributions are paid net of basic rate tax, regardless of the individual's employment or tax status. This means a gross contribution of £100 will require an actual payment of £78. Employers can contribute to an employee's personal pension but will pay gross contributions and claim the payment as a business expense. Higher rate taxpayers can claim an additional 18% through self-assessment;
- ◆ as an alternative to buying an annuity, it is possible to take income directly from the fund, although this may be too risky for the majority of people, as the fund will remain invested and subject to market performance. Income received will be taxed as non-savings income through the PAYE system;
- ◆ personal pensions belong to the individual and cannot be assigned to a lender; neither can they be arranged in joint names.
- ◆ if an employer contributes to an employee's pension, the maximum combined contribution is equal to the annual allowance of £215,000, with the employee's contribution limited, as above.

**Figure 1.6 The pension mortgage**



**Page 25**

The following text in bold is **added** to the last two bullet points under '1.3.6.2 Disadvantages':

- ◆ benefits are not available until age 50 (**55 from 2010**). This may result in a term longer than 25 years for younger borrowers;
- ◆ annuity rates for those under 60 are low, which means it may not be prudent to **buy an annuity until** then. This may result in a long-term mortgage.

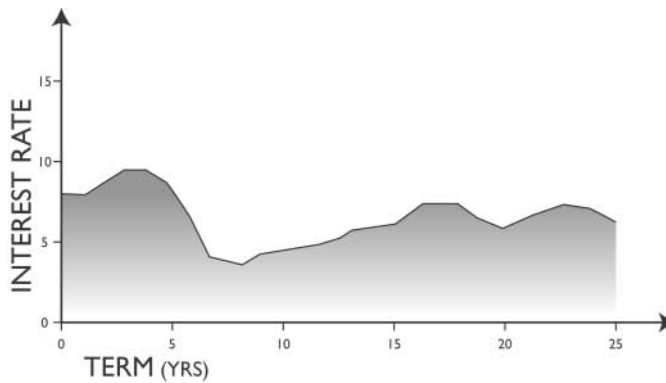
## SECTION 2 Mortgage products and schemes

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### Page 29

The following diagram is **added** after the second paragraph under the heading '2.1.1 The standard variable rate mortgage':

**Figure 2.1** The variable rate mortgage



The following text is **added** after the last paragraph under the heading '2.1.1 The standard variable rate mortgage':

The Bank of England base rate is reviewed by the Monetary Policy Committee of the Bank on a monthly basis.

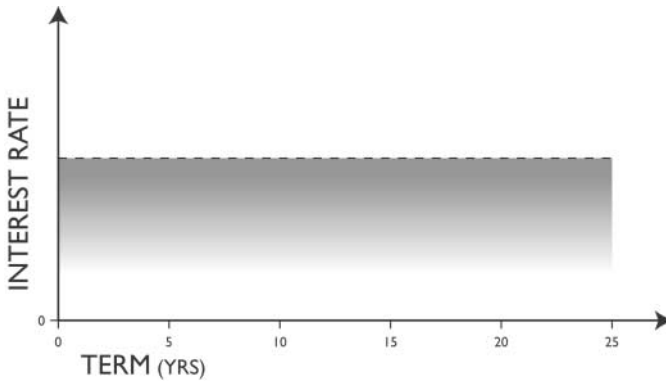
**Page 30**

The following text is **added** before the first paragraph under the heading '2.1.2 The fixed-rate mortgage':

A **fixed-rate mortgage** does exactly what it says on the label; the rate of interest, and so the payment, is fixed for an agreed period, typically from one to five years, although even longer terms are becoming more common.

The following diagram is **added** after the second paragraph under the heading '2.1.2 The fixed-rate mortgage':

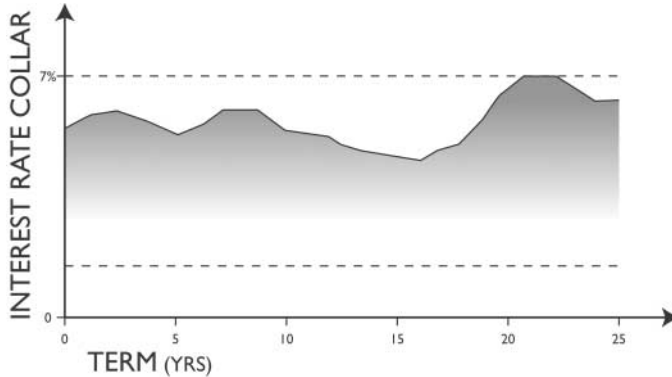
**Figure 2.2 The fixed-rate mortgage**



**Page 33**

The following diagram is **added** after the second bullet point under the heading '2.1.4 The capped-rate mortgage':

**Figure 2.3 The capped-rate mortgage**



The following text is **added** at the end of the first paragraph under the heading '2.1.5 The Base Rate tracker mortgage':

The BOEBR is reviewed and set by the Monetary Policy Committee every month.

**Page 36**

The following text is **added** at the end of the fifth paragraph under the heading '2.1.8 The flexible mortgage' ie the paragraph starting 'The lender will set a limit...':

Typical lending limits will not usually exceed 75% LTV.

**Page 39**

The following text is **added** after the last paragraph under the heading '2.1.9 The foreign currency mortgage':

## **Sub-prime and non-status mortgages**

### **Sub-prime mortgages**

As well as more generalist providers, the mortgage market is home to a number of specialist businesses that have made a niche in lending to, or arranging loans for, people who might not fit neatly into standard lending criteria.

The mortgages offered by *sub-prime* lenders reflect the risk taken and interest rates are usually higher than those applying to conventional mortgages. The borrower will also have a more limited range of options to choose from, although choice is improving.

As lenders develop more expertise in underwriting **sub-prime mortgages**, the products have evolved, to the extent that it is now possible to select from a range of products similar in structure to those in the general market. So, for example, it is now possible to arrange sub-prime mortgages on a variable, tracker, fixed, capped or discount basis. The essential difference lies in the rate charged and the underwriting process. It is even possible for borrowers with extreme credit problems to arrange a sub-prime mortgage – at a price.

The essential features that differentiate sub-prime mortgages from the mainstream are:

- ◆ previous bad credit can be accommodated. On occasion, those within weeks of repossession have been able to arrange remortgages;
- ◆ arrangement fees tend to be higher than those for equivalent prime products;
- ◆ interest rates are higher than those for prime borrowers. Many lenders set the interest rates in broad bands depending on the credit history of the borrowers: the rate might be 1–2% higher than the prime rate, for those with one or two county court judgments (CCJs), and 2–3% higher for those with more against them. It is not unknown for fixed rates as high as 11% to be offered to those with severe problems;

- ◆ some lenders will include certain state benefits as part of assessable income;
- ◆ early repayment charges can be considerably higher than on conventional mortgages, and overhanging penalties are not unusual;
- ◆ maximum loan-to-value ratios may also be lower.

### **Non-status (or self-certified) mortgages**

The **self-certification mortgage** is designed for those who have difficulty producing evidence of income. In principle, the applicant states their true income but the lender does not seek validation, allowing the mortgage to be underwritten on the basis of the income declared. This has led to some applicants exaggerating, or even falsifying, their income in an attempt to obtain a higher mortgage, working on the basis that low interest rates will cushion the impact of higher borrowing.

Many self-certification products have been withdrawn from the market following evidence of relatively large scale 'cheating', often encouraged by lenders and intermediaries, and the scandal that followed. It should be remembered that overstating income is fraud, even if the lender will not seek to verify the figures given. In general, the products available are similar to those in the general market, although arrangement fees and the interest rate charged will usually be higher. In many cases, the loan-to-value ratio before additional security is required, will also be lower.

### **Page 42**

*Heading 'Self(new)-build mortgages' is **renamed** 'Self-build mortgages'.*

*The following text **replaces** the four paragraphs under the heading '2.1.13 Self(new)-build mortgages':*

Some potential homeowners feel that building a home to their own design and specifications is a better option than buying from a developer or on the general market. This option can result in significant cost savings when compared to the traditional route but can pose problems, in particular relating to finance, although the situation has improved over recent years. Self-builders can either build from traditional materials or use modern timber-framed technology, which is both flexible and speedy in comparison.

A number of lenders provide finance for such people, generically termed 'self-build' mortgages. The self-build mortgage allows the borrower to purchase the land and finance the building as well. Once the land has been purchased, the self-builder will need finance in stages, to pay for each phase of the building project.

Until relatively recently, lenders advanced finance as each phase was completed, usually limiting the lending to 75% of the land costs and 75% of the build costs. This left the self-builder with cash flow challenges as each phase was built, sometimes requiring expensive short-term borrowing to keep the work on track. Modern self-build mortgages are more flexible, and provide advance funding for each phase. Lenders vary in their attitude and approach to underwriting, but it is now possible to obtain self-build finance for up to 95% of the land costs, 95% of the cost of a timber-framed house kit and 95% of the build costs. In addition, most self-build lenders allow the borrower access to all or most of the normal products – variable, fixed and so on.

## Page 46

The following text is **added** after the last paragraph under the heading '2.3.1 Equity share schemes':

### 2.3.1.1 The Homebuy scheme

As a result of concern over housing affordability for those unable to afford their own home, the government developed the *Homebuy scheme*, which started in April 2006. The target is to help 100,000 households to own their own property by 2010, 20,000 of whom will be helped through an agreement between the government and three major lenders announced in December 2005.

The scheme is targeted at three groups:

- ◆ *social tenants and those on the housing register, waiting for accommodation;*
- ◆ *key workers – those in the public sector in health, education and public safety; such as teachers, nurses and police officers;*
- ◆ *first-time buyers – those who cannot afford their own home and have been identified as eligible for the scheme and have been prioritised for assistance in the region by the Regional Housing Board.*

The Homebuy scheme is based on the principle of equity share and there are three types of Homebuy product.

### **2.3.1.1.1 Social Homebuy**

The **Social Homebuy scheme** is available to those 'social' tenants who do not have the right to buy or who cannot afford to exercise their right to buy. To qualify, the applicant must be in rented accommodation provided by a registered social landlord or local authority, or on an official waiting list and nominated by the local authority as being in need. Those on a temporary tenancy do not qualify and the social landlord can decline an application if it feels the tenant could afford to buy without help. From the landlord's perspective, the scheme is voluntary; it does not have to be offered to tenants.

Tenants will be able to buy a share in the equity of their local authority or housing association property, with a discount on the purchase price. In order to encourage landlords to participate, the government will meet the cost of the discount offered.

The tenant is able to purchase a minimum initial share of 25%, with the landlord holding the remaining equity. The landlord can charge up to 3% per annum of the retained equity. When the new owner sells the property, the landlord will be entitled to its share of the equity.

### **2.3.1.1.2 New Build Homebuy**

The **New Build Homebuy scheme** is designed to allow the buyer to acquire a minimum of 25% of the equity in a new property built with public subsidy. The remaining equity will be held by the provider, who is able to charge up to 3% of the remaining equity each year.

The **first-time buyer initiative** is a variant of the New Build scheme, through first-time buyers will be able to buy property built on land owned in the public sector at less than the full market price. 50% of these houses will be available to key public sector workers, with the remainder available to other first-time buyers identified as a priority for assistance by the regional housing boards.

### **2.3.1.1.3 Open Market Homebuy**

The **Open Market Homebuy scheme** allows a buyer to purchase an equity share of up to 75% in a property sold on the open market. The balance of the purchase price will be covered by a loan from a housing provider on an equity share basis. The maximum loan for the equity share is £50,000; certain teachers in London, identified as future leaders, will be able to receive up to £100,000. From October 2006, a number of lenders will provide equity loans in a two-year pilot scheme; the loan will be split between the lender and the government.

### **2.3.1.1.4 Homebuy rules**

In all of the above cases, buyers will be able to buy further portions of the property, with a minimum of 10% bought each time (based on the property value at the time), until they own the whole property: this is known as *staircasing*. In exceptional circumstances the buyer may be able to sell a portion back to the provider.

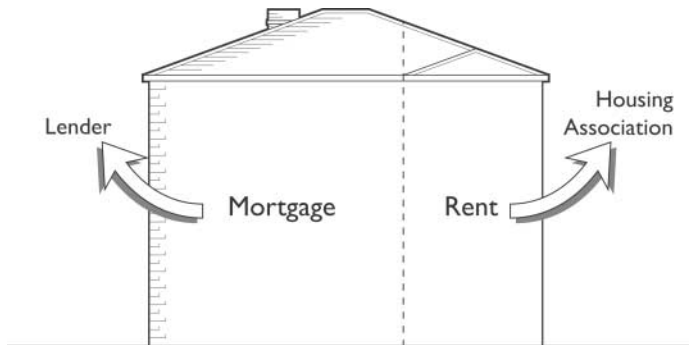
On selling the property, the owner will receive a share of the proceeds in proportion to the equity he owns: if the property is worth £150,000 and he owns 75%, the owner will receive £112,500 and the provider/landlord will keep £37,500. The provider may retain the right to buy back the property or to sell it to a prospective buyer from a waiting list. If this is not the case, the property can be sold on the open market. The new buyer will buy a share of the property, with the provider retaining the balance.

Any money received by a housing provider on resale of the property must be put back into the scheme to provide more housing.

## Page 47

The following diagram is **added** after the last paragraph under the heading '2.3.2 Shared ownership schemes':

**Figure 2.4 Shared ownership**



## Page 48

Heading '2.3.4.2 Maximum discounts' is **renamed** 'Discounts'.

## Page 50

Heading '2.3.5 Buy-to-let schemes' is **renamed** 'Buy-to-let mortgages'.

Heading '2.4 Arrangements for the elderly' is **renamed** 'Lifetime mortgages'.

**Page 52**

Heading '2.4.1 The schemes available, but NOT including any text underneath this heading, is **deleted**.

The following text is **added** before the first paragraph under the heading '2.4.1.1.1 Home income plans':

The term **home income plan (HIP)** is a misnomer: such a plan does not have to provide income at all.

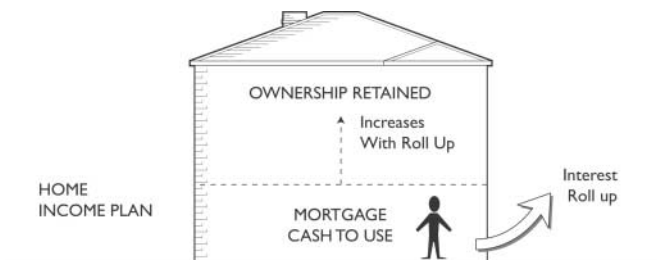
**Page 53**

The following text is **added** to the end of the fifth paragraph under the heading '2.4.1.1.1 Home income plans', ie the paragraph starting 'People who found themselves...':

A number of court cases resulted in some lenders paying compensation to borrowers for selling an unsuitable product.

The following diagram is **added** after the sixth paragraph under the heading '2.4.1.1.1 Home income plans', ie after the paragraph starting 'On the vast majority of modern HIPs,...':

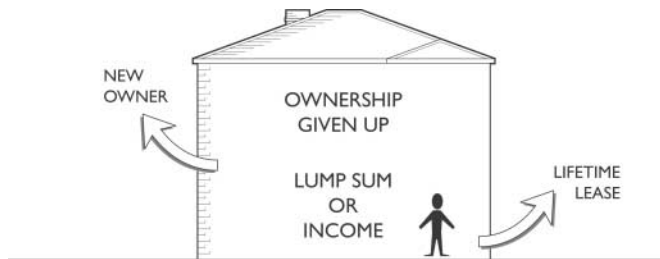
**Figure 2.5 Home income plans**



## Page 54

The following diagram is **added** after the first paragraph under the heading '2.4.1.2.1 Home reversion schemes':

**Figure 2.6 Home reversion schemes**



## Pages 55–58

The text under, and including, the headings '2.5 Business customers', '2.5.1 Business partnerships', '2.5.2 Corporate borrowers' and '2.5.3 Commercial borrowers' is **deleted**.

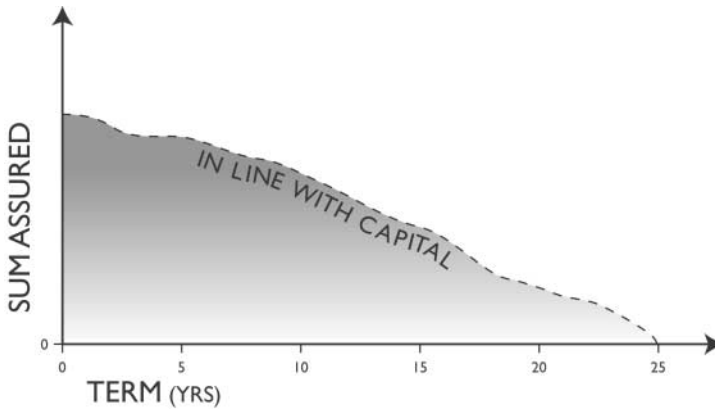
## SECTION 3 Other mortgage-related products

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### Page 65

The following diagram is **added** after the first paragraph under the heading '3.2.1 Decreasing term assurance':

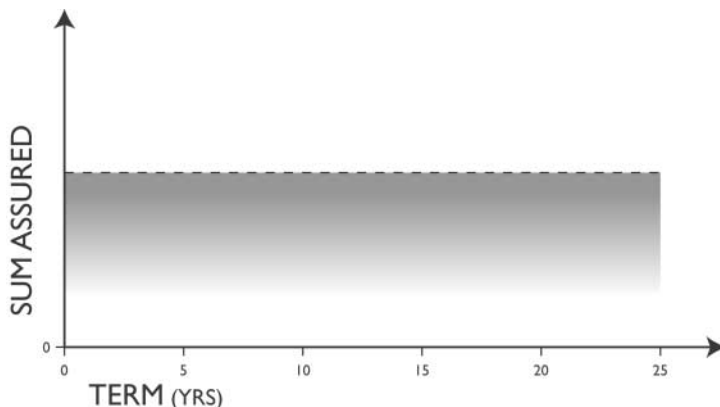
**Figure 3.1 Decreasing term assurance**



**Page 66**

The following diagram is **added** after the first paragraph under the heading '3.2.2 Level term assurance':

**Figure 3.2 Level term assurance**

**Page 67**

The following text **replaces** that under the heading '3.2.4 Personal pension term assurance':

It is possible to arrange single-life level term assurance within a personal pension arrangement – known as *personal pension term assurance (PPTA)*. This will allow the plan-holder to benefit from income tax relief on premiums, in the same way as on pension contributions, and can offer a tax-efficient way of protecting a mortgage. From 6 April 2006 the amount of PPTA that can be purchased is not subject to strict limits as before.

There are three factors to consider:

- ◆ in the event of the plan-holder dying, the value of the pension fund and any pension-related life assurance will be added together. Any excess over the lifetime allowance (£1.5 million for 2006/07) will be subject to a tax charge of 55%, unless it is used to buy dependants' pensions. In the

vast majority of cases, this means that pension life assurance can be arranged to cover a mortgage, with the entire premium benefiting from tax relief;

- ◆ the combined total of pension and pension life assurance premiums that will qualify for tax relief cannot exceed the greater of £3,600 or the individual's earned income, subject to a maximum contribution equal to the annual allowance – £215,000 for 2006/07;
- ◆ the pension term assurance cannot go past the holder's 75th birthday, and cannot be assigned to a lender.

## Page 72

The following text **replaces** that under the heading '3.3.6 Mortgage indemnity insurance':

Not all lenders take out **mortgage indemnity insurance (MIG)**. Where they do, the threshold varies between lenders but is usually between 75% and 90%.

The policy is regarded as additional security because it protects the lender in the event of a property being taken into possession and sold for less than the outstanding debt. Although the premium is usually paid by the borrower, the policy does not actually benefit him, except that without it he will be unlikely to be able to borrow a high proportion of the value of the property.

Under the Mortgage Conduct of Business (MCOB) rules the premium for a MIG policy must be explained and described to applicants as a **higher lending charge**, **not** simply as a MIG premium.

## Pages 72 & 73

The text under, and including, the heading 'Calculation of a higher lending charge' is **deleted**.

## Unit 6

# Mortgage arrears and post-completion

### **SECTION I Further advances and remortgaging**

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#### Page 3

The following text is **added** before the heading '1.1 Further advances':

#### **Mortgage Conduct of Business rules**

---

Before looking in detail at further advances, remortgaging and other matters, it is important to consider the requirements of the Mortgage Conduct of Business rules once a mortgage is in place. The rules are contained in MCOB 7. In brief, the requirements are as follows.

- ◆ The lender must send an annual statement to the borrower, covering the mortgage and any tied products purchased.
- ◆ The annual statement must contain:
  - a statement of whether the mortgage is interest-only, repayment or a combination;
  - on an interest-only mortgage, whether the payment includes the premiums on a repayment vehicle and the need to check its performance. Where payments do not include the costs of a repayment vehicle, the firm should give a prominent reminder that the customer should have arrangements in place to repay the mortgage, and that they should check their performance;
  - details (since the last statement) of payments made (date and amount); the amount due each time; the rates of interest charged; the amount of interest charged; any other amounts of fees paid;
  - a reminder for the borrower to contact the lender if he is having problems making the mortgage payments;
  - the amount owed on the statement date;
  - the remaining mortgage term;
  - the date on which any early repayment charges cease to apply;
  - a revised tariff of charges where they have changed.

## Further advances

Before the customer submits an application for a further advance, the lender must supply an *illustration* as required for a new mortgage as described in Unit 4 (MCOB 5 – see Unit 4). The illustration must be based on the amount of the further advance only, and must show the total amount of borrowing and the new total payment.

## Adding or removing a party to the mortgage

Where the removal of a party is due to death, the lender does not have to provide a new illustration. In all other cases of removal or addition of a new party, the lender must provide the new or remaining party with the illustration as required for a new mortgage (MCOB 5)

## Changes to the monthly payment

Where the monthly payment will change as a result of a customer request, capitalising arrears or the end of a special 'deal', the lender is required to provide the borrower with the following before the change takes effect:

- ◆ the amount outstanding at that point;
- ◆ the new payment due and the date it will start;
- ◆ the new interest rate to be charged and the date it will start;
- ◆ the details of any charges for making the change;
- ◆ if the loan is changed from repayment to interest-only, a reminder of the need to make arrangements to repay the capital at the end of the term..

*The following text in bold is **added** to the end of the first paragraph under the heading 1.1 Further advances':*

...loan to an existing borrower **usually over the remaining term of the existing loan.**

## Pages 4 & 5

The following text **replaces** that under the heading '1.1.2 Determining purpose':

Consumer credit legislation requires lenders to determine the purpose of any loan in order to ascertain whether it is regulated by the Consumer Credit Act or any proposed amendments to the Act. Details of the legislation were given in Unit 3; from the lender's perspective the loan will be regulated unless it is exempt. For a loan to be exempt, the following requirements must be met:

- ◆ the loan must be for the purchase, improvement, enlargement, alteration or repair of a main dwelling house; and
- ◆ in the case of a further advance, the original loan must be with the same lender.

The Act only affects loans to personal borrowers. Most residential mortgages are exempt from the provisions of the Consumer Credit Act 1974 but beware of the exceptions.

## Page 5

The following text is **added** directly under the heading '1.1.3 Assessment of status':

In assessing the status of an applicant for a further advance, the lender will look at the same areas that are critical to a mortgage application.

Heading '1.1.3.3 Circumstances' is **renamed** 'Family circumstances'.

## Page 6

The following text is **added** to the end of the second paragraph under the heading '1.1.3.3 Circumstances':

This would also apply to children who are 17 or over when the further advance is made and intend to live in the property as their main home.

## Page 6

The following text is **added** to the end of the paragraph under the heading '1.1.3.4 Conduct of existing account':

Where the borrower had problems in the past but has since maintained the account in a satisfactory manner for a number of years, it is unlikely to influence the lender's decision if all other factors are satisfactory.

The following text is **added** directly under the heading '1.1.4 Assessment of security':

When considering a further advance, the lender will need to reassess the security on which it will be based.

## Page 7

The following text is **added** to the end of the paragraph under the heading '1.1.4.2 Loan required':

The lender will also wish to ensure that total new borrowing will be in line with its standard income multipliers.

## Page 8

The 'Think about this...' heading on this page under '1.1.4.4 Purpose of the loan', including the paragraph underneath it starting 'Most home improvements...', is **deleted**.

## Page 9

The 'Think about this...' heading on this page under '1.1.6.2 Postponement of second charges', including the paragraph underneath it starting 'A puisne mortgage...', is **deleted**.

Heading '1.1.6.3 England and Wales', but NOT including any text underneath this heading, is **deleted**.

## Page 10

Heading '1.1.6.4 Scotland', but NOT including any text underneath this heading, is **deleted**.

## Page 11

The 'Think about this...' heading on this page under 1.1.6.5 The higher lending charge', including the three paragraphs and bullet list underneath this heading, is **deleted**.

## Pages 12 & 13

The following text **replaces** the second to fifth paragraphs (including bullet points) under the heading '1.1.6.6 Planning permission':

If changes are made, it is unlikely that the local authority would grant retrospective planning consent, leaving both lender and borrower in a potentially disastrous position.

## Page 13

The following text **replaces** all that cited under the heading '1.1.6.7 Listed buildings':

Listed building consent is required where the owner wants to demolish a listed building or change or extend it in a way that would affect its character as a building of special architectural or historical interest (as explained in Unit 3). Such work is covered by statutory legislation – primarily the Listed Building and Conservation Area Act 1990. As with planning consent, any changes made without listed building consent may result in the local authority requiring reinstatement to the previous position.

## Pages 15–17

The text from the third paragraph under the heading ‘1.1.7 Remortgaging’ up to and including the heading and text underneath ‘1.1.7.1 Issues facing the borrower’, is **deleted**.

The following text is **added** after the last paragraph under the heading ‘1.1.7 Remortgaging’:

### **Second mortgage (or second charges)**

---

A **second mortgage** is one secured on the same property by a lender other than the first mortgagee. Second mortgages are offered by some banks and virtually all finance houses. By contrast, building societies tend not to offer these unless they already hold the first charge.

Although the second charge is secured on the property, it ranks after prior charges. This means that the lender is taking a higher level of risk than with a conventional mortgage, and will charge a higher rate of interest to reflect that risk. An example of where a second mortgage might be advantageous is shown below:

#### Example

Jazad and Marie have a property valued at £200,000 and a mortgage of £145,000. They wish to borrow a further £20,000 to build a conservatory. Their existing lender applies a higher lending charge on loans over 75% LTV. This means a higher lending charge on £15,000 of the loan.

Taking a second mortgage might incur a higher interest rate but they will avoid the higher lending charge, which might work out as a better deal for them.

If another lender is approached for additional finance, a questionnaire will be received by the existing lender making enquiries about the conduct of the account and details of the mortgage. In applying for the second mortgage, the

applicant will have given consent for this information to be released. A lender is not obliged to supply information to the second lender and a fee is normally charged for supplying the information.

If the second mortgage is granted, the second lender will notify the first mortgagee and will create a charge on the property.

Sometimes, if the conduct of the loan deteriorates significantly, first and second mortgagees will co-operate on litigation for recovery.

The existence of a second charge can be an early warning sign of problems, especially if the borrower has already been turned down for a further advance by the first lender. In particular, finance houses tend to charge higher rates of interest, commensurate with higher risk, indicating that the borrower may be more than anxious to secure a lump sum urgently. Alternatively, the borrower may be capable of taking on the extra debt without the risk of inability to service both loans.

If a mortgage is in default, the lender will eventually proceed to possession and exercise its power of sale to recover the debt. The holder of the first charge (the *original lender*) takes what is legally due to it from the proceeds then passes the balance of the sale money (if any) to the second mortgagee (the *second lender*), who takes what is due to it. When all lenders have been satisfied, the balance, if any, is passed to the borrower.

There might even be third, fourth and even subsequent mortgagees, all with loans secured on the same property.

## **Bridging finance**

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**Bridging finance** may be required when a borrower moves house and the date of disposal of the existing property falls after the date of acquisition of the new one.

There are two types of bridging finance:

- ◆ *open bridging* arises when a borrower seeks to take out a new mortgage without having obtained a buyer for the existing mortgaged property – this can represent a high risk because there is no guarantee that the latter will be sold within a reasonable period of time, and borrowers should be advised to think very seriously before committing to this arrangement;

- ◆ *closed bridging* arises when the person buying already has a firm buyer for the existing property – this is less risky.

Bridging finance is offered by all banks and some of the very largest building societies. For obvious reasons, lenders are much more prepared to lend in closed bridging situations than open bridging ones.

## **Advantages and disadvantages of bridging**

There are few advantages of open bridging, other than enabling the borrower to complete the purchase of the new property more quickly than would otherwise be possible. It can impose a heavy financial burden on the borrower for quite a long period of time, particularly if he has an inflated view of the value of the property that is on the market.

Closed bridging, however, provides a valuable service:

- ◆ it enables a purchase to go ahead that otherwise might break down as a result of the purchase/selling chain being irrevocably disrupted;
- ◆ it can usually be obtained at a reasonable rate – and if the borrower sets aside funds during the bridging period, there should be no problems.

There are a few significant disadvantages, even with closed bridging:

- ◆ bridging is yet another cost at a time when the borrower is already incurring many other outgoings;
- ◆ arranging a bridging loan requires yet another negotiation with the bank manager, involving time and expense;
- ◆ many borrowers believe that they pay 'over the odds' for bridging finance, particularly when the need for such funds is underestimated.

The practice of many developers in taking properties in part exchange has reduced the need for bridging finance to some extent.

## **SECTION 2 Arrears, debt management and recovery**

### **Page 19**

The following text is **added** before the heading '2.1 Arrears awareness':

### **Mortgage Conduct of Business Rules**

Before looking at the detailed process firms undertake in relation to arrears, it is important to consider the FSA requirements, as set out in MCOB 13.

#### **Principles**

MCOB 13 requires that a borrower who has arrears or a mortgage debt shortfall must be dealt with fairly by the lender. The lender is required to put in place written policy and operational procedures for dealing with such cases.

The procedures should include:

- ◆ using reasonable efforts to reach agreement with the customer over the method of repaying the arrears or shortfall;
- ◆ liaising with a third-party source of advice regarding the arrears or shortfall;
- ◆ adopting a reasonable approach to the time over which the arrears or shortfall should be repaid, taking into account the borrower's circumstances;
- ◆ allowing the borrower to change the mortgage payment date or repayment method, unless it has good reason not to do so;
- ◆ where no reasonable payment arrangement can be made, considering allowing the borrower to remain in the property until a sale is made;
- ◆ taking possession of the property only when all other reasonable attempts at resolution have failed.

The FSA considers that a 'reasonable period' for repayment of arrears or shortfall will depend on the borrower's circumstances. In some cases, this can mean spreading the payments over the remaining mortgage term.

The lender must keep records of its dealings with borrowers who are in arrears or have a shortfall debt. The record must be kept for a year from when the borrower cleared the arrears or debt.

## **Information**

Under MCOB 13, the lender must write to the borrower within 15 business days of becoming aware that the account is in arrears. The letter must contain:

- ◆ the current FSA information sheet on mortgage arrears;
- ◆ a list of due payments either missed or partly paid;
- ◆ the total of the arrears;
- ◆ the charges incurred as a result of the arrears;
- ◆ the total outstanding debt, excluding charges that may be made on redemption;
- ◆ the nature and level of charges that will be incurred unless the arrears are cleared.

## **Procedure before taking possession**

Before taking action for possession, the lender must:

- ◆ provide a written update of the information (see above);
- ◆ ensure the borrower is informed of the need to contact the local authority to establish his eligibility for rehousing after repossession;
- ◆ clearly state the possession procedure.

## **Pressure**

The lender must not put pressure on the borrower through excessive telephone calls or correspondence, or by contact at an unreasonable hour. A reasonable hour is generally considered to be between 8am and 9pm, but taking into account the borrower's work patterns and religious faith.

## **Marketing a repossessed property**

Once a property has been taken into possession, the lender must take steps to:

- ◆ market the property for sale as soon as possible;
- ◆ obtain the best price that might be reasonably paid, taking into account market conditions and the increasing debt.

If the proceeds of the sale are less than the debt, the lender must advise the customer as soon as possible after sale of:

- ◆ the mortgage shortfall;
- ◆ whether another firm – mortgage indemnity insurer, etc – may pursue the debt.

Where a lender decides to recover any shortfall, it must notify the borrower of this intention within six years of sale. If the proceeds of the sale are more than the debt, the lender must take reasonable steps to inform the borrower and pay the surplus to him, subject to the rights of any subsequent mortgagees.

*Heading '2.1.1 Assistance to borrowers in arrears by the lender' is **renamed** 'Lender assistance to borrowers in arrears'.*

*The following text is **added** directly after the original heading '2.1.1 Assistance to borrowers in arrears by the lender':*

Lenders should always encourage borrowers to contact them as early as possible in cases of difficulty.

*The following text is **added** after the last paragraph under the original heading '2.1.1 Assistance to borrowers in arrears by the lender':*

If it appears that the arrears situation can be retrieved, the lender has many options. The decision will also be influenced by the lender's perception of the risk posed. For example, where the current loan-to-value is relatively low, the lender's security is under less threat; it may be prepared to consider a wider range of options.

## Pages 19 & 20

The text under, and including, the heading '2.1.1.1 Warning' is **deleted**.

## Page 20

The following text in bold **replaces** that in the last sentence of the fourth paragraph within heading '2.1.1.2 Payment of arrears over a given period':

Some lenders have **budget factfind** aids for use by debt counsellors:...

## Page 21

Heading '2.1.1.4 Accept interest only' is **renamed** 'Accepting interest-only payments'.

## Page 22

The following text **replaces** the fourth paragraph under the heading '2.1.1.5 Extend the term':

With-profits endowment mortgages cannot usually have their term extended because they mature on a particular date. Other repayment vehicles, like unit-linked endowments and ISAs, are more flexible and more likely to allow the holder to increase payments or increase the term.

## Page 24

Heading '2.1.2.1 Income Support – mortgage interest (ISMI)' is **renamed** 'ISMI rules'.

The 'Think about this...' heading on this page under the original heading '2.1.2.1 Income Support – mortgage interest (ISMI)', including the paragraph underneath it starting 'Government support for those in difficulty...', is **deleted**.

## Page 25

The seventh bullet point under the original heading '2.1.2.1 Income Support – mortgage interest (ISMI)' is **deleted**.

## Page 26

The following text is **added** after the last bullet point under the original heading '2.1.2.1 Income Support – mortgage interest (ISMI)':

### **The 52-week linking rule**

A borrower who has already served the waiting period and then ceases to claim benefit for up to 52 weeks will not have to serve a further waiting period at the start of the second claim. This means that those who claim the benefit will be able to take up offers of short-term or seasonal work without losing their entitlement to mortgage interest payments.

The regulations represent an attempt by the government to reduce the public spending budget on Income Support. The measures were heavily criticised by many mortgage lenders as ones that will cause considerable hardship, particularly to borrowers who run into financial difficulties very quickly after becoming unemployed.

## Page 27

The 'Think about this...' heading on this page under the heading '2.1.4 Mortgage rescue schemes', including the paragraph underneath it starting 'Mortgage rescue schemes are...', is **deleted**.

## Page 28

The following text is **added** after the third paragraph under the heading '2.1.5 Mortgages and debt consolidation':

One way to control such consolidation is to arrange a mortgage with a drawdown facility. This allows further funds to be withdrawn to pay debts, but no interest is charged until the funds are taken.

## Page 29

The following bullet point is **added** before the last bullet point under the heading '2.1.5 Mortgages and debt consolidation':

- ◆ increasing the secured debt in this way will reduce equity and increase the risk of the repossession.

The text under, and including, the heading '2.1.6 FSA requirements for borrowers in arrears' is **deleted**.

The 'Think about this' box should be **deleted**.

## Page 30

Heading '2.2.1 General', but NOT including any text underneath this heading, is **deleted**.

## Page 32

The 'Think about this...' heading on this page under the heading '2.2.1.1 England and Wales', including the paragraph underneath it starting 'The receiver is the agent...', is **deleted**.

## Page 33

The last sentence of the fifth paragraph (in brackets), ie the paragraph starting 'Failure by a borrower to comply with...' under the heading '2.2.1.2 Scotland' is **deleted**.

## Page 40

The 'Think about this...' heading on this page under the heading '2.2.3 Sale procedure, including mortgagee obligations', including the three paragraphs underneath it starting 'It is a fact that properties held' to the last paragraph starting 'Conversely, in another court decision...', is **deleted**.

## Pages 41 & 42

The following text and diagram **replace** the text under, and including, the heading '2.2.5 Higher lending charge claims for shortfalls':

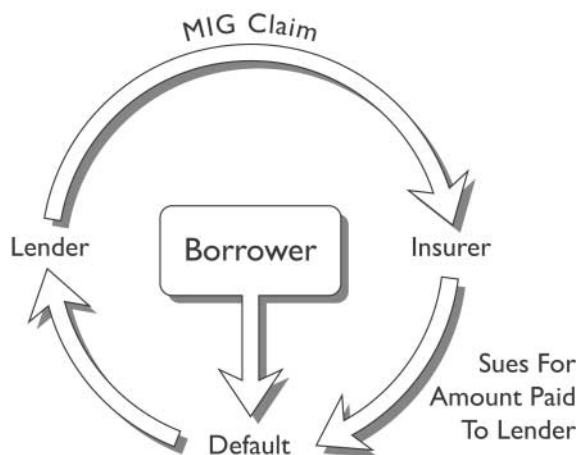
### The right of subrogation

The higher lending charge is often used to arrange a mortgage indemnity guarantee (MIG). This insurance policy pays the lender any shortfall on sale of the property when it exercises the power of sale. The MIG will pay any shortfall up to the amount guaranteed *less* any excess on the policy. The borrower pays the premium for this policy but the policy protects the lender only.

In turn, the insurance company underwriting the MIG can sue the former borrower for the amount that has been paid to the lender under its **right of subrogation**. This practice was deemed to be legally acceptable in a 1996 court case between a Mr Browne and the Woolwich Building Society. The mortgage deed commits the borrower to meet all payments due under contract. It is unrealistic to expect to be able to insure away this obligation with a one-off insurance premium.

Mortgage advisers must confirm that a borrower understands this principle: while some borrowers may bring legal action of the type taken by Mr Browne on a matter of principle, some may have been advised wrongly in the past on what the MIG actually does.

**Figure 2.5 Procedure on default where a MIG is in place**



## **SECTION 3 Other post-completion matters**

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### **Page 43**

Heading '3.1 Other post completion matters, but NOT including any text or headings underneath this heading, is **deleted**.

Heading '3.1.1 Changes in interest rates and fees/charges associated with the loan' is **renamed** 'Changes in interest rates and fees/charges'.

### **Page 44**

The 'Think about this...' heading on this page under the original heading '3.1.1 Changes in interest rates and fees/charges associated with the loan' including the paragraph underneath it starting 'Most mortgage interest rate changes...', is **deleted**.

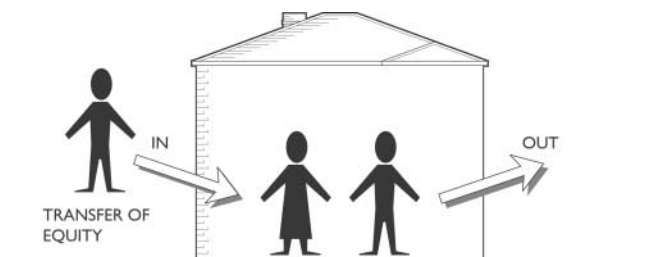
### **Page 46**

The 'Think about this...' heading on this page under '3.1.2 Variation of mortgage conditions', including the paragraph underneath it starting 'The mortgage contract cannot be varied...', is **deleted**.

## Page 47

The following diagram is **added** after the first paragraph (including bullet points) under the heading '3.1.3 Transfers of equity':

**Figure 3.1 Equity transfer**



The 'Think about this...' heading on this page under the heading '3.1.3 Transfers of equity', including the paragraph underneath it starting 'A transfer of equity is usually requested...', is **deleted**, as the text is now incorporated into the section.

