

## Section 4

### From offer of advance to completion

Section 4 covers an explanation of the MCOB rules on disclosure; and a description of the process from offer of advance to completion, including: the contents of a mortgage offer and their implications; legal work; the legal charge and mortgage conditions; the release of money; the mortgage deed; and consolidation.

Section 4 covers part 2 of the syllabus for Unit 3. Reference should also be made to MCOB.

#### 4.1 Offer of advance

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If, having reviewed a prospective borrower's application, a lender decides that the loan is viable, the next stage is for it to inform the applicant – and the terms on which it is prepared to lend. This is done by way of ***an offer of advance or offer letter***.

An offer letter is not itself the final legal contract – this comes later. The offer letter is an invitation to the applicant to enter into an agreement, rather than the agreement itself. The offer letter will, however, contain many of the details that will also eventually be reflected in the mortgage contract.

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*.

### **4.1.1 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.
- ◆ 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.

### **4.1.2 The offer**

Offer letters are generally issued *conditionally*: they are not binding on the lender unless and until the applicant fulfils the conditions set out. An offer may be withdrawn if:

- ◆ it comes to the lender’s attention that false or inaccurate information has been submitted in the mortgage application;
- ◆ the applicant’s financial or other relevant circumstances have materially changed since the application was made;
- ◆ something happens to the property that makes it less suitable or valuable.

The lender will generally send one copy of the offer letter to the applicant and another to the solicitor who is acting for him on the transaction. Offer letters are highly standardised and a typical one will contain:

- ◆ general details confirming the applicant, property and loan;
- ◆ standard warranties and conditions, applicable to the vast majority of mortgages;
- ◆ any specific conditions that might be applicable.

The general details the offer letter will contain are as follows:

<b>Personal details</b>	<b>Significance</b>
Name and address of applicant	Confirms details of the prospective borrower.
Customer/account number, if an existing account-holder	

### **Details of Property to be mortgaged**

### **Significance**

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Address or Plot Number	Confirms details of the property to be mortgaged, its value for lending and insurance purposes. This ensures that the value of the security and its resaleability is not prejudiced.
Brief description	
Tenure – freehold or leasehold	
Value for mortgage purposes	
Value for insurance purposes	
It will be a requirement that the property is subject to vacant possession	

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### **Details of the loan being offered**

### **Significance**

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Account number (if allocated)	Tells the applicant(s) unambiguously what the lender is prepared to lend and on what terms.
Amount the lender will be prepared to advance	
Term of years	
Method of repayment	
Monthly repayment amount	
Number of instalments	
Rate of interest, whether fixed or variable, how calculated and applied, and (if fixed) the period that that fixed rate is in force	
Cashback and clawback details and conditions	
Any special conditions re low-start mortgages, flexi-mortgages etc	
Annual percentage rate (APR)	
Any higher lending charge	
Details of any life assurance policies to be assigned or deposited	

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The **standard warranties and conditions** contained in the offer letter include:

<b>Warranties and general conditions</b>	<b>Significance</b>
A disclaimer, to the effect that the offer to lend does not imply a warranty of the reasonableness of the purchase price or condition of the property	Limits the lender's liability in respect of the value of the property and sets out the conditions that must be met if the borrower wants to proceed.
Notification of any additional security, if any	
The fact that the offer is subject to conditions, including a satisfactory report on title	Confirms the property is indeed marketable should this become necessary.
Statement that the lender can withdraw the offer at any time	
Statement that the lender can vary the terms of the offer	
The period for which the offer letter remains valid	The offer will not remain open indefinitely and so the offer must be accepted within a certain period

In addition to these standard conditions, an offer may also be subject to certain *specific conditions*:

<b>Specific conditions</b>	<b>Significance</b>
Conditions relating to an additional guarantee, if any	Sets out the obligations of the guarantor
Completion of roads and access	Important to maintain market value of property – relevant for new developments
Conditions that the applicant must carry out any work deemed necessary and by when	Relevant where the lender believes remedial work is necessary to protect the condition and value of the property

The lender's right to inspect the property to check the work has been done	Protects the lender against the borrower's failing to carry out remedial work
Retention conditions, if applicable	Allows the lender to hold back part of the advance until remedial work is done
Conditions in respect of stage payments, if any (including the lender's right to inspect progress)	Applicable for self-build schemes and prevents the lender having to release all the money at the outset
'Consent to mortgage' form in respect of occupants aged 17 or over (not all lenders currently use these)	Prevents an occupant deriving an overriding interest* in the property (preventing the lender from easily obtaining vacant possession of the property)
Requirement for the redemption of any existing mortgages or other borrowings on, or before, completion	Prevents the applicant becoming overstretched
Any other non-standard requirements	

\*An **overriding interest** is a right established in favour of the occupants of a property who are not a party to the mortgage, but who nevertheless have an interest in it. Such interests were originally established under s70 of the Land Registration Act 1925 so as to prevent hardship and unfairness on (for example) non-owning spouses, for example, who might be severely disadvantaged if the owning spouse were to default on the mortgage, leaving them homeless. The range of those who can establish overriding interests has widened considerably over the years to include a number of people other than the borrower's spouse. The practical relevance for a lender is that it is important to be aware of who the potential occupants of a mortgaged property, other than the borrower, are. Otherwise, if the lender has to take over the property in the event of default, it may have difficulty getting vacant possession quickly. This may considerably delay any sale of the property and realisation of the security.

If, on receipt of the offer letter, the applicant wishes to proceed on the basis of the terms set out in it, he will complete it and return it to the lender. At the same time his solicitor will be liaising with the seller's solicitor to agree terms for the sale.

Should all go to plan, the applicant now knows that subject to his being able to meet all the conditions, the lender will make funds available to him. The next step is for contract terms to be agreed with the seller and for the buyer's solicitor to carry out all the relevant searches.

Once these stages are complete, signed contracts are exchanged between seller and buyer and, at this point, a non-refundable deposit is generally paid by the buyer to the seller. Both parties are now committed to the transaction and the buyer also becomes responsible for insuring the property. Between exchange of contracts and completion – the actual handover of the property – the lender will prepare the mortgage documentation.

## **4.2 Report on title**

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Before a lender enters into a binding contract with a borrower, it will insist on receiving a satisfactory **report on title** (also known as **certificate of title**): the solicitor arranging this will make any additional observations that he thinks may be relevant. The report on title will confirm the borrower's full name as it is recorded in the legal documents, and show the outcome of the various searches on title that the solicitor has undertaken as covered in Section 3.2.1.

If the title to the property is not free from defects, the solicitor must advise how these affect the security and/or how they may be overcome: more legal work may be needed to overcome the problem; insurance cover might be arranged.

Essentially the lender wants to know that the property can safely be taken as security for the loan.

With some legal matters, rather than incur the additional costs and delays in investigating the matter further, it may be possible to arrange a *defective title indemnity policy* that protects the lender against future losses that may occur as a result of the legal defect.

The process of investigating title is becoming increasingly straightforward because land registration is now compulsory in England and Wales, as well as in many areas of Scotland registered details of the property, ownership and incumbrances affecting the property are guaranteed to be accurate.

Some lenders are now arranging *title insurance policies* on mortgages that reduce the amount of legal work that needs to be undertaken, and simply provide insurance cover to protect the lender against any losses that might

occur as a result of the full legal work not being completed. This means the necessary legal work can be reduced enabling the purchase, and the mortgage, to be completed more quickly. The borrower may also benefit from reduced costs but, while the title insurance policy will indemnify the lender against specified title defects, the borrower will still need to satisfy themselves about their own position in the event of any defective title problems.

### 4.3 Legal charge, standard security and mortgage conditions

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A **legal charge** is the main way of creating a mortgage in England and Wales (see Section 2.2.2). In Scotland, a **standard security** is used. The charge is created by **mortgage deed**. The deed often contains a set of mortgage conditions, to which the borrower is bound from the time the deed is signed.

The deed is a formal and binding contract between **mortgagee** (lender) and **mortgagor** (borrower). Its contents and those of any document 'linked' to it (such as the mortgage conditions) cannot be varied without the consent of both parties to the contract.

Although the methodology is rather different in England and Wales to that in Scotland, the principles relevant to mortgage advisers are broadly similar.

Under the FSA's Mortgage Conduct of Business Rules, lending institutions must undertake to make conditions of mortgage clear to borrowers. Even if this were not the case, they would still have such obligations under the Unfair Terms in Consumer Contracts Regulations 1994. In fact, since these regulations were passed following passage into law of an EU directive several lenders have been commended for the effectiveness of 'plain English' documentation.

#### 4.3.1 Release of money

The lender will only release money to fund the mortgage when it is certain that all necessary conditions have been met and safeguards are in place. This involves checking that the report on title is consistent with the application details. If everything is in order, an advance cheque is sent to the solicitor in time for completion. The solicitor confirms the date of completion, enabling the lender to assume that completion will take place on the date specified and that this will be within a few days of the date of receipt of the cheque.

#### 4.3.1.1 Stage payments

**Stage payments** are made when a borrower wishes to fund a self-build project. Stage payments involve splitting the loan into *tranches* (separate amounts) progressively released as the project advances. Most lenders offer stage payments in three or four parts, depending on policy. Stage payments can also apply if a small builder is building only two or three new properties. Larger developers will not require stage payments.

Self-build is more common in certain areas of the UK than others. It is a highly cost-effective way of acquiring a dwelling that can save up to 25% in comparison with buying an existing house. It does remain a niche activity, however, probably due to the complex procedures involved.

Matters of concern to lenders in respect of self-build projects are:

- ◆ overall costs of the project, including supervising architect fees;
- ◆ upfront funds available;
- ◆ plans and their consistency with lending policy and local regulations;
- ◆ method of construction and consistency with lending policy;
- ◆ commitment of the applicants to see the project through to completion;
- ◆ quality/reputation of the contractor and whether a member of NHBC or similar;
- ