Section 2

Mortgage and property regulation and law

Section 2 covers identifying the FSA definition of a regulated mortgage and a lifetime mortgage; and explanations of the principles of mortgage and property law, including: the Law of Property Act 1925 and other related laws; tenure; ownership; land registration and unregistered land; easements, covenants and charges; consumer legislation relating to mortgages; testacy and intestacy; and legal obligations.

Section 2 covers part 1 of the syllabus for Unit 3.

2.1 The Mortgage Conduct of Business Rules

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.

2.1.2 The structure of the MCOB Sourcebook

The Mortgage Conduct of Business Rules (MCOB) form a separate *Sourcebook* within the FSA *Handbook*. They comprise 13 chapters, which are summarised as follows.

Chapter	Title	Content
MCOB 1	**Application and purpose**	♦ Helps firms understand which parts of the MCOB rules apply to them ♦ Provides guidance on the application of other parts of the FSA Handbook
MCOB 2	**Conduct of business standards: general**	♦ General requirements that apply throughout the mortgage Sourcebook ♦ Communications must be clear, fair and not misleading ♦ Rules on inducements
MCOB 3	**Financial promotions**	♦ Content requirements for qualifying credit promotions ♦ Rules banning unsolicited real-time promotions (cold calling)
MCOB 4	**Advising and selling standards**	♦ The initial disclosure document ♦ Independence ♦ Suitability of advice ♦ Non-advised sales

MCOB 5	**Pre-application disclosure**	♦ Timing and content of the key facts illustration (KFI)
MCOB 6	**Disclosure at the offer stage**	♦ Content of the offer document
MCOB 7	**Disclosure at start of contract and after sale**	♦ Start of contract information requirements ♦ Annual statements ♦ Information requirements for post-sale contract variations (such as further advances)
MCOB 8	**Lifetime mortgages: advising and selling standards**	♦ A tailored regime for advising and selling lifetime mortgages
MCOB 9	**Lifetime mortgages: product disclosure**	♦ Tailored product disclosure requirements for lifetime mortgages
MCOB 10	**Annual percentage rate**	♦ How to calculate the APR
MCOB 11	**Responsible lending**	♦ A requirement for lenders to check the consumer's ability to repay
MCOB 12	**Charges**	♦ Charges in key areas (for example, arrears and early repayment charges) must be reasonable, based on the cost to the lender ♦ Charges must not be excessive
MCOB 13	**Arrears and repossessions**	♦ information requirements for fair treatment of borrowers in arrears and facing repossession

The key points of each of the relevant MCOBs will be covered in the appropriate section of the text.

2.2 Principles of mortgage and property law

The purpose of a mortgage is, quite simply, to enable a person or organisation to borrow money using the property as security. This text is concerned mostly with residential mortgages, which enable people to purchase private dwelling houses. As the prices of houses are beyond the immediate personal resources of most purchasers, it is necessary to enter into a borrowing agreement with a lender.

A **mortgage** is an arrangement where an asset is used as security for a loan. For the purposes of this study text, we will be concentrating on a specific situation; that is, where the asset used as security is residential property and where the purpose of the loan is to fund the purchase of that property. You should bear in mind, however, that other assets, such as share portfolios, can be mortgaged and that mortgage-backed loans may be used for other purposes.

The means of transferring rights in property used as security is described as a ***conveyance***. The borrower is described as the ***mortgagor*** and the lender as the ***mortgagee***. It is not uncommon for people to get these two terms confused, so ensure that you memorise them correctly.

In Scotland, the terms *debtor* and *creditor* are used instead for the borrower and lender respectively.

The vast majority of UK owner-occupiers fund their house purchases by way of a mortgage. Historically, building societies were the major residential mortgage lenders but banks and other financial institutions now have an increasingly large share of the market.

Mortgage law and practice has evolved over time, generally to the benefit of borrowers. This has arisen both from changes to the law (for example, with the introduction of equitable principles), but also latterly as a consequence of social policy and improved consumer protection. While borrowers were once unable to repay a mortgage loan early, they now have the right to do so at any time. Borrowers are also now far better protected in the event that they cannot make a repayment on the due date.

There are material differences between Scots and English land law, and consequently in mortgage practice and terminology. These will be highlighted throughout the text.

2.2.1 Law of Property Act 1925

The Law of Property Act 1925 is the main legislation that governs the ownership of land in England and Wales. It simplified the ways in which mortgages can be created, the most common method now being by way of a ***legal charge***. A brief summary of some of the key provisions of the Act is as follows:

- a minor (a person under the age of 18) cannot hold an interest in land;
- where two or more loans are secured on a property, their priority is determined by the date of their registration;
- the borrower has a right to let the mortgaged property – in practice, however, all lenders include a clause in their mortgage deed that specifically excludes this right;
- the legal remedies that are available to the lender, in the event of default or other breach of the terms of the mortgage by the borrower, are set out in the Act;
- the lender is not liable for any loss made on the execution of its power of sale; and
- the lender has the right to determine how the proceeds of any insurance claim relating to the mortgaged property are used.

2.2.2 Types of mortgage

2.2.2.1 Legal mortgage

Most lenders will only lend for property purchases on the strength of a ***legal mortgage***. Prior to the Law of Property Act 1925, there were a number of ways in which a legal mortgage could be created. The Act of 1925 reduced these to two:

- *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;

- *mortgage by way of legal charge* – in full, a 'charge by deed expressed to be by way of legal mortgage'. In Scotland, it is known as a *standard security*. Unlike the mortgage by demise, the property itself is not transferred to the lender. Instead, the ***legal charge*** is a deed that states that the property has been charged with the debt (the loan) as security for the lender. The lender acquires certain rights that leave it in a very strong position should the borrower default.

2.2.2.2 Securities over heritable property (Scotland)

Heritable property, in Scots law, consists of land and things built on it, and attached to it. It is divided into *corporeal heritable property* (including, for example, land, buildings, crops and growing timber) and *incorporeal heritable property* (including bonds or securities over land).

Until the introduction of the Conveyancing and Feudal Reform (Scotland) Act 1970, the two main rights in security of heritable property were:

- *the bond and disposition in security* – which created a real right in favour of the creditor and qualified the rights of the debtor in the property.
- *the ex facie absolute disposition* – which made the creditor the nominal owner of the property. Many of these still exist today.

The Act, which came into effect on 29 November 1970, meant that all new securities had to be created as a *standard security* – a new form of security governed by the Act.

A standard security comprises two main aspects:

- a personal obligation whereby the debtor undertakes to the creditor to perform the obligation to which the security relates, eg to repay sums advanced by the bank; *and*
- a grant by the debtor to the creditor of his interest in the heritable property.

For the creditor to obtain a real right in the heritable property it is necessary for the standard security to be recorded in the General Register of Sasines or registered in the Land Register of Scotland as appropriate. Until then, it will not be effective against third parties.

2.2.2.3 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.

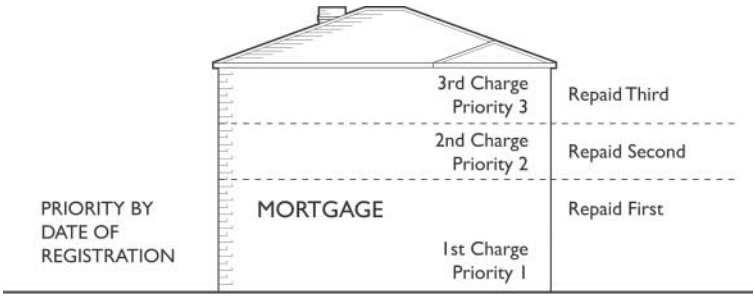
The second charge will be registered with the relevant Registry and it is the order of this registration that determines who takes priority in the event of default.

The general rule is that later mortgagees rank after the first mortgagee in terms of their security, provided that earlier mortgagees have followed proper procedures in registering their charges. This means (among other things) that, if the borrower defaults and the property is sold, the first mortgagee will benefit first from any sale proceeds before any surplus is available for the second, and so on; the earlier mortgage takes priority. Subsequent mortgagees receive their share of any surplus in order of priority until each of their claims is satisfied or until the sale proceeds run out. If there is anything left at the end, it must be repaid to the borrower.

If the first mortgagee fails to receive enough from the sale of the property to repay its loan, then clearly subsequent mortgagees will get nothing. Naturally, a lender will only accept a second or subsequent mortgage if he feels that there is sufficient *equity* – value – in the mortgaged property to cover both earlier mortgages and his own comfortably.

Second mortgages present the lender with higher risk and are therefore likely to be offered at higher rates of interest or with higher tariffs of charges and fees; they are often provided by finance houses, who specialise in higher risk secured lending.

Figure 2.1 Ranking of mortgage securities



Most large retail banks and some building societies have subsidiary finance houses. For example, HSBC owns Forward Trust, Royal Bank of Scotland owns Lombard Direct and Barclays Bank owns Mercantile Credit. Some finance houses are wholly or partly owned by overseas institutions.

These institutions offer services such as:

- second mortgages for home improvements;
- secured and unsecured loans for cars, holidays and consumer goods;
- leasing and hire purchase.

When a borrower has existing commitments of this kind, it is extremely important for the adviser to evaluate the effects of these existing borrowings on his ability to service the mortgage.

2.2.3 Types of joint ownership

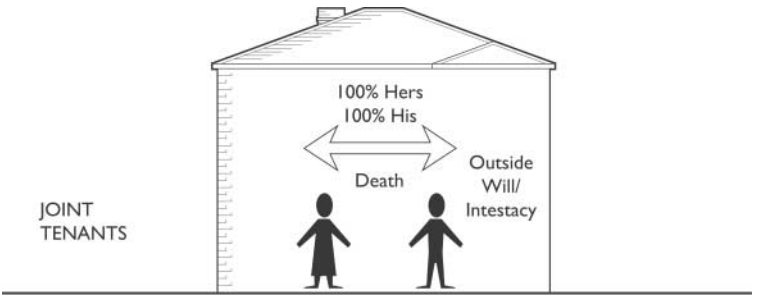
There are two types of joint ownership associated with mortgages – both described as a type of tenancy. This should not be confused with the more modern use of the word tenancy in relation to lettings.

2.2.3.1 Joint tenancy

In the case of **joint tenancy**, each of the joint tenants owns the whole of the property and, on the death of any joint tenant, the surviving joint tenant(s) will

take over the whole interest in the property under the principle of the *right of survivorship*. The transfer is automatic and cannot be overridden by any provisions made by a joint tenant in a will or through the laws of intestacy.

Figure 2.2 Joint tenancy



2.2.3.2 Tenancy in common

In the case of **tenancy in common**, each joint owner has a defined share of the property, although not necessarily an equal share. Therefore, if one of them dies their share of the ownership passes to whoever is entitled to inherit it under their will or under the rules of intestacy. As an example, if Naseem and Julie buy a house on a tenants in common basis, each would own 50% of the house. If Naseem dies, his 50% will pass into his estate. Julie would only benefit if Naseem has left his share to her in his will.

It must be remembered that this 'tenancy' refers to the ownership of the property itself and not the mortgage. Lenders are generally likely to prefer the ownership of the property to be on a joint tenancy basis. If the property were held on a tenancy in common basis and one of the joint owners were to die, then part of the ownership of the property would transfer to somebody else who might be unknown to the lender and not residing in the property. The mortgage would then be in different names from the ownership of the property.

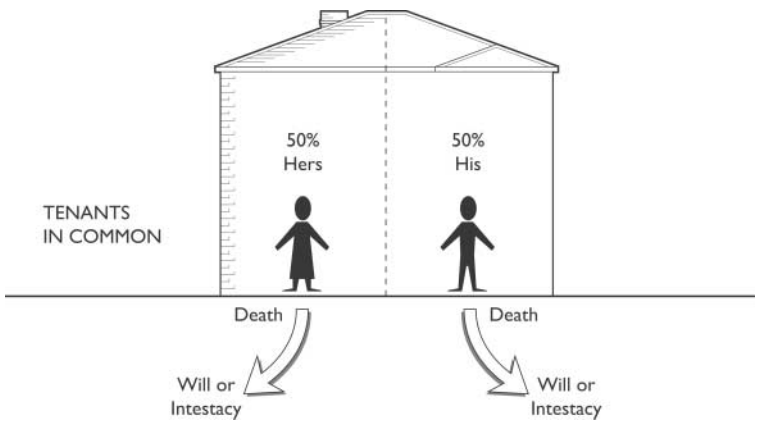
Tenancy in common can be useful if the intention is to leave one's share of the property to someone else rather than the joint owner, in most cases as part of an inheritance tax (IHT) mitigation plan. You will be aware that the first part of an individual's estate on death is not subject to IHT; this is known as the *nil*

rate band. This means that, with good planning, a couple could leave twice the nil rate band in total to their heirs without inheritance tax.

An example might be where Mum and Dad buy a holiday home on the coast. They have reasonable assets and would like to avoid inheritance tax if possible. In the event that either of them were to die, it would be better to leave the children a share of the property rather than cash because the survivor would need the cash in order to live. In order to achieve this, the parents can arrange ownership on a tenants in common basis, each leaving 50% to the children in their wills. On death of one parent, the children will own 50% of the property and the survivor the other 50%. Most importantly, the share of the property left to the children will form part of the deceased's nil rate band and this will enable the survivor to benefit from the cash left in the estate.

While tenants in common is ideal for second homes, it is risky for the main home. If the children were to fall out with the survivor, the worst that can happen with a holiday home is that it is sold and the survivor has to change holiday arrangements. Forcing a sale on the main home is a totally different matter.

Figure 2.3 Tenants in common



2.2.3.3 Vesting of property – Scotland

A similar distinction is made in Scotland between the two types of joint ownership but with slightly different terminology.

2.2.3.3.1 Joint property

Joint property is similar to a joint tenancy in England and Wales.

2.2.3.3.2 Common property

Common property is similar to a tenancy in common in England and Wales.

2.2.4 Land tenure

Tenure denotes the way in which title to the property is held; it is taken from the French *tenir* meaning to hold. The Law of Property Act (1925) reduced the number of ways in which property (legal estates in land) can be held to two: freehold and leasehold.

2.2.4.1 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.

Freehold ownership does not always mean that the property is better security than leasehold property. Freehold land can provide defective title and have specific features that render it undesirable from a lender's point of view. In particular, many lenders are reluctant to consider mortgages on freehold flats. The reason for this is that these invariably have common areas for which there is no specified accountability. For example, the ceiling of one person's flat is another person's floor. If the property is leasehold, there is a freeholder who determines such obligations; if the flats are freehold, it is necessary to have a management company in place to resolve such issues.

2.2.4.2 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.

The lender must understand the nature of the lease when a leasehold property is considered for mortgage. If the lease is too restrictive, it will affect the resale value of the property.

The unexpired term of a lease is very important. When a lease expires, the land reverts totally to the freeholder. As the lease approaches expiry date, the value will fall significantly. As a consequence, lenders specify that the lease must have a certain minimum number of years to run beyond the redemption date of the mortgage. A typical requirement would be 30–40 years.

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.

Failure to comply with a lease can result in its being terminated. This is called *forfeiture* and this is a serious matter for the lender. In all instances, the rights of the freeholder take precedence over those of the lender. If the borrower fails to comply with the conditions of the lease and rights are forfeited, the lender is left with no security. Consequently, all lenders include a clause in the legal charge, standard security or mortgage conditions that the conditions of lease can be fulfilled by the lender if the borrower does not do so. As lenders will not always become aware of this happening, many have insurance policies in place to cover them against losses caused by forfeiture.

Most lenders will have a policy with regard to the remaining duration of leaseholds against which they are asked to lend: in particular, many will decline to lend against short leases and those which do not exceed the planned mortgage duration by a specific amount.

2.2.4.3 The Commonhold and Leasehold Reform Act 2002

The Commonhold and Leasehold Reform Act 2002 made changes to the provisions contained in earlier reform Acts. It is designed to make it easier for leaseholders of flats to purchase collectively the freehold of their building, or for individuals to extend their lease. It was felt that the previous provisions were too restrictive and prevented many leaseholders from being able to exercise the *right of enfranchisement*.

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.

2.2.4.3.1 Buying the freehold of a flat

In order for leaseholders to be able to buy the freehold of a flat, they must be *qualifying tenants*. The main requirement for qualification is that the original lease on the flat was for a period of more than 21 years. Where the lease has changed ownership, the right passes to the new leaseholder, providing the original lease was for longer than 21 years.

Leaseholders listed below cannot be qualifying tenants:

- where the landlord is a charitable housing trust and provides the flat as part of its charitable work;
- where the lease is for commercial purposes;
- where the leaseholder owns qualifying leases of more than two flats in the building.

A qualifying tenant can purchase the freehold where the building meets the following criteria:

- the building must contain two or more flats;
- at least two-thirds of the flats must be held on a long lease, ie a lease that was originally granted for a term of more than 21 years;
- no more than 25% of the internal floor area of the building (excluding common areas such as stairs and hallways) is used for non-residential purposes.

At least 50% of the leaseholders in the block must agree to participate. So, for example, in a block of 12 flats, at least eight must be held on a long lease and at least six leaseholders must agree to participate in the purchase.

Where a leaseholder does not wish to participate in the purchase of the leasehold, he is not obliged to do so. He will lease his property from the new freeholders.

There are a number of circumstances where leaseholders cannot purchase the freehold of their building. The major restrictions include situations where:

- it is a converted property with four or fewer flats and the same person has held the freehold since before the conversion, and he (or an adult family member) has lived in one of the flats as his main residence during the previous 12 months; *or*
- the leaseholder has sublet his or her flat on a long lease; *or*
- more than 25% of the building's internal floor area is for commercial use.

2.2.4.3.2 Extending the lease

As an alternative to buying the freehold, those who have held a long lease for more than two years have the right to buy a new lease, effectively extending the term of their existing lease. The leaseholder is able to buy a new lease, running for 90 years from the end of the existing lease.

2.2.4.4 Commonhold

The Commonhold and Leasehold Reform Act 2002 brought about a change in the way in which property can be owned.

Commonhold was introduced as a new type of tenure to provide flexibility for those who would previously have owned leasehold property within a larger development – a block of flats, for example. The larger development is called the *multi-unit property* and each individual property is called a *unit*. The basic rules are set out below.

- A *commonhold association* is formed. This will be formed as a company and will manage the overall estate. As a company, the association must have a memorandum, articles of association and a commonhold community statement. The *community statement* will include the rights and obligations of individual unitholders, voting majorities and other essential rules for the community. In essence, the association performs a similar function to a leasehold management company.
- The land/property must be registered with the Land Registry as an estate in commonhold land. This can only be done after the commonhold association has been formed.
- Each individual unitholder owns the freehold of his property and a share in the commonhold association. Ownership of an individual unit confers membership of the association.

- The rights and obligations that would exist between a landlord and tenant on a leasehold property now exist between the association and each unitholder. The association will collect a *commonhold assessment,* which replaces the management charge on leasehold property.
- Any common areas in the overall property will be owned by the association.
- Existing multi-unit estates can only be converted to commonhold where all leaseholders and the freeholder are in agreement. On conversion, all leasehold obligations and agreements will terminate.

2.2.4.5 Land tenure in Scotland


There is much less leasehold estate in Scotland than in England and Wales – few residential properties are held on leases of substantial duration. There is no freehold estate at all.


In the past, land was held in Scotland mainly on *feudal principles*. This involved land being 'held by a vassal on perpetual tenure from a superior'. The word 'feudal' implies a hierarchy of rights that started with the monarch at the top and is passed down to vassals or a subordinate. Originally all land was owned by the monarch and rights were granted exclusively by the King or Queen, most often to the nobility. The nobles would hold land *immediately* under the monarch. The nobles would then create rights to 'lesser' citizens – these would hold land immediately under the noble.


When a person granted rights to another in respect of the land, this was called a *feu* and the grant of ownership was called *feuing*. The person granting the rights was called the *grantor* (or *superior*) while the recipient of those rights was the grantee or *vassal*, or *feuar*.


The system of holding land resembled a large pyramid with the monarch at the top and a succession of superiors and vassals all the way down to the bottom.

- *Subinfeudation* occurred when a new feudal estate was created. The grantee then became the grantor to a new grantee or feuar.
- *Outright sale* occurred when a new vassal took the place of an existing one and the latter came out of the feudal chain altogether.


Under the feudal system, land was normally held on the basis of feu holding. The vassal paid a periodic sum to the superior called a *feu duty*. As with leaseholds in England and Wales, the vassal had to observe any conditions imposed by the superior.


In the later part of the 20th century, however, the feudal system was determined inappropriate, largely because of its association with medieval servile relationships, and has been abolished by the measures set out below.

2.2.4.5.1 Land Tenure Reform (Scotland) Act 1974


Scotland's Land Tenure Reform Act 1974 enables vassals to redeem their feu by paying out a lump sum to a prescribed formula. This effectively means that the vassal buys out the feu. The Act prohibits the creation of new feu duties, though not the creation of new feus.


In feudal tenure, superiors and vassals have rights of ownership. The superior has a higher right, called the *dominium directum* while the vassal has a right called *dominium utile*. The rights of the vassal are more practical – while the superior has the rights to duties and other specified obligations, the vassal effectively retains the right to use the land.

2.2.4.5.2 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.

2.2.4.5.3 The Title Conditions (Scotland) Act 2003

The Title Conditions (Scotland) Act 2003 operates in tandem with the Abolition of Fedual 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.

This does not mean, however, that burdens will cease to exist. Many existing burdens (around half) are non-feudal, in that they do not arise from the relationship between superior and vassal. These non-feudal burdens can (subject to conditions) be created at any point in time in the ownership chain of land by inserting the relevant condition in the title deed when land is transferred from one vassal to another. They are 'real' in the sense that they run with the land and are permanent obligations that require compliance on the part of all future owners.

In particular, the following types of burden remain in place:

- *community burdens*, set by a developer for a whole estate;
- *conservation burdens*, enforceable by local authorities and the National Trust;
- *economic development burdens*, enforceable by a local authority;
- *rural housing burdens*, created and enforced by a rural housing authority.

2.2.4.5.4 Tenements (Scotland) Act 2004

The Tenements (Scotland) Act 2004 does not alter the rules of ownership of tenement flats. It introduces a statutory management scheme called the *Tenement Management Scheme*, which acts as a default management scheme for all tenements in Scotland (this is set out in the Schedule to the Act). It provides a structure for the maintenance and management of tenements, if this is not provided for in the title deeds. Where

the title deeds are silent on the issue of decision-making, the Scheme allows a majority of the owners in a tenement to make decisions by majority vote.


The Tenement Management Scheme introduced the new concept of *scheme property*. This sets out, in statute, the main parts of a tenement that are so fundamental to the building as a whole that they should be maintained in common. This will not, however, affect the ownership of the different parts of the building, which remains unchanged.


The Tenement Management Scheme also contains default provisions on emergency repairs and apportionment of costs, which become effective if the relevant title deeds do not expressly deal with these issues.

2.2.4.5.5 Allodial land


A small amount of land in Scotland is held allodially, or with no superior. *Allodial land* is as close as Scotland comes to absolute, unencumbered ownership.


Allodial land includes:

- Crown property;
- some Church of Scotland land (such as churches, graveyards and manses);
- land acquired by compulsory purchase under the Land Clauses Consolidation (Scotland) Act 1845.

2.2.4.5.6 Udal land


Udal land is an extremely old form of land tenure that exists in Orkney and Shetland. It is based on Norse law.

2.2.5 Giving advice on matters relating to property law

The mortgage adviser is not an expert on matters of land law: it is a complex and specialised area, and one in which the solicitor will advise the borrower.

It is useful, however, for the adviser to be able to:

- understand those factors applicable to freehold, leasehold and feudal estate that affect the saleability of the property, especially those of which the owner may not normally be aware;
- outline the rights and obligations of the lender under the mortgage deed;
- (in England and Wales) distinguish between freehold, leasehold and commonhold, particularly to answer basic questions by the borrower;
- (in Scotland) understand the feudal basis of land ownership and its implications for borrowers;
- understand the problems associated with lending on leasehold properties and on freehold flats;
- understand the principles of leasehold reform and other recent legislation.

2.3 Land registration

The purpose of **land registration** is to complete, simplify and maintain an ongoing and continuous record of ownership of land. In England and Wales it is the responsibility of the Land Registry.


In Scotland, land registration is the responsibility of the registers of Scotland.

Land registration is the process by which the state guarantees the validity of a title in a registry; the registration process can also alert prospective buyers and lenders to a variety of rights that third parties may have over, and obligations that owners may have in respect of, land. A detailed search of certain relevant registers is therefore a critical part of the mortgage process.

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.

2.3.1 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.

Rights of way can be removed by the courts but this is rare because they are normally created for good reason. Indeed several walking and conservation groups have recently won cases confirming the rights of the general public to use rights of way that landowners have sought to deny.

A right of light is less commonly encountered but can be established when one person wants to build a property adjacent to that of another. The occupant of the existing property can take action to secure his right of light, effectively forcing the developer to build a certain minimum distance away from the existing property – even if the land between is owned by the developer or by his customer.

2.3.2 Positive covenants

A ***positive covenant*** is a condition of title imposed by an earlier owner: it states what subsequent owner-occupiers *must do*.

The most common example is the obligation to maintain boundaries. In a terrace of houses, a middle house will have boundaries with at least two neighbouring properties. There will in most cases be a covenant, specifying which fence is the neighbour's responsibility and which is not. This will be shown clearly in the title deeds.

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

2.3.3 Restrictive covenants

Restrictive convenants 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.

2.3.4 Registering land in England and Wales

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.

Land registration has been compulsory for all transfers of land since 1990. This means that eventually every piece of land in the country will be registered, although unregistered land remains as such until it changes hands. The process is therefore a long one because some land rarely, if ever, is transferred (such as land belonging to national and local government).

It is important to be clear that registration is triggered by the transfer of the property after 1990 or by the creation of a first legal mortgage after 1 April 1998. The Land Registration Act 2002 replaced in its entirety the Land Registration Act 1925, although many of the principles have remained unchanged. The new Act is designed to encourage and facilitate electronic registration and conveyancing.

For **registered land**, HM Land Registry holds details on three registers as follows.

- The *property register* details the land, its title number and a plan of the property (easements that are beneficial to the property will be included here).
- The *proprietorship register* gives the name and address of the estate and owner, the nature of the title, date of registration and any property restrictions on ownership. It sets out the class of the title, which can be (in descending order of what might be seen as security or robustness):
  - absolute is where clear title is established. Absolute title is the best title and the most desirable. It may be either freehold with good title, or it may be leasehold where the lease is for at least 21 years and the freeholder/immediate leaseholder can demonstrate good title;
  - good leasehold can apply only in connection with leases of more than seven years. It means that the leasehold itself is good, but that the lessor's right to grant the lease is not guaranteed, because his own title as freeholder may not be absolute. It would therefore be necessary to check up on the freehold title, as well as the leasehold one. This can clearly create uncertainties for prospective purchasers of, and lenders against, the land – a factor that a lending bank will be bound to take into account when considering whether to lend.

    Where a prospective borrower wishes to raise money against land to which he holds good leasehold title only, perhaps because the freehold cannot be guaranteed as the deeds are missing, the lending bank may suggest registration of a *possessory title* (see below). While this does nothing in itself to free the land up from any pre-existing right, it does potentially make it easier to create a charge or effect a sale of the mortgagor's interest in the land. It also evidences his possession of the land as at the registration date and may facilitate conversion, in due course, to absolute title;
  - 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.

♦ 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.

When land is registered it makes life easier for the conveyancer because a search of the Land Registry confirms beyond doubt the quality of title and any conditions attached to it.

2.3.4.1 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.

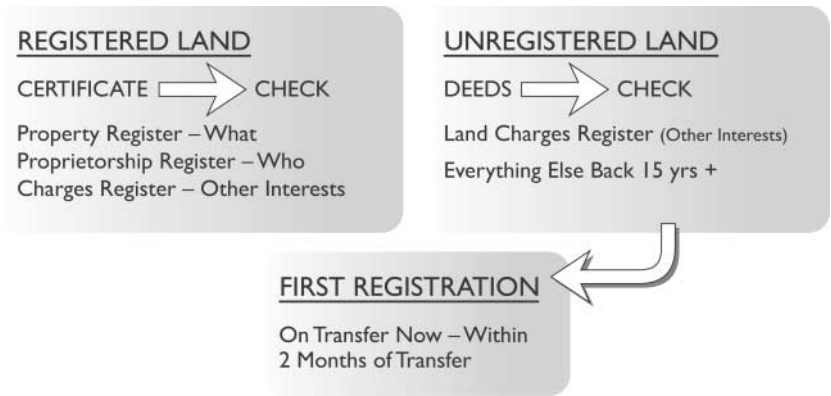
It is more difficult for a conveyancer to establish good title when unregistered land is sold. It is necessary to search back over at least a 15-year history of the property in order to discover anything that might affect the rights of the owner – this is known as the *root title*.

Rights over unregistered land can be registered through the Land Charges Registry. There are six classes of land charge that can be registered but it is not necessary for this text to detail of all of these – they are conveyancing matters dealt with by the solicitors acting in a sale and purchase.

The most common types of land charge registered are:

- *Class C (I) land charges* – these are legal mortgages not protected by deposit of title deeds (puisne mortgages) – second charges and so on;
- *Class F land charges* – these are notifications of spouses' interests from provisions of the Family Law Act of 1996.

Figure 2.4 Land registration



2.2.8.5.3 Title guarantees

A contract for the sale of a property states whether the vendor is selling:

- with *full title guarantee*;
- with *limited title guarantee*;
- with *no guarantee*.

The various types of *title guarantee* essentially replace an earlier system, where vendors sold properties in a specific capacity (eg as the beneficial owner, as the trustee, as a mortgagee, etc). Depending on the capacity in which the vendor was acting, certain covenants (promises) as to the robustness of the title being conveyed were implied.

This changed after the Law of Property (Miscellaneous Provisions) Act 1994: these covenants are no longer driven by the vendor's capacity but rather by the type of title guarantee he is conveying.

Title guarantees provide certain levels of comfort as to the robustness of the title being conveyed. For example, *full title guarantee* establishes that the property is free from charges and encumbrances. *Limited title guarantee* also gives some guarantees, but not the categorical guarantee available with a full title guarantee.

Under the 1994 Act, certain covenants are implied, depending on the nature of the title being given. It is up to the vendor to decide what type of title guarantee he is giving, but a purchaser, and indeed a mortgage lender, will have a keen interest in the type being offered. Many mortgage lenders insist in full title guarantee before they will proceed.

For example, irrespective of whether a property is transferred with full or limited title guarantee, the vendor is deemed to covenant that:

- he has the right to sell it; *and*
- he will do all that can be done to give the purchaser the title they require, including assistance with any details required by the Land Registry.

If he sells with *full title guarantee*, he is also covenanting that:

- he sells free from any charges and encumbrances, and free from any rights exercisable by third parties other than those of which he could not reasonably be expected to know.

If he sells with *limited title guarantee*, he instead covenants that:

- since he acquired it, he has not created any charges or encumbrances that still subsist over the property; *and*
- that as far as he knows, no one else has done so either.

2.3.6 Registering land in Scotland

Land registration principles are similar in Scotland to those applicable in England and Wales, though more recent in origin.

2.3.6.1 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.

Each property registered in the Land Register is detailed on a title sheet. This contains the following information:

- name of the person entitled to the property;
- heritable securities affecting the property;
- location of the property, based on the Ordnance Survey position;
- land obligations (or burdens) affecting the property.

Whenever changes in ownership or rights are made that affect the property, the Register should be changed. When a property is registered, the *Keeper of the Land Register* issues the owner with a land certificate, which is a copy of the title sheet. When a lender registers a security such as a mortgage, the Keeper issues a charge certificate that will be retained by the lender and which gives details of the security.

Registration does not guarantee a good title in every case. Those who wish to dispute ownership or rights can appeal to the Lands Tribunal for Scotland. There is also a right of appeal to the Court of Session. The Keeper is obliged to follow the directions of the Tribunal or court.

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.

2.3.6.2 The Register of Sasines

The *Register of Sasines* provides a system of registration of deeds relating to land. It was introduced by the Registration Act 1617. It is a public register comprising mainly title deeds and records of charges, judgments and burdens over land, including *conveyances* (legal documents that

transfer land from one party to another). Recording of a document in the Register of Sasines only guarantees protection of its contents; no title guarantee is provided.


Compulsory land registration in the Land Register has been gradually extended through Scotland but is not yet applicable in all geographical areas. In those areas not yet operative for the purposes of the Land Register, title deeds and security documents must still be recorded in the Register of Sasines.

2.3.7 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.

There are many properties where only one partner in the marriage is the registered owner. For older owners, this dates back to times when it was traditional for only the husband to be named as owner. There are also properties owned by an individual who met his spouse only after acquiring the property. The legislation recognises the rights of a *non-owning spouse* to register an interest in the property through a formal entry on the register. Effectively, this prevents the property from being sold or transferred until the spouse's notice is removed at the appropriate registry.

The legislation ensures that a non-owning spouse can continue in occupation of a property and provides a right of entry and occupation for those not already in occupation. The lender therefore has to satisfy itself at application stage as to who exactly will occupy the property, whether signatories to the mortgage deed or not.

Any non-owning spouse who will not become party to the mortgage can be asked to sign a *consent to mortgage* form, waiving rights of residence (in England and Wales) or to renounce occupancy rights (in Scotland). In the latter case, the non-entitled spouse swears before a notary public that the renunciation is made freely and without coercion.

A lender needs to exercise great care because it may later be bound by the occupational rights of a person who was not revealed at the time of application and who did not sign a 'consent to mortgage' form. The seller of the property may not be the only person who is in occupation and it is not only the spouse who has rights of occupation. The Family Law Act extended those who may claim rights of occupation and these can now include adult children, for example.

Cohabitants can apply for protection through the courts.

Example

Consider the following circumstances of a lady who calls at your office, in respect of her home, which is mortgaged.

Her husband is the sole borrower with a mortgage of £85,000 outstanding. This is because they met five years after he bought the property. The house is worth £90,000. Two months ago, her husband left and is unlikely to return.

Since she has lived in the house, she has contributed substantially to the mortgage because she has always had a better paid job than her husband. She cannot, however, afford to pay the mortgage on her own indefinitely.

She is desperate to know about the conduct of the mortgage and to receive advice on her immediate future. She wants to stay in the house but is concerned that any money she pays to your institution will be for the husband's benefit alone. She is also worried that your institution can evict her at short notice.

- What do you think she should do?
- Has she immediate cause for concern?
- What are the alternative outcomes in this situation?

The law in Scotland relating to matrimonial interests is contained in the Matrimonial Homes (Family Protection) (Scotland) Act 1981 as amended. It is broadly similar to the law in England. The existence of matrimonial interests will not be disclosed in the Register of Sasines, Land

Register or Personal Register. In the case of a registered title, the title sheet may state that there are no subsisting occupational rights of spouses of previous owners if the Keeper of the Land Register is satisfied that this is the case. This statement is backed by a state indemnity but does not cover the current owner, so an enquiry is still necessary as to his/her position.


When title is in one name only, a lender should take an affidavit, or sworn statement, from the owner confirming that there is no 'non-entitled' spouse, or, where there is a non-entitled spouse, a renunciation of such rights should be obtained. This protects a third party (such as a lender), dealing with the entitled spouse against the risk of subsisting occupancy rights affecting the property.


The position in respect of occupancy rights must be checked each time a subsequent advance is granted.

2.3.8 The results of a title search: the lender's view

We have seen that on sale of land, there are varying degrees of robustness of title being conveyed offered by the type of title guarantee. We also know that, when the solicitor handling the conveyance searches the relevant registers, he may alert a prospective lender to a variety of third-party rights over land or, indeed, of certain obligations enforceable against the owner of that land.

It is worth considering briefly what the effect of these may be on the lender's inclination to lend.

- *Different types of title guarantee* – some lenders will insist on full title guarantee and will not lend against a property where the title conveyed is anything less.
- *Easements* – if the valuer of a property is aware of any easements, their effects will be included in the valuation figure. If, however, they only come to light later (for example, during the legal work) then not only may this figure need to be reviewed for purposes of any sale, but the lender may also decline to lend as much as he otherwise would – or indeed to lend at all. Easements are not always negative, however, and so may not be detrimental to the value of the land.
- *Restrictive covenants* may also have a significant effect on the value and saleability of the land where they severely restrict its use. They are often largely immaterial – as, for example, where they impose a restriction on

the use of residential land for some unlikely purpose such as pig farming – which would probably indicate an attempt by an earlier vendor (presumably a pig farmer) to prevent the establishment of a rival enterprise on the land he has sold. Such a restriction would be unlikely to affect the resale value of land that is now in use for very different purposes. As with positive covenants, restrictive covenants may be binding between the covenanting parties only or may run with the land.

- *Matrimonial interests* and the potential interests of others who may be occupying the property will require special attention on the part of the lender. The Family Law Act 1996 gave certain rights of occupation and access to occupants who are not themselves a party to the mortgage and, when the mortgage itself is executed, the lender will:
  - search for the registration of any charges under the Family Law Act 1996;
  - enquire on the application form what adult occupants there will be who are not party to the mortgage; and
  - require that any such adult occupants sign a 'consent to mortgage' form.

  If it comes to light at a later stage that there are occupants of which the lender was not aware and who might for various reasons have or derive rights, then the lender must proceed with care in order not to prejudice its security.

It is clear that there are a number of steps that a lender can take, in each of the above circumstances. These range through:

- taking the appropriate initial steps, including, ensuring a search of relevant registers, requiring 'consent to mortgage' forms, etc;
- declining to lend at all;
- insisting on a revaluation of the property, taking account of the issues affecting title;
- taking out indemnity insurance against the eventuality of defective title having an adverse impact on the lender's security. This will protect the insured (the lender and owner) from claims made by others who lay claim to the property. The fee for such a policy is likely to be around 0.10% of the property value, subject to a specified minimum premium.

2.4 Consumer Legislation

2.4.1 The Consumer Credit Act 1974

The majority of mortgages are now regulated by the FSA and subject to the Mortgage Conduct of Business Rules but secured loans up to, and including, £25,000 that are not regulated by the FSA may be regulated under the Consumer Credit Act 1974. Second charges, for example, do not fall under FSA regulation and any such loan for £25,000 or under will be regulated under the 1974 legislation unless it is for an exempt purpose.

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.

2.4.2 The Data Protection Act 1998

The Data Protection Act 1998 deals with how personal data should be stored, used and accessed. It covers data held electronically and in manual records. Anyone who processes personal data, referred to as a *data controller*, must be registered with the Information Commissioner who is responsible for enforcing the Act.

All data controllers must follow the eight principles of good practice set out in the legislation. These state that data must:

- be fairly and lawfully processed;
- be processed for limited purposes;
- be adequate, relevant and not excessive for its intended purpose;
- be accurate and kept up-to-date;
- not be kept longer that necessary;
- be secure;
- be processed in accordance with the rights of the *data subject*;
- not be transferred to any other country that does not guarantee an adequate level of protection of the rights of data subjects.

The FSA is a registered data controller.

It is important to remember that financial advisers and mortgage advisers may be held accountable, as well as their employers, for any breach of the data protection legislation.

2.5 Testacy and intestacy

A person who dies having made a valid will is said to have died ***testate***. The executors will have been named in the will by the ***testator*** (the deceased) and they are responsible for obtaining a ***grant of probate*** to enable an estate to be distributed in accordance with the terms of the will. There is nothing to prevent the executors also being named as beneficiaries under the will, but those who witnessed the testator's signature when the will was made cannot be beneficiaries.

To be valid, a will must be:

- in writing;
- properly executed;
- signed by the testator in the presence of two witnesses.

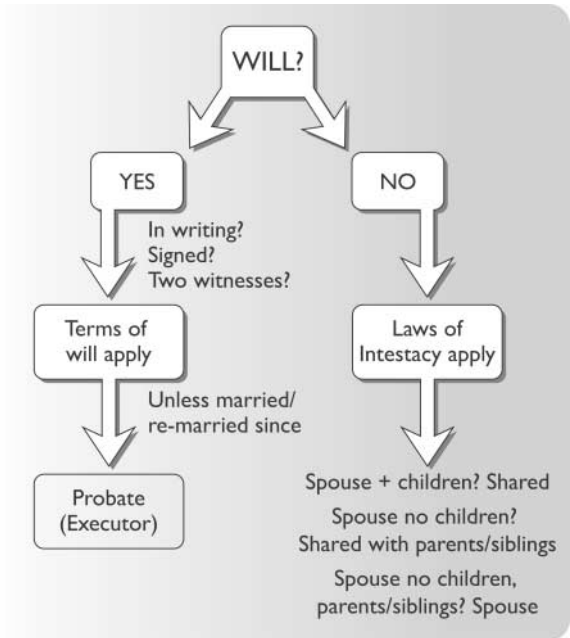
If the testator marries, or remarries, after having made a will, then the document will be deemed invalid unless it was made specifically in contemplation of that marriage.

The majority of people in the UK do not make a valid will and die ***intestate***. This means that it is quite likely that their estate will not be distributed in quite the way they might have wished. The *rules of intestacy* apply in such cases and involve the issue of a *grant of letters of administration* to an appropriate person who takes responsibility for the distribution of the estate in accordance with the intestacy rules.

These require that:

- if the deceased leaves a spouse but no children: the spouse gets the first £200,000 plus half the remainder; the balance goes to the deceased's parents or, if they are dead, to the deceased's brothers and sisters;
- if there are both spouse and children: the spouse gets the first £125,000; half of the balance goes to the children; the other half of the balance goes into a trust from which the spouse receives an income for life, but the capital of which will go to the children when the spouse dies;
- if there are children, but no spouse: the estate is shared equally among the children;
- if there is neither spouse nor children: the estate goes to the deceased's parents or, if they are dead, to the deceased's brothers and sisters.

Figure 2.5 The rules of intestacy



2.6 Legal obligations and guarantees

An ***offer of advance*** is not a legal contract in itself – it is essentially an invitation to the applicant to enter into a legal contract, subject to certain specified conditions being met. Because an offer of advance has no legal status, it is not binding on either the lender or the applicant and can be withdrawn in certain circumstances, such as:

- if it subsequently comes to light that the application contained false or inaccurate information;
- the applicant's financial or other relevant personal circumstances have changed since the offer was issued;
- the property offered as security for the loan is no longer considered to be suitable, perhaps because it has suffered extensive damage or as a result of the investigation of title carried out by the conveyancer.

If all the conditions attached to an offer of advance can be satisfied, then dates can be set for *exchange of contracts and completion* of the purchase.

The legal charge (or ***mortgage deed***) is executed shortly before completion. This *is* a formal contract that binds both the lender and the borrower. It sets out the rights of the lender and the covenants with which the borrower must comply. None of the terms of the mortgage deed can be altered without the consent of both parties.

2.6.1 Lender's rights

The lender's rights include:

- to charge capital, interest and any other fees;
- to call in the whole debt in the event of the borrower's default or bankruptcy, or if a compulsory purchase order is made on the property;
- to insure the property, if the borrower fails to do so;
- to meet any conditions imposed by statute, a local authority or title, if the borrower fails to do so;
- to let the property after it has been taken into possession;
- to transfer the mortgage to another lender, subject to the borrower's consent;
- to make further advances without the need for a new mortgage deed.

2.6.2 Borrower's covenants

The borrower must covenant:

- to make payments in accordance with the mortgage deed;
- to insure the property in accordance with the lender's requirements;
- to comply fully with appropriate legislation, local authority byelaws and other regulations;
- not to let the property without the lender's prior consent;
- to keep the property in good repair and allow access to the lender for the purpose of inspection at any reasonable time;

- to comply fully with all conditions of title, eg positive covenants, restrictive covenants and easements;
- in the case of a leasehold property, to comply fully with the terms of the lease.

Test your knowledge and understanding with these questions

Take a break before using these questions to assess your learning across Section 2. Review the text if necessary.

Answers can be found on page [3] 63.

Answer true or false to the following statements.

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'?

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.

Answers

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.