## Page 50

The following text is **added** to the end of the second paragraph under heading '3.1.3.6 Life assurance policies':

If the policy is not assigned, it should be transferred or assigned to one or other of the policyholders, usually as part of any settlement. Where a party is to be added to the mortgage, they should consider the way in which the mortgage will be repaid. For example, if both original policies had ISAs to repay the bank, there will be a shortfall as the person 'leaving' the mortgage takes their ISA with them. The new party to the mortgage will need to consider how to address the shortfall.

## Pages 54–57

The following text **replaces** that under headings '3.1.7 Changing the mortgage', '3.1.8 Second charge administration', '3.1.9 Transfers of mortgages', '3.1.9.1 Advantages of transfers', and '3.1.9.2 Disadvantages of transfers' up to, but NOT including, the heading and text under '3.1.10 Lettings – authorised and unauthorised.

## Changing the mortgage

---

Borrowers are often tempted to convert their existing mortgage deal to another. This can often result in a lower rate of interest or a more attractive arrangement. Lenders often impose charges when a borrower switches to another 'deal'.

These may include:

- ◆ arrangement fees;
- ◆ early redemption charge on the original loan (if applicable);
- ◆ valuation.

The borrower should weigh up the potential savings against the set-up costs to see if the new 'deal' is viable.

## Transferring to a new lender

---

There are two main reasons for borrowers seeking to transfer their mortgage to a new lender:

1. when they move house – in order to obtain a better rate or a more advantageous deal;
2. to remortgage their existing property in order to raise money, or to arrange existing borrowing on better terms.

## **Property moves**

Moving home is an opportunity for the borrower to reassess existing arrangements and decide whether better terms can be achieved elsewhere. Factors that could influence the decision include:

- ◆ the existing lender's service standards;
- ◆ the existing lender's interest rates compared with the market;
- ◆ special deals available elsewhere and the existing lender's efforts to retain the borrower;
- ◆ the comparative costs and attractiveness of offerings from new and existing lenders.

## **The property**

Moving home is not an inexpensive process, and the owner should weigh up the benefits of moving compared to the costs. In general people move for three reasons:

- ◆ the move may be required as part of a job change, where it is impractical to remain at the current location. In this case, the buyer should be sure that he has researched the proposed area, assessed property available within the budget, and ensured family needs can be met by local facilities, like schools, shops, medical facilities and so on. Closeness to work might also be a consideration, depending on the situation. For example, a non-driver who works in town would probably like to be on a bus route; and a commuter might like to live within walking distance of a railway station. Conversely, someone who works in a mobile role, or works on a detached basis may not view closeness to work as an important factor. The owners may be fortunate and move to an area where house prices are lower, in which case they may be able to reduce borrowing or choose a larger house. Conversely, they may be forced to move to an area where prices are higher, resulting in a much higher mortgage or a smaller property for their money. Finally, moving a family to a new area can be traumatic, particularly for children, who would have to settle into a new school and make new friends;
- ◆ the move may be required as the family expands and a larger home becomes essential, usually in the same area. Similar considerations apply as moving to a new area, although the owners will have the benefit of knowing the area and family disruption can be minimised;

- ◆ the owners decide to move through desire, rather than necessity. This would include moving to a 'nicer' area, a more attractive or larger home, or just something 'different'. This is more likely to be the case with buyers who either have yet to start a family, or whose family are independent.

## **The costs**

Moving home involves costs, as considered in Unit 4. To summarise, they include:

- ◆ an estate agent's fees;
- ◆ mortgage fees – arrangement, reservation, valuation;
- ◆ a possible higher lending charge;
- ◆ a broker's fees;
- ◆ legal and search fees – buying and selling;
- ◆ Stamp Duty Land Tax.

On the sale of a £200,000 house and the purchase of another one for £250,000, typical costs might be £8,000 or even more. This means that the buyer needs to factor the costs into any new borrowing.

## **Remortgaging**

Where an existing borrower is considering remortgaging, several matters should be considered:

- ◆ purpose of the loan – this determines whether the loan:
  - falls within the current lending policy;
  - is to be regulated by the Consumer Credit Act 1974;
- ◆ status and personal circumstances of the applicant;
- ◆ value of the security offered for mortgage;
- ◆ other underwriting considerations, including MIG, guarantor, insurance, etc.

The procedure for remortgaging is relatively straightforward and mirrors in many ways the normal mortgage application procedure:

- ◆ as mentioned above, the necessary status and security information has to be gathered;
- ◆ in particular, details of the existing mortgage have to be confirmed – the lender should obtain details of the existing mortgage, together with statements going back over a reasonable period of time;
- ◆ the lender should check whether the information given at application stage is consistent with evidence presented by the existing lender – for example, the borrower may state that the switch is to get a lower rate of interest, but evidence might suggest that the existing lender is at an advanced stage of action for recovery;
- ◆ the borrower should obtain a redemption statement in order to establish accurate borrowing requirements – otherwise there may be a shortfall that cannot be met from personal resources;
- ◆ once the remortgage is assessed as acceptable by the lender, a formal offer of advance will be issued;
- ◆ once the borrower is happy, the conveyancing work can start;
- ◆ the solicitor acting for the borrower will arrange to pay off the existing mortgage from the proceeds of the advance cheque, alongside any other costs, fees, or expenses involved.

### **Issues facing the borrower**

Remortgaging can be a painless way of raising extra money, and the costs can be reduced by taking a deal that offers free valuations and legal services. However, the borrower should be aware of the following issues before remortgaging.

- ◆ Replacing a mortgage without raising additional capital can be a good way to reduce the interest paid, or to take advantage of special offers. The borrower should make sure he understands the terms and conditions – often there are tie-in conditions with financial penalties for early redemption, or other conditions that may not be obvious.
- ◆ There are likely to be fees and costs associated with remortgaging, unless the lender offers free valuations and legal services. They would include arrangement fees with the new lender, valuation and conveyancing fees;

and might also include redemption penalties from the existing lender. In view of this, the borrower should consider the impact of the costs on the overall arrangement. For example, if the fees on a three-year fixed rate deal amount to £500 and the borrower pays them from his own resources, he will need to save at least £14 a month in order to make it viable. If he chooses to add the costs to the amount borrowed, he should consider what impact this will have over the term of the mortgage.

- ◆ Replacing an existing mortgage with an increased loan to consolidate other debts can be a money saver in the short term, as mortgage rates are lower than other forms of borrowing. However, the borrower will be paying interest on the consolidated debt until the end of the mortgage term, which will usually be longer than the original loan it replaced. Over the full term of the mortgage, the costs will be higher.
- ◆ Moving unsecured loans to secured status can be risky. If the borrower defaults on a mortgage, his house could be repossessed, whereas this would not happen with an unsecured loan.
- ◆ Using a remortgage to raise additional money for other purposes – car purchase, holidays etc – can be attractive at the time, as mortgage rates are generally lower than other forms of borrowing. However, the borrower will be paying the increased borrowing to the end of the mortgage term; this could mean the car is financed for upwards of 20 years, even though it will lose value rapidly.
- ◆ Increasing the level of borrowing in this way may result in a loan-to-value in excess of the new lender's threshold for a higher lending charge. In this case, the higher lending charge should be taken into account when calculating the overall benefit of the new arrangement.

## The mortgage

Implications for those considering transferring to a new lender include:

- ◆ *redemption penalties on the existing mortgage.* Those who took advantage of a special deal in the past – a fixed rate, for example – might be subject to a charge if they transfer the mortgage to another lender during the term of the special deal. The typical charge will apply until the end of the fixed rate term but some deals are subject to an 'overhang', where the penalty continues beyond the term. Many lenders offer a portability option, where an existing mortgage can be transferred to a new property during the special term without penalty, providing the same terms and

conditions apply. For example, a borrower with a £75,000 five-year fixed rate deal would be allowed to move without penalty within the five-year term, providing that £75,000 of his new mortgage was on the same deal. Effectively, he would be transferring that mortgage to the new property. Other companies offer portability on the basis that the new mortgage must be for at least the same amount but may be on different terms;

- ◆ *administration fees* – most lenders charge a fee to close a mortgage account. In some cases, this can be as high as £295;
- ◆ *loyalty offerings*. Some lenders offer borrowers special loyalty bonuses after a specified period. For example, the borrower may be given a 0.5% discount from the standard variable rate once he has held the mortgage for five years.
- ◆ *relationships*. Many borrowers develop a positive relationship with their lender and feel a degree of loyalty. In some cases, the relationship has enabled them to overcome problems, or to arrange lending outside the lender's normal criteria.

### **Pages 58–62**

*The text under, and including, the headings '3.1.11 Death of a Borrower', and '3.1.11.1 Joint borrowers', and '3.1.11.2 Sole borrower' and '3.1.11.3 A quick refresher – intestacy, and 3.1.11.3.1 Intestacy', and '3.1.12 Moving home' is **deleted**.*

### **Pages 62 & 63**

*The text under, and including, the headings '3.1.13 Bridging finance', '3.1.13.1 Advantages of bridging' and '3.1.13.2 Disadvantages of bridging' is **deleted**.*

## Pages 64–66

The following text **replaces** the text under, and including, the headings '3.2 Home income plans' and '3.3 Home reversion schemes':

### **Home income and home reversion plans**

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Homeowners in, or nearing, retirement often have a requirement for additional cash or income. They have equity in their property, which will normally allow them to raise additional finance by a remortgage or a further advance. This route is likely to pose problems:

- ◆ any additional income produced by investing the cash raised will be eroded by the increased mortgage payments;
- ◆ they may not have sufficient income to validate the extra borrowing;
- ◆ to make payments affordable, they may have to extend the mortgage term past retirement age.

There are two alternatives in this situation:

- ◆ a *lifetime mortgage*, often called a home income plan, where the mortgage is on an interest-only basis, with no defined term. The interest payable is usually rolled up rather than paid when due;
- ◆ a *home reversion plan*, where the property is sold in return for a lump sum or an income, together with a guaranteed tenancy for life.

Both these plans were considered in detail in Unit 5: at this stage we will consider the advantages and disadvantages of choosing these products.

### **Advantages and disadvantages of lifetime mortgages**

The advantages of a lifetime mortgage include:

- ◆ with an interest roll-up plan, no monthly payments are required. This means that all the cash or income raised can be used as the borrower(s) wish;
- ◆ most lifetime mortgages offer a no-negative-equity guarantee, which means that the debt will never exceed the value of the property;

- ◆ the borrowers will be able to benefit from the additional finance without having to move house;
- ◆ the borrower retains ownership of the property;
- ◆ if the property increases in value at a higher rate than the interest accrues, the borrower's estate will benefit;
- ◆ an annuity-linked home income plan fixes the interest rate payable and the annuity received. The interest is paid from the annuity, which alleviates the need for interest roll-up.

Their disadvantages, however, include that:

- ◆ interest may roll up quickly, depending on the rate charged;
- ◆ 'younger' borrowers are likely to live for many years, allowing the debt to increase significantly;
- ◆ the borrower has little control over the increasing debt and may see his children's legacy significantly reduced;
- ◆ increases in income or capital may affect eligibility for means-tested state benefits, like Income Support and Pension Credit;
- ◆ it may not be possible to move house because repaying the mortgage plus rolled-up interest may leave insufficient capital to buy another property.

## **Advantages and disadvantages of home reversion schemes**

The advantages of the home reversion scheme include that:

- ◆ no interest is payable or rolled up. This means that the planholder does not have to worry about repayment;
- ◆ the scheme will probably provide more cash than a mortgage-based scheme;
- ◆ the planholder is guaranteed tenancy for life;
- ◆ part-reversion is available, allowing the planholder to retain an interest in some of the equity in the property.

The disadvantages of the home reversion scheme include:

- ◆ the cash or income provided will be at a discount to the value of the property given up;
- ◆ increases in income or capital may affect eligibility for means-tested benefits, like Income Support and Pension Credit.
- ◆ the owner loses all rights to the increase in value of the part of the property given up;
- ◆ if the plan holder dies relatively shortly after starting the arrangement, it will have been a very costly way of raising the cash or income;
- ◆ schemes are quite inflexible. Moving may be a problem;
- ◆ any improvements made to the property will not benefit the plan holder as the provider owns it.

## Questions

**The self-assessment questions that follow include existing questions alongside some that have been amended or added for 2006/07.**

### **Unit 3 Test 1**

**Test your knowledge and understanding with these questions**

**Take a break before using these questions to assess your learning across each section. Review the text if necessary.**

**Answers can be found on the pages following the questions.**

***Answer true or false for each of these statements.***

1. Alan was declared bankrupt in England on 5 May 2006. He will be discharged on 4 May 2009.
2. In a contract to buy and sell property, both vendor and purchaser give a consideration.
3. A partnership business has a legal existence of its own, separate from that of the individual partners.
4. A company's power to borrow is normally established in its Articles of Association.
5. A person who makes a power of attorney is known as a donor.
6. A lender can lend to trustees provided that the trust deed does not prohibit borrowing.
7. The age of majority is lower in Scotland than in England.
8. A person of unsound mind cannot enter into a contract but can appoint an attorney to do so for him.
9. People who are declared bankrupt remain as undischarged bankrupts for one year.
10. Loans of £25,000 and above are not regulated by the Consumer Credit Act 1974.

## **Test 2**

1. Federico and Edwina are retired with two adult children; they own their house outright. They are considering buying a holiday property in Devon and have enough capital to spend up to £200,000 without needing a mortgage. They are aware that their total estate is already well over the IHT threshold and would like to be able to avoid tax as far as possible. Outline the advantages and disadvantages of arranging to own the Devon property on a 'tenants-in-common' ('common property' in Scotland) basis.
2. 27 Beech Close is a new apartment block. There are 20 apartments in total, all of which are subject to 99-year leases, and the freehold is owned by a local property magnate who has agreed to sell the freehold. Some, but not all, of the residents are keen to buy the freehold and manage the estate, although none of the residents object to the transfer. Can they do so and what rules will apply?
3. What is the difference between a 'positive covenant' and a 'restrictive covenant'?

### **Answer true or false to the following statements.**

4. The borrower is known as the 'mortgagor'.
5. A legal charge is known in Scotland as a mortgage by demise.
6. A 'second mortgage' is a further loan from the same lender.
7. Second mortgages generally attract a higher rate of interest.
8. If two people own respectively 60% and 40% of a property, they are said to be 'joint tenants'.
9. Lenders always prefer freehold to leasehold property.
10. A qualifying residential leaseholder has the legal right to extend the lease by up to 99 years.
11. A commonhold association must be established as a company.
12. The requirement to maintain a stockproof fence is a positive covenant.
13. Easements can only be removed by a court.
14. Rights over unregistered land are registered with the charges register.
15. Vendors are deemed to covenant that they do have the right to sell the property.

### **Test 3**

1. James has heard that bargains can be had by buying at property auctions. What cautionary advice would you give him?
2. Outline the searches made by a solicitor during the conveyancing process and indicate in what circumstances and why they are made.
3. Dawn is considering buying a three-bedroom detached house for £215,000 or a four-bedroom detached house for £310,000. How much Stamp Duty Land Tax will she have to pay on each?

***Answer true or false to the following statements.***

4. Under the Property Misdescriptions Act 1991, the vendor is liable for false or exaggerated claims in an estate agent's particulars about a property.
5. It is proposed that copies of title documents will be included in Home Information Packs.
6. Town planning issues will be highlighted by a Local Land Charges Registry search.
7. Either party can drop out of the sale/purchase of a property at any point up to the completion date.
8. Stamp Duty of up to 4% is payable by the vendor.
9. The Home Information Pack will contain a structural survey report.
10. Environmental searches usually cost under £40.

## **Test 4**

***Answer true or false to the following statements.***

1. An offer of advance cannot be withdrawn once it is accepted in writing by the borrower.
2. The requirement for completion of roads and access is a general condition found in all offers of mortgage advance.
3. The 'certificate of title' is supplied by the borrower's solicitor.
4. In the mortgage deed, the borrower promises to comply with any positive or restrictive covenants.
5. 'Consolidation' is a right that the borrower can exercise in order to combine two existing mortgages.
6. A 'further advance' could be described as a top-up loan to an existing mortgagor.
7. 'Stage payments' may be made where the loan-to-value ratio is above the lender's normal limit.
8. One borrower's covenant may be to allow the lender to insure the property if he fails to do so.
9. Most mortgage contracts will allow the borrower to let the property if they wish.
10. Only occupants over the age of 18, who will not be party to the mortgage, will be required to sign a 'consent to mortgage' form.

## **Test 5**

***Answer true or false to each of the statements below.***

1. All building societies are mutual organisations.
2. Lending to people who have county court judgments against them is referred to as the 'sub-prime market'.
3. 'Securitisation' is the buying and selling of mortgage portfolios.
4. Inflation can be reduced by reducing interest rates.
5. Firms must keep records of non-real-time promotions for at least three years

## **Unit 4 Test 1**

***Answer true or false to the following statements.***

1. It is not necessary to establish the customer's attitude to risk when advising on mortgages because there is no investment exposure.
2. When an adviser selects a number of suitable products for the customer to select from, it is referred to as an 'advised sale'.
3. George has been asked to talk to Mike regarding arranging finance to buy an apartment in Turkey. He will not have to give Mike an initial disclosure document.
4. The mortgage illustration must show the amount repaid per £1 borrowed.
5. The firm must keep a copy of the illustration for 12 months after the advice is given.

## **Test 2**

1. Rebecca and Rachel want to buy their first house. Rebecca is an engineer, earning £25,000 basic and an average of £3,000 overtime in the past three years, although this is not guaranteed. Rachel is a personal assistant, earning £22,000 basic. Which of the following lenders would give them the highest mortgage?
  - ◆ The Generous Society – 3.25 primary plus 1 secondary or 2.25 joint; income based on guaranteed basic plus 50% regular additional.
  - ◆ The Eclectic Building Society – 3.5 primary plus 1 secondary or 2.5 joint; income based on guaranteed income.
2. Andreas is self-employed with an income of £30,000. He has seen just the property he wants at £200,000, which will mean taking out a mortgage of £170,000. A friend has advised him to go for a self-certified mortgage, because he can declare his income as £50,000 and get the mortgage he needs. What would you advise Andreas?

### **Answer true or false to the following questions.**

3. It is illegal to refuse a mortgage on the grounds that the applicant is not resident in the UK.
4. Variable sales-related income is not normally considered by lenders when assessing a borrower's ability to repay a loan.
5. Business projections are of limited use when deciding what size of loan to offer to a self-employed person.
6. Mortgage application forms normally ask about the tenure of the property – freehold or leasehold.
7. All sole traders produce a set of accounts comprising a profit and loss account and a balance sheet.
8. An employer's reference will only be accepted if it is dated.
9. When lending to a partnership, it is important to assess the incomes of all the partners from all sources.
10. Lenders always ask about applicants' credit card commitments.
11. Individuals can obtain details of information about them held by credit reference agencies, on payment of a fee of £10.

12. An 'individual voluntary arrangement (IVA)' is an alternative to repossession of a property by a lender.
13. A person cannot be prosecuted for giving false information in a mortgage application unless a mortgage is actually granted.
14. Opinions about people are not considered to be 'data' for the purpose of the Data Protection Act 1998.
15. A 'non-status loan' is one where the lender does not seek to corroborate the applicant's declared earnings.

### **Test 3**

1. What is the difference between a 'retention' and an 'undertaking'?

***Answer true or false for each of these statements.***

2. A basic valuation is for the benefit of the lender and is paid for by the lender.
3. A homebuyer's report is expected to report on the existence and condition of a damp-proof course.
4. All new houses have a guarantee of either 10 or 15 years against major defects.
5. Lenders generally require valuers to specify both the value for lending purposes and the insurance value of a property.
6. Lenders sometimes require borrowers to carry out certain repairs within a specified time as part of the mortgage contract. This is known as an 'undertaking'.
7. Local authorities generally give retrospective planning permission if all their requirements have now been met.
8. A car port would be exempt from building regulations.
9. A survey shows significant work is required on a property's roof. The lender is likely to require an undertaking.
10. Where the valuer identifies a problem with a property, he can recommend an increase in the interest rate.

## **Test 4**

1. Sally has been asked to stand as guarantor for her son George's mortgage. What are her obligations and what should she be advised to do?
2. What is the purpose of the Mortgage Indemnity Guarantee?

### **Answer true or false to the following statements.**

3. A guarantor promises to make someone else's loan repayments if they are made redundant.
4. An item of security put up by a guarantor is known as a surety.
5. Guarantors must seek independent legal advice about the obligations of providing a guarantee.
6. The borrower pays the premium for a mortgage indemnity guarantee policy, even though the policy is not for his benefit.
7. Mortgage indemnity guarantee policies normally only pay out 80% of a lender's loss.
8. Where a lender makes a higher lending charge, it must use it to purchase a MIG.
9. A reservation fee will be charged on the majority of mortgages.
10. Bankruptcy search fees are non-refundable.

## **Unit 5 Test 1**

1. Explain the differences between a 'full' endowment and a low-cost endowment in relation to mortgage repayment.
2. In what ways does a unit-linked endowment differ from a with-profits endowment?
3. Clara would like to repay her £100,000 interest-only mortgage with the proceeds of her personal pension plan. What will the fund value need to be in order for her to be able to do so?

### ***Answer true or false for each of the following statements***

4. In the first year of a capital and interest mortgage, repayments are mainly interest.
5. Repayment mortgages offer borrowers the possibility of a capital surplus at the end of the term.
6. One advantage of an interest-only mortgage is that the capital is guaranteed to be repaid at the end of the term.
7. If a borrower's endowment policy seems likely to result in a shortfall, the mortgage can be converted to the repayment method.
8. If an endowment policy is assigned to a lender, the lender can surrender the policy.
9. A low-cost endowment guarantees to repay the mortgage on the death of the borrower.
10. The full endowment method is the cheapest way of guaranteeing repayment of the mortgage.
11. The low-cost endowment has reduced premiums for the first five years.
12. Unit-linked endowment policy funds grow at a specified annual rate.
13. Unit-linked endowments can usually be extended to a longer term if there is a shortfall in the amount needed for repayment.
14. Joint mortgage applicants can take out a joint ISA to repay their mortgage.

15. A unit trust ISA must have at least half of its investment in shares issued on EU stock exchanges.
16. If an investor contributes £2,000 to a mini cash ISA in the current tax year, the most he can invest in an equity ISA is £5,000.
17. A PEP can be used to repay an interest-only mortgage.
18. A pension mortgage cannot normally be repaid until the borrower reaches the age of 50.
19. The contributions to a pension mortgage are four times greater than the actual amounts needed to fund the mortgage repayment.
20. The daily basis of calculating interest methodology is advantageous to people who are often late with their mortgage repayments.

## **Test 2**

1. Ellen is considering a mortgage that has a fixed rate for three years and an early redemption penalty of 1% for redemption during the first three years, reducing to 0.5% for the next two years. The arrangement fee is £250. Does this mortgage meet CAT standards? Explain your answer.
2. The Prudent Building Society are offering a flexible mortgage, with a maximum loan-to-value lending limit of 80%. Will and Grace are looking to borrow an initial £130,000 on a property valued at £220,000; this figure is well within their income multiples. One of the attractions of this mortgage is that Will and Grace can drawdown further funds to finance a holiday home later on. How much can they draw down?
3. Bob and Luka have an offset mortgage, with an interest rate of 6.25%. The outstanding mortgage is for £120,000 and they have £20,000 in an investment account with a local building society, earning 4.2% gross. Their financial adviser has suggested they move their savings into the offset account. Comment on this advice, giving facts and figures to support your position.
4. Explain the differences between a 'home income plan' and a 'home reversion scheme'.
5. Peter and Nicky are considering a 125% mortgage to buy their first home. What words of warning would you give them?

**Answer true or false to the following statements.**

6. The maximum permitted arrangement fee on a CAT-standard fixed-rate mortgage is £100.
7. One feature of most flexible mortgages is that interest is calculated on a daily basis.
8. An offset mortgage is one in which a repayment mortgage is linked to a savings account.
9. 'Deferred interest mortgage' is another name for a discounted mortgage.
10. Discount mortgages usually have an early repayment charge.
11. A shared ownership mortgage is one on which part of the loan attracts zero or very low rate of interest.
12. In an equity share mortgage arrangement, the borrower pays rent for a portion of the property while owning the remainder.
13. Interest rates on a base rate tracker mortgage remain equal to the Bank of England's base rate, and must change within 30 days of the base rate changing.
14. Sharia mortgages reflect the principle that Muslims must not enter into transactions where interest is paid.
15. Foreign currency mortgages can be secured on UK properties.
16. Under FSA rules, lifetime mortgages are available to borrowers of all ages.
17. Under the Safe Home Income Plans code of practice, borrowers must be permitted to transfer their loan to a different property if they wish to move.
18. Home reversion schemes require the customer to pay interest based on the value of the property.
19. Buy-to-let mortgages are available only to property companies.
20. Under the 'right to buy' scheme, those who bought in 2004 should be aware that the authority will claim back some of the discount if they sell again within three years.

### Test 3

1. Fill in the table below, which considers life assurance policies that can be used with mortgages. Tick, cross or complete the relevant box if it applies to the product.

Feature	Convertible term	Whole-of-life	Level term	Mortgage protection
Limited term	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Can be investment-linked	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Conversion to whole-of-life or endowment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sum assured level	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sum assured decreases in line with mortgage	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Order of cost – lowest first 1 to 4	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

2. Outline the difference between critical illness and permanent health insurances.

**Answer true or false to the following statements.**

- Mortgage protection life assurance is appropriate for people with capital and interest mortgages.
- The minimum deferred period for permanent health insurance is 13 weeks.
- Accident, sickness and unemployment (ASU) policies do not pay out if redundancy occurs within a specified period after the policy starts.
- Mortgage lenders can insist on specifying how the money from a claim on the mortgagor's property insurance must be spent.
- Damage from burst water pipes is normally covered by property insurance policies.

8. Many lenders offer block policies, which can include cover for both property and contents.
9. Block policies are cheaper for borrowers because no commission is paid.
10. Property insurance cover should commence, at the latest, by the completion date.

## **Unit 6 Test 1**

1. Walter and Alice have a mortgage with the Providential Building society. They wish to extend the mortgage by a further £18,000 to add another en-suite bedroom to their house. What would be the position of the further advance in relation to the Consumer Credit Act? Explain your answer.
2. Walter and Alice's proposed extension will increase their detached house from its original size of 600 cubic metres to 700 cubic metres. The extension will follow the existing roof line at the back of the house. What will the lender need to see before agreeing to a further advance?

### ***Answer true or false to the following statements.***

3. Any loan of up to £25,000 for a property extension is exempt from regulation by the Consumer Credit Act 1974.
4. If an application for a further advance shows that a borrower's income has greatly reduced, the lender can call in the original loan.
5. The value of the security should be reassessed if a further advance is requested.
6. A 'puisne mortgage' is one where the lender does not have possession of the title deeds.
7. A 'remortgage' is a replacement loan for one already in force and is always with a different lender.
8. Closed bridging is seen as riskier than open bridging.
9. A £10,000 loan to buy a car, secured on a first charge basis, would be covered by consumer credit regulations.
10. Listed building consent will be required where the owner wishes to demolish a listed building.

## **Test 2**

1. What must a lender do if it becomes clear that a borrower's mortgage account is in arrears?
2. Gavin has a mortgage of £125,000, £90,000 of which was taken out in May 2001, with a further advance of £35,000 to build an extension taken out in August 2003. He was made redundant on 1 February 2004, receiving £5,000 in compensation. This is his only capital. Explain Gavin's position with regard to Income Support for mortgage interest.

### ***Answer true or false to the following questions.***

3. Lenders are under no obligation to contact borrowers about mortgage arrears.
4. Accepting interest-only payments is a way of helping repayment mortgage borrowers in financial difficulties.
5. Extending the term in order to reduce mortgage repayments is not appropriate for low-cost endowment mortgages.
6. Income Support mortgage interest is not available to people whose savings exceed £4,000.
7. People with post-1995 mortgages are entitled to have half of their mortgage interest paid after 39 weeks of claim.
8. Income Support mortgage interest does not assist with the payment of contributions to the repayment vehicle on an interest-only mortgage.
9. An outright possession order granted by a court gives the lender immediate possession of a property on which the mortgagor is in default.
10. A suspended possession order automatically becomes an outright possession order if the borrower fails to keep up the agreed repayments.
11. Appointing a receiver is a legal remedy available where a property is let to tenants.
12. When a property has been taken into possession, the borrower has the right to repay the arrears at any time until the property has been sold.
13. Lenders have a legal obligation to sell a repossessed house for at least the amount of the mortgage.

14. A register of persons who have had their properties repossessed is maintained by the Financial Services Authority.
15. The right of subrogation enables insurers to sue borrowers for any amount paid out on a mortgage indemnity guarantee policy.

### **Test 3**

***Answer true or false to the following statements.***

1. Alan and Ann are divorcing and Ann will take over their mortgage. The joint endowment can be left as it is.
2. The terms and conditions of a mortgage contract can be changed by the lender but not by the borrower.
3. Lenders must tell prospective borrowers about their tariff of charges before the mortgage is completed.
4. Changes in a lender's tariff of charges must be notified to borrowers within two weeks of the change.
5. A transfer of equity occurs when a mortgage or block of mortgages is sold by one lender to another.
6. Removing a borrower from a mortgage deed cannot be done without the lender's permission.
7. Changes to terms and conditions of a mortgage are subject to the agreement of any guarantor involved.
8. If a borrower requests early redemption, it is inappropriate for the lender to attempt to sell them a further loan.
9. If a court determines that a redemption penalty imposed by a lender is too high, it can set it aside.
10. Releasing a borrower from his mortgage obligations at the end of the term is known as 'vacation' of the mortgage.

### *Mortgages*

11. When interest rates fall, borrowers with interest-only mortgages can choose to reduce the mortgage term and retain the same level of repayment.
12. When a second mortgage is taken, the new lender informs the original lender of the situation.
13. Moving home could cost as much as £8,000, even more in some circumstances.
14. An unauthorised tenancy does not confer rights of occupation, even if the rent has been regularly paid.
15. Borrowers can sell part of their property without the lender's consent.

## Answers

### Unit 3 Test 1

1. **False:** he will be discharged on 4 May 2007.
2. **True:** money from the buyer; property from the seller.
3. **False:** the partnership is not a separate legal existence. Assets/liabilities are jointly owned by the partners.
4. **False:** it is found in its memorandum.
5. **True:** attorneys themselves are sometimes known as donees.
6. **False:** the trust deed must specifically give the power to borrow.
7. **True:** the age of majority in Scotland is 16, rather than 18 – but there are special provisions between the ages of 16 and 18.
8. **False:** the Court of Protection can appoint someone but the individual cannot.
9. **True:** the period to discharge used to be three years but is now 12 months.
10. **False:** loans of £25,000 are regulated (unless exempt). Loans above £25,000 are not regulated.

## Test 2

1. Federico and Edwina will each own 50% of the property and can dispose of their share as they wish. This means that they can each leave their share to the children on death while the survivor can continue to own the other half. The share left to the children will take up part of the nil rate band for IHT and will not be subject to IHT. Transferring half of the property as part of the nil rate band will enable the survivor to keep more cash, etc. Once the deceased's share has been transferred to the children, the survivor will have no control over that share. The deceased is not able to put conditions on the use of the property if it is to be considered a genuine transfer. The children can force a sale or do as they wish with their share. Although this is likely to be a major problem with a main home, it is likely to be an acceptable risk with a second home. With a joint tenancy arrangement, the survivor will automatically inherit the other's share, which cannot be left to anyone else.
2. **Yes**, the residents can buy the freehold under the Commonhold and Leasehold Reform Act 2002. This is possible because:
  - ◆ more than two-thirds of the flats are on long leases (over 21 years);
  - ◆ no more than 25% of the floor area is for non-residential purposes;
  - ◆ at least 50% of the leaseholders must agree to purchase the freehold;
  - ◆ those owning more than two leases cannot participate;
  - ◆ those who do not wish to buy the freehold can lease their property from the new freeholders.
3. A **positive covenant** states what the owner must do – maintain boundaries, etc. A **restrictive covenant** states what the owner cannot do – run a business, keep livestock and so on.
4. **True**: the borrower is known as the mortgagor, the lender is the mortgagee.
5. **False**: a legal charge is known in Scotland as a standard security.
6. **False**: a further loan from the same lender would be called a further advance.
7. **True**: because the risk of a second mortgage to the lender is greater.

8. **False:** they are tenants in common.
9. **False:** in the case of flats, freehold can be a problem because of common areas.
10. **False:** the lease can be extended by up to 90 years.
11. **True:** a commonhold association is a management company for a multi-unit property.
12. **True:** it is something the owner must do and so a positive covenant.
13. **True:** easements are rights such as rights of way and can only be removed by a court.
14. **False:** rights over unregistered land are registered with the Land Charges Registry.
15. **True:** vendors are deemed to covenant their right to sell whether or not they sell with full title guarantee.

### Test 3

1. A successful bid is binding; 10% deposit is paid at the auction and contracts are exchanged the same day. There is no time to change your mind. Finance – mortgage or cash – must be in place prior to the bid. The survey and preliminary legal work must be completed before the auction. This can all be money wasted if the bid is not successful.
2. Searches are as follows:
  - ◆ **Land Registry search** – made if the land is registered;
  - ◆ **Land Charges Registry search** – made if the land is unregistered;
  - ◆ **Local Land Charges Registry search** – identifies details of road charges, town planning schemes and so on. These charges apply to the land rather than the individual and apply to both registered and unregistered land;
  - ◆ **Companies Registry search** – provides details on the mortgage applicant, where it is a company;

- ◆ **Bankruptcy search** – made by the lender’s solicitor to ensure that the applicant is not a bankrupt;
  - ◆ **Commons registration search** – checks that the land being sold is not common land.
3. Three-bedroom house – £2,150 – 1% of the purchase price; four-bedroom house – £9,300 – 3% of the purchase price
  4. **False:** the estate agent is liable for exaggerated claims about a property.
  5. **True:** title documents will be included in Home Information Packs, along with draft contract, searches and various other documents.
  6. **True:** a Local Land Charges Registry search will also include details of proposed new roads, etc.
  7. **True:** technically, either party can drop out from a purchase prior to the completion date but will lose their deposit if they were to withdraw after exchanging contracts and might also be sued for breach of contract.
  8. **False:** the purchaser pays the stamp duty.
  9. **False:** the Home Information Pack will contain a home condition report.
  10. **True:** environmental searches usually cost £39.

## Test 4

1. **False:** an offer of advance can be withdrawn for various reasons, eg if the value of the property is reduced by damage.
2. **False:** it is a special condition usually applying only to new developments.
3. **True:** the certificate of title is also known as a report on title.
4. **True:** these promises are among the conditions of title that the borrower covenants to comply with.
5. **False:** consolidation is the right of the lender, when a borrower has two or more mortgages with them on different properties, to insist that all are redeemed if one is redeemed.

6. **True:** a further advance is a loan from the same lender as the main mortgage.
7. **False:** stage payments are made when a borrower is building a new property or a large extension.
8. **False:** insuring a property if a borrower fails to do so is a lender's right.
9. **False:** letting a property is usually prohibited via a covenant.
10. **False:** the consent to mortgage form applies to occupants aged 17 or over who will not be party to the mortgage.

## **Test 5**

1. **True:** but some building societies have converted to banks and become plcs.
2. **True:** sub-prime lending is lending to those with poor credit histories.
3. **False:** securitisation is the issuing of securities backed by mortgage assets.
4. **False:** inflation usually increases when interest rates are reduced.
5. **False:** copies of non-real-time promotions must be kept for at least 12 months.

## Unit 4 Test 1

1. **False:** attitude to risk relating to mortgages is important.
2. **False:** an advised sale is where the adviser selects and recommends a particular product.
3. **True:** an IDD is only required for regulated mortgages.
4. **True:** the mortgage illustration must show the overall cost of the mortgage.
5. **False:** the illustration must be kept for 12 months after the application is made.

## Test 2

1. The Eclectic would lend them £117,500 based on 2.5 x joint income.

The calculations are:

- ◆ **Generous** – Rachel's income will be £26,500 (basic plus 50% overtime); Rebecca's income, £22,000.

$$3.25 \times \text{primary plus } 1 \times \text{secondary} = \text{£}108,125$$

$$2.25 \times \text{joint} = \text{£}109,125$$

- ◆ **Eclectic** – Rachel's income will be £25,000 and Rebecca's will be £22,000.

$$3.5 \times \text{primary plus } 1 \times \text{secondary} = \text{£}109,500$$

$$2.5 \times \text{joint} = \text{£}117,500$$

2. Even with a self-certified mortgage, declaring a false income figure is fraudulent and can result in criminal charges. In addition, taking out a mortgage of that size can lead to financial problems.
3. **False:** but it can be difficult to sue a non-resident in the event of default.
4. **False:** variable sales-related income it is usually averaged over three or five years.

5. **True:** business projections are only the business-owner's perceptions and are likely to be over-optimistic.
6. **True:** if a mortgage application is for leasehold property, additional information about the lease is required.
7. **False:** all sole traders produce a profit and loss account but not necessarily a balance sheet.
8. **True:** otherwise the employer's reference could contain out of date information.
9. **True:** a partnership is effectively a group of self-employed persons working together. It is not a separate financial or legal entity.
10. **True:** applicants' monthly credit card repayments are effectively a reduction in their available income.
11. **False:** the current fee for disclosure of credit-rating information, under the Data Protection Act 1998, is £2.
12. **False:** an IVA is an alternative to bankruptcy.
13. **False:** the Theft Act 1968 permits prosecution for fraud whether or not a mortgage is granted.
14. **False:** facts and opinions are both covered under the Data Protection Act 1998.
15. **True:** a non-status loan is also known as self-certification.

## Test 3

1. A **retention** is where the lender holds back (retains) part of the mortgage advance until certain work or repairs have been done. There will probably be a reinspection to ensure the work has been carried out. An **undertaking** is where the lender asks the borrower to carry out certain minor work or repairs within a stated time-frame. Although the lender reserves the right to a reinspection, this is not usually required.
2. **False:** a basic valuation is paid for by the borrower.
3. **True:** the homebuyer's report will also the state of beam, rafters, etc, and any sign of dry or wet rot, etc.
4. **False:** this guarantee exists only if the builder is covered by the NHBC or Zurich schemes.
5. **True:** the insurance value is often different from both the value for lending purposes and the selling price.
6. **True:** If they hold back part of the loan until it is done, it is called a retention.
7. **False:** local authorities rarely grant retrospective planning permission and taking down an 'illegal' extension can reduce a property's value, so lenders require all permissions to have been obtained.
8. **True:** a car port is exempt from building regulations.
9. **False:** the lender on a property needing extensive roof repairs is likely to insist on a retention.
10. **False:** recommending an increase in interest rates that is outside the valuer's remit.

## **Test 4**

1. Sally will become responsible for the mortgage if George defaults. She should be advised to seek independent legal advice before agreeing to provide the guarantee.
2. A mortgage indemnity guarantee protects the lender in the event of the borrower defaulting on the mortgage. It will pay the lender the shortfall between the sale price and the outstanding mortgage in the event that the lender takes possession on default. The insurance company has the right to sue the borrower for any money paid out in this situation.
3. **False:** a guarantor promises to make the repayments if the borrower is unable to do so for any reason.
4. **True:** a surety occurs when a guarantor puts up some security.
5. **False:** guarantors must be advised to take independent legal advice.
6. **True:** the mortgage indemnity guarantee policy indemnifies the lender if they have to repossess and sell the property at a loss.
7. **True:** most mortgage indemnity guarantee policies have a 20% excess.
8. **False:** the lender is not under any obligation to use a higher lending charge to purchase a MIG.
9. **False:** a reservation fee usually applies only to special deals.
10. **True:** bankruptcy search fees are non-refundable.

## Unit 5 Test 1

1. A full endowment has a sum assured equal to the mortgage amount on death or maturity. This means that the loan is guaranteed to be repaid as long as premiums are paid and any bonuses added will provide a surplus at the end of the term.

A low-cost endowment has a sum assured lower than the mortgage amount – typically 50% to 60%. It relies on (usually) 80% or so of the anticipated reversionary bonuses to make up the shortfall. The shortfall in the death benefit is covered by decreasing term assurance, the amount of which decreases as the bonuses are added each year. As reversionary and terminal bonuses are not guaranteed, there is a significant risk that the policy will not pay off the loan at maturity. Although the full endowment guarantees to pay off the mortgage, it is much more expensive than the low-cost version.

2. The unit-linked endowment does not have a guaranteed sum assured at maturity. The maturity value is the bid value of the units, which may or may not be enough to repay the mortgage. With-profits plans have a guaranteed sum assured, although in the case of the low-cost version it will not be as much as the mortgage.

The unit-linked endowment is flexible, in that the premiums and sum assured can be changed (within limits). The with-profit endowment sum assured and premium are fixed at the start and cannot be changed.

The unit-linked endowment allows the investor to select from a range of funds, while the with-profit endowment offers only the with-profits fund.

In the event of early encashment, the unit-linked plan will pay the bid value of units. There will sometimes be a surrender penalty in the early years, as stated in the policy terms. The with-profits plan's early surrender value is worked out by actuaries and is unlikely to represent the plan's value at the time or include the bonuses added to date. The company might also impose a market value adjustment.

The charges on a unit-linked endowment are 'transparent' – that is, clearly stated in the policy terms. Other than a policy administration fee, the charges on a with-profit fund are taken from the fund and are worked out by the actuaries.

3. £400,000.

4. **True:** gradually the proportion of capital repaid increases as the term of a capital interest mortgage progresses.
5. **False:** repayment mortgages simply repay the borrowed capital over the term.
6. **False:** no guarantees are provided.
7. **True:** converting a mortgage to repayment is the safest method of ensuring a full repayment, but may be expensive.
8. **True:** the lender may surrender an endowment policy if a mortgage is in default.
9. **True:** a low-cost endowment guarantee to repay the mortgage on the death of the borrower though the automatic inclusion of sufficient life cover.
10. **False:** a full endowment mortgage is expensive. A repayment mortgage is a cheaper way of guaranteeing mortgage repayment.
11. **False:** the low-start endowment has reduced premiums for the first five years.
12. **False:** a specified rate is used (assumed) in determining the premium level of a unit-linked endowment policy, but it is not guaranteed.
13. **True:** most unit-linked policies can be extended to compensate for a shortfall, subject to qualifying rules.
14. **False:** ISAs can be in single names only – but they can have one each.
15. **True:** although there is no such limit for unit trusts that are not in ISAs.
16. **False:** he can only invest in a mini equity ISA, so the maximum is £4,000.
17. **True:** many PEPs still exist, although no new investment can now be made into them.
18. **True:** 50 is the current minimum age at which personal/stakeholder pension benefits can be taken.
19. **True:** only 25% of a pension fund can be taken as a lump sum to repay a mortgage.
20. **False:** the daily calculation of interest benefits early payers, because their total interest is reduced.

## Test 2

1. No, it does not meet CAT standards, because it has a redemption penalty after the end of the fixed period and the arrangement fee is £250, which is £100 more than the CAT maximum.
2. They can draw down a further £46,000, which will take them up to the 80% limit. Of course, they will need to make sure they can afford the increased payments if they do take extra funds.
3. They should seriously consider doing so. If they move the £20,000 into the offset account, they will pay mortgage interest on £100,000. This will save them £104.17 a month. Their £20,000 is currently earning £70 per month gross, £56 net of basic rate tax.
4. A **home income plan** involves the property owner taking out an interest-only mortgage on the property. The capital released is used to buy an annuity or to invest in an income-producing vehicle, or as capital to meet the owner's needs. Interest on the mortgage is rolled up and repaid when the borrower moves or dies. The amount that can be borrowed is usually 25% to 50% of the property value, depending on the individual's age (usual minimum 60) and will be lower for younger people.

A **home reversion scheme** involves the owner selling part, or all, of the property to the provider in return for a capital sum, or sometimes an income through an annuity; it is not mortgage-based and no interest is payable. The owner(s) will have a legal agreement to remain in the property for the rest of their life (lives). The amount paid for the property will depend on the age of the owner but will be a low percentage of the market value to allow for the fact that no interest is payable. On death, the provider will sell the property and take a percentage of the sale proceeds equal to the proportion it bought.

5. They will have no equity in the property for quite a while. If house prices fall, they could find themselves in a negative equity situation. They will have a wider choice of mortgages if they can keep their borrowing to 95% of loan-to-value (or less).
6. **False:** the maximum fee permitted on a CAT-standard fixed-rate mortgage is £150.
7. **True:** the benefit of the daily interest calculation is that any early payments or overpayments immediately reduce the interest charged.

8. **True:** the two accounts in an offset mortgage are kept separate and can be dealt with independently.
9. **False:** a deferred interest mortgage adds the outstanding interest to the mortgage at the end of the initial period.
10. **True:** discount mortgages usually do have an early repayment charge.
11. **False:** the low rate part of the loan is a feature of the equity share mortgage.
12. **False:** rent paid for a portion of the property is a feature of a shared ownership mortgage.
13. **False:** interest rates on a base rate tracker mortgage are not usually equal to the base rate but are a specified amount above it.
14. **True:** the most popular method of Sharia mortgage sees the lender owning the property and the customer paying rent.
15. **True:** the capital owed on a foreign currency mortgage is denoted in the foreign currency.
16. **False:** lifetime mortgages are available only to people over a specified age, typically 65 or 70 years.
17. **True:** part of the home income plan may have to be repaid if transferred to a property with a lower value.
18. **False:** with a home reversion scheme, all, or part, of the property is sold to the finance company, who get no interest or rent, but get the property value when the customer dies.
19. **False:** buy-to-let mortgages are for individuals wishing to buy property to rent out.
20. **True:** the discount repayment necessary if selling after exercising right to buy may cause problems if the buyer has taken a large mortgage to assist with improvements. Had they bought the property on or after 18 January 2005, the period would be five years.

**Test 3**

1.

Feature	Convertible term	Whole-of-life	Level term	Mortgage protection
Limited term	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
Can be investment-linked	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Conversion to whole-of-life or endowment	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Sum assured level	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Sum assured decreases in line with mortgage	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Order of cost – lowest first 1 to 4	<input type="text" value="3"/>	<input type="text" value="4"/>	<input type="text" value="2"/>	<input type="text" value="1"/>

- Critical illness insurance** pays a lump sum on diagnosis of a specified serious (critical) illness. Permanent health insurance pays an income in the event of the insured being unable to work through illness or injury.
- True:** the sum assured under mortgage protection life assurance reduces in line with the outstanding capital.
- False:** the minimum deferred period for permanent health insurance is four weeks, which may be appropriate for self-employed people.
- True:** the suggestion is that the client may have known about a redundancy occurring soon after before starting the policy.
- True:** mortgage lenders wish to ensure the insurance money is used to maintain the value of their security.
- True:** property insurance claims will cover damage from burst water pipes but it may be excluded if a property is left unfurnished.

8. **True:** contents cover under block policies may be expressed as a percentage of property cover.
9. **False:** commission on block policies is paid by the insurer to the lender.
10. **False:** property insurance should be in place when contracts are exchanged.

## Unit 6 Test 1

1. The loan will be exempt because:
  - ◆ it is for the improvement/enlargement of their main dwelling house;  
*and*
  - ◆ the original loan is with the same lender.
2. They will need to see evidence of planning permission.
3. **False:** the loan will only be exempt if it is also from the same lender as the original mortgage.
4. **False:** if a borrower's income has reduced at the time of applying for a further advance, the lender should only flag the original loan as 'impaired'.
5. **True:** there are several possible reasons why the property value may have gone down.
6. **True:** a puisne mortgage might, for example, be a second mortgage.
7. **False:** a remortgage may be with the existing lender, who may offer better terms to retain the business.
8. **False:** open bridging is riskier than closed because there is no guarantee of when the loan will be repaid, if at all.
9. **True:** although secured on property, the loan is for the purchase of a car.
10. **True:** Consent is required for all listed building demolitions.

## Test 2

1. A lender must write to a borrower within 15 days of it becoming aware of the account being in arrears. The letter must contain:
  - ◆ the current FSA information sheet on mortgage arrears;
  - ◆ a list of due payments either missed or paid in part;
  - ◆ the total of the shortfall;
  - ◆ the total outstanding debt, excluding charges that may be made on redemption;
  - ◆ an indication of the nature and level (if possible) of charges likely to be incurred unless the shortfall is cleared.

2. He has 'new housing costs', which means he will not receive any benefit until 39 weeks have elapsed.

He will receive benefit from week 40, based on the first £90,000 of his mortgage. He will not receive benefit for the further advance because it was for improving the home and the maximum loan for benefit purposes is £100,000.

He will receive benefit for interest payments only.

The benefit will be paid directly to Gavin's lender.

3. **False:** a lender must contact a borrower within 15 business days of becoming aware of arrears.
4. **True:** making interest-only payments will reduce the monthly payment, although it should only be seen as a temporary measure.
5. **True:** the term of with-profit endowments cannot normally be extended.
6. **False:** the ISMI may be reduced where savings exceed £4,000, but is not removed altogether until £8,000.
7. **False:** the full ISMI entitlement is paid after 39 weeks to people with post-1995 mortgages.
8. **True:** ISMI will not cover endowment or other similar payments and neither does it cover other expenses such as buildings insurance.

9. **False:** an outright possession order can normally be executed after 28 days.
10. **False:** a suspended possession order, if enforced, requires that the borrower make payment. If he does not, the lender can return to court to seek possession.
11. **True:** the receiver applies rental income to ensure that the mortgage payments are maintained.
12. **False:** until sale, the borrower has only the equity of redemption, which is the right to repay the whole debt.
13. **False:** the lender must sell a repossessed property at the best price reasonably obtainable.
14. **False:** the possessions register is maintained by the Council of Mortgage Lenders.
15. **True:** the right of subrogation has been tested in the courts and confirmed.

### **Test 3**

1. **False:** the endowment should be assigned or transferred to one party.
2. **False:** contract terms can only be changed with the consent of both parties.
3. **True:** for a cashback scheme, for instance, changes to a tariff or charges would include details of possible clawback.
4. **False:** changes in a lender's tariff must be notified at least once a year.
5. **False:** transfer of equity is the addition or removal of a borrower from the mortgage deed.
6. **True:** removing a borrower from the deed may result in a fundamental change in the remaining borrower's ability to pay the mortgage.
7. **True:** changes to terms and conditions may affect the likelihood of a guarantee being called in.

## Mortgages

8. **False:** on the contrary, offering a further loan instead of early redemption makes good business sense because mortgages are often redeemed in order to obtain a better deal elsewhere.
9. **True:** a penalty that is too high might be said to be a 'clog on the equity of redemption'.
10. **True:** vacation is the technical term in England and Wales for the release from obligation at the end of the term ('discharge' in Scotland).
11. **False:** only borrowers with capital and interest mortgages can reduce the term and maintain the same payments.
12. **True:** the new lender will wish to receive any surplus after the first mortgage has been paid off on repossession and sale.
13. **True:** Fees and costs can often amount to a sum in excess of £8,000.
14. **True:** this is different from a spouse living in the property, who can establish right of occupation.
15. **False:** any sale may reduce the property value to less than the outstanding loan and a borrower cannot sell without the lender's consent.

# **Mortgages**

## **Certificate in Mortgage Advice and Practice (CeMAP®)**

### **Module 2 – Syllabus**

#### **Learning Outcomes**

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#### **Unit 3 Mortgage Law, Policy Practice and Markets**

On completion of the module, candidates will be expected to

Demonstrate a knowledge of:

- 1 the definition of a mortgage.
- 2 the house-buying process, the key parties involved and their roles.
- 3 the principal types of property defect that surveys can identify and understand their implications when seeking a mortgage, including the options available to consumers.
- 4 the process and implications of buying property at auction.
- 5 the common types of borrower and how their main mortgage related requirements may differ and what factors may disqualify people from borrowing.

Demonstrate an understanding of:

- 1 the main requirements of the Mortgage Conduct of Business Rules and the legislation affecting mortgages.
- 2 the economic and regulatory context for giving mortgage advice.

## **Unit 4 Mortgage Applications**

On completion of the module, candidates will be expected to

Demonstrate an understanding of:

- 1 the role of a Mortgage Adviser and the importance and principles of providing advice, including the key factors affecting the advice given.
  - 2 the implications for consumers of 'gazumping' and 'gazundering'.
  - 3 the purpose of additional security, including the role of guarantors.
  - 4 the fees and charges involved in arranging a mortgage, identify where these apply, the services they cover, when they become due, which are refundable and how the opportunity for refunds diminishes as the process nears completion.
- U5 the principal factors affecting the value of property, including their implications for consumers seeking mortgages and when consumers should be referred for specialist advice.
- U6 the different forms of valuation and survey and which might be appropriate for different properties and/or the borrower's circumstances.
- U7 the need to obtain Local Authority planning consent for house development/extensions.

## **Unit 5 Mortgage Payment Methods and Products**

On completion of the module, candidates will be expected to

Demonstrate an understanding of:

- 1 the key features of the different types of mortgage repayment options and their advantages and disadvantages for different types of borrower.
- 2 the key features of the common types of mortgage product and interest rate options.
- 3 the structure and features of other types of mortgage.
- 4 the main features and functions of different forms of life assurance and other insurances (eg mortgage payment protection insurance (MPPI), life, accident and sickness insurance (ASU), building insurance, contents insurance) associated with arranging a mortgage.

## **Unit 6 Mortgage Arrears and Post-Completion**

On completion of the module, candidates will be expected to

Demonstrate an understanding of:

- 1 the principles and procedures associated with raising additional money and the circumstances when further borrowing might be appropriate.
- 2 the principles, procedures and costs associated with transferring mortgages.
- 3 the principles of using mortgages within debt consolidation arrangements.
- 4 the implications for the borrower of the non-payment of mortgages, other breaches of the Mortgage Deed, non-payment of building insurance and the options available.
- 5 the legal rights/remedies available in respect of non-payment from borrowers.
- 6 the main provisions made by the State to assist consumers in difficulties over the repayment of mortgages.

**It is important to note that the indicative percentages quoted should be used as a guide only. In order to ensure that each exam is consistent in terms of difficulty, the actual number of questions that are tested in each topic area will not always equate exactly to the rounded percentage weightings.**

## Detailed Syllabus

### Unit 3 Mortgage Law, Policy Practice and Markets

Attainment Level	Outcome	Indicative Content	Approx. Weighting
Demonstrate a knowledge of:	1 The definition of a mortgage	K1.1 Definition as given in the FSA Handbook	5%
	2 The house-buying process, the key parties involved and their roles	<p><i>England/Wales</i></p> <p>K2.1a Role of estate agent/valuer/conveyancer/legal adviser;</p> <p>K2.2a Process to contract exchange/ completion and when a contract becomes binding;</p> <p>K2.3a Proposed use of home information packs (as published in the Housing Act 2004).</p> <p>OR</p> <p><i>Scotland</i></p> <p>K2.1b Role of estate agent/valuer/legal adviser;</p> <p>K2.2b Conditional/unconditional offer;</p> <p>K2.3b Private bargain/private treaty;</p> <p>K2.4 Acceptance/ completion/conclusion of missives;</p> <p>See separate 'Mortgage Conduct of Business Rules' requirements'</p>	15%
	3 The principal types of property defect that surveys can identify and understand their implications when seeking a mortgage, including the options available to consumers	<p>K3.1 Main property defects;</p> <p>K3.2 How property defects may affect the lending decision and/or require immediate remedial works.</p>	10%
	4 The process and implications of buying property at auction	<p>K4.1 Requirement for funding (ie cash/ mortgage commitment) to be in place up front;</p> <p>K4.2 Contracts exchanged, with associated deposit, on the day</p>	10%
	5 The common types of borrower and how their main mortgage related requirements may differ and what factors may disqualify people from borrowing	<p>K5.1 Private/residential borrowers;</p> <p>K5.2 Intermediary/business/commercial borrowers (outline only);</p> <p>K5.3 Those who cannot borrow:            ♦ undischarged bankrupts;            ♦ mentally            ♦ incapacitated; minors</p>	10%

<p>Demonstrate an understanding of:</p>	<p>I The main requirements of the Mortgage Conduct of Business Rules and the legislation affecting mortgages</p>	<p>Requirements of the Mortgage Conduct of Business Rules</p> <p>U1.1 National House-Building Council guarantees</p> <p>U1.2 Property Misdescriptions Act</p> <p>U1.3 Contract Law</p> <p>U1.4 Principles of Agency</p> <p>U1.5 Consumer law</p> <p>U1.6 Principles of testacy and intestacy, including grants of probate and letters of administration</p> <p>U1.7 Legal obligations and guarantors</p> <p>U1.8 Lenders Rights and Borrowers Covenant</p> <p>U1.9 Financial Services and Markets Act 2000 (including the Mortgage Conduct of Business Rules)</p> <p><i>England/Wales/Northern Ireland:</i></p> <p>I.10 Property Law (Law of Property Act 1925, Leasehold Reform Act 1967, Leasehold Reform, Housing and Urban Development Act 1993)</p> <p>OR</p> <p><i>Scotland:</i></p> <p>U1.11 Policies, as determined by the Scottish Executive, affecting the mortgage process and property market in Scotland</p> <p>U1.12 Matrimonial Homes Act (eg single borrowers require an affidavit)</p> <p>U1.13 Tenancy Act</p> <p>U1.14 Mortgage Rights Act</p> <p>U1.15 Statutory Repair Act</p> <p>U1.16 Bankruptcy Act (refers to 'sequestrian' in Scotland)</p> <p>U1.17 Land Tenure Reform Act (note – new legislation due 2003)</p> <p>U1.18 Legislation regarding intestacy – impact upon partner where mortgagee dies intestate</p> <p>U1.19 Feu disposition (reference Land Certificate in England/Wales)</p> <p>U1.20 Court decree (reference County Court Judgment in England/Wales)</p>	<p>40%</p>
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## Mortgages

2	The economic and regulatory context for giving mortgage advice	U2.1	The property market and the main conditions that affect it	10%
		U2.2	Interest rates and their drivers	
		U2.3	The UK mortgage lending sector	
		U2.4	Mortgage regulation: MCOB and its implications for the mortgage adviser	

## Unit 4 Mortgage Applications

Attainment Level	Outcome	Indicative Content	Approx. Weighting	
Demonstrate an understanding of:	1 The role of a Mortgage Adviser and the importance and principles of providing advice, including the key factors affecting the advice given.	U1.1	Affordability	30%
		U1.2	Suitability	
		U1.3	Risk	
		U1.4	Term of mortgage	
		U1.5	Principles of ethical advice, including FSA guidance (for example, Treating Customers Fairly)	
		U1.6	Methods of verifying information supplied by consumers	
		U1.7	Methods of checking that mortgage solutions match consumer immediate and long term needs and circumstances	
		U1.8	Ways of advising clients in arrears who have differing attitudes to risk and indebtedness	
2	The implications for consumers of 'gazumping' and 'gazundering'	U2.1	Gazumping	5%
		U2.2	Gazundering	
3	The purpose of additional security, including the role of guarantors	U3.1	The requirement for guarantors to be advised to seek independent legal advice	10%
		U3.2	MIGs and other types of security (life policies and collateral)	

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4	The fees and charges involved in arranging a mortgage, identify where these apply, the services they cover, when they become due, which are refundable and how the opportunity for refunds diminishes as the process nears completion	<p><i>Commonly applicable charges and fees:</i></p> <p>U4.1 Reservation fees</p> <p>U4.2 Application fees</p> <p>U4.3 Arrangement fees</p> <p>U4.4 Lenders reference fees</p> <p>U4.5 Land Registry fees</p> <p>U4.6 Valuation fees</p> <p>U4.7 Estate agent fees</p> <p>U4.8 Legal/solicitors fees</p> <p>U4.9 Stamp Duty Land Tax</p> <p>U4.10 Local Authority searches</p> <p>U4.11 Bankruptcy searches</p> <p>U4.12 Telegraphic transfer costs</p> <p>U4.13 Environmental searches, eg flooding, mining</p> <p><i>Less common/other party charges (outline only):</i></p> <p>U4.14 Survey fees and fees for other specialist reports</p> <p>U4.15 Booking fees</p> <p>U4.16 Title indemnity fees</p> <p>U4.17 Higher lending charge</p> <p>U4.18 Brokers fees</p>	<p>20%</p>
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## Mortgages

Demonstrate an understanding of:	5	The principal factors affecting the value of property, including their implications for consumers seeking mortgages and when consumers should be referred for specialist advice	U5.1	Type of property	
			U5.2	Location	
			U5.3	Building materials and any restrictions	
			U5.4	Age of property	
			U5.5	Freehold/commonhold/leasehold (England & Wales)	
			U5.6	Tenure (Scotland – note: new legislation from 2003)	
			U5.7	Multiple use	
			U5.8	Vacant possession	
			U5.9	Reinstatement value	
			U5.10	Whether it is insurable, ; including but not limited to risk of flooding/subsidence/heave	15%
			U5.11	Planning permission	
			U5.12	Building regulations	
			U5.13	Contract guarantees	
			U5.14	Listed/heritage	
			U5.15	Easements, including but not limited to rights of way	
			U5.16	Due diligence enquiries, including but not limited to outstanding disputes	
				U5.17	Covenants.
	6	The different forms of valuation and survey and which might be appropriate for different properties and/or the borrower's circumstances	U6.1	Forms of valuation and or survey (basic valuations, homebuyer's report, building survey, full structural survey)	15%
			U6.2	Requirements of lenders	
			U6.3	Rights of the consumer	
	7	The need to obtain Local Authority planning consent for house development/extensions	U7.1	The legal basis of local authority planning procedures	
			U7.2	The main procedures in obtaining local authority planning consent	5%
			U7.3	Development limitations that apply to different categories of listed buildings	

## Unit 5 Mortgage Payment Methods and Products

Attainment Level	Outcome	Indicative Content	Approx. Weighting
Demonstrate an understanding of:	1 The key features of the different types of mortgage repayment options and their benefits and disbenefits for different types of borrower	U1.1 Capital and interest repayment (repayment mortgages)	20%
		U1.2 Interest payment (interest only mortgages)	
		U1.3 Implications for the consumer of the under-performance of repayment options	
		U1.4 Repayment vehicles used in conjunction with interest-only mortgages – endowment policies; personal pension plans; ISAs; OEICs; Unit Trusts	
2	The key features of the common types of mortgage product and interest rate options	U2.1 Standard variable rate mortgages	35%
		U2.2 Straight repayment tracker mortgages (variable rate/LIBOR/ base rate tracker mortgages)	
		U2.3 Interest only tracker mortgages	
		U2.4 Fixed rate mortgages	
		U2.5 Capped rate (including capped and collared) mortgages;	
		Discounted rate (including cash back/gift) mortgages	
		Deferred rate low start mortgages	
		U2.6 Equity release mortgages (links to mortgage/home reversion schemes)	
		U2.7 Flexible mortgages	
		U2.8 All in one/current account mortgages/offset mortgages, including drawdown facilities	
		U2.9 CAT marked mortgages	
U2.10 Hybrid arrangement products, for example – ‘part and part’ mortgages			
U2.11 The performance and volatility of fixed and variable interest rates for different types of borrower			

## Mortgages

<p>3 The structure and features of other types of mortgage</p>	U3.1 Commercial mortgages	
	U3.2 Lifetime mortgages (defined term for 'equity release' mortgages for older consumers)	
	U3.3 Low start/deferred interest mortgages	
	U3.4 Self build mortgages	
	U3.5 100%/125% mortgages	
	U3.6 Foreign currency mortgages	
	U3.7 New build mortgages	
	U3.8 Buy to let mortgages (including types of tenancy)	
	U3.9 'Right to buy' Council property mortgages	25%
	U3.10 Shared appreciation mortgages	
	U3.11 Shared ownership mortgages (Housing Association)	
	U3.12 Equity share mortgages	
	U3.13 Adverse credit/sub-prime mortgages (for 'non-conforming' or 'non-status' borrowers, with, eg CCJs/arrears/discharged bankruptcy)	
	U3.14 Sharia-compliant mortgages (also known as Islamic mortgages)	
<p>4 The main features and functions of different forms of life assurance and other insurances (eg mortgage payment protection insurance (MPPI), life, accident and sickness insurance (ASU), building insurance, contents insurance) associated with arranging a mortgage</p>	U4.1 Life assurance; Pension term assurance	
	U4.2 Accident/sickness/critical illness/unemployment/redundancy insurance	20%
	U4.3 Permanent health insurance	
	U4.4 Buildings and contents insurance	
	U4.5 Waiver of premium benefit	
	U4.6 Mortgage indemnity insurance	

## Unit 6 Mortgage Arrears and Post-completion

Attainment Level	Outcome	Indicative Content	Approx. Weighting
Demonstrate an understanding of:	1 The principles and procedures associated additional money and the circumstances when further borrowing might be appropriate	U1.1 Homeowners reversionary income plans	25%
		U1.2 Home income plans	
		U1.3 Further advances	
		U1.4 Draw down facilities	
		U1.5 Release of part security (equity release products, home income schemes, home reversion plans)	
		U1.6 Remortgages, second mortgages)	
		U1.7 Bridging loans	
		U1.8 Charging structures	
		U1.9 Legal implications	
2	The principles, procedures and costs of transferring mortgages.	U2.1 Transfer of mortgage to a new lender	25%
		U2.2 Implications of property moves	
		U2.3 Converting one mortgage to another	
		U2.4 Removing one party from a joint mortgage	
		U2.5 Redeeming a mortgage before/at the end of its term	
		U2.6 Making additional/lump sum capital repayments on a mortgage, during its term	
3	The principles of using mortgages within debt consolidation arrangements	U3.1 Relationship between costs/penalties/repayments/term	15%
		U3.2 Risk to the consumer associated with consolidation	
		U3.3 Risks associated with moving loans from unsecured to secured status	
		U3.4 Draw down facilities	

## Mortgages

4	The implications for the borrower of the non-payment of mortgages, other breaches of the Mortgage Deed, non-payment of building insurance and the options available	U4.1	When to provide a mortgage warning, ensuring that this is understood	15%
		U4.2	Possible courses of action available (eg Scotland mortgage to rent scheme)	
		U4.3	FSA requirements regarding the treatment of those in arrears	
		U4.4	Mortgage Rights Act (Scotland)	
5	The legal rights and remedies available to lenders in respect of non-payment from borrowers	U5.1	Role of Citizens Advice and other agencies	15%
		U5.2	Rights of subrogation of insurers to pursue borrowers	
		U5.2	Legal remedies on default	
6	The main provisions made by the State to assist consumers in difficulties over the repayment of mortgages	U6.1	Income Support for Mortgage Interest (ISMI)	5%
		U6.2	52 week linking rule	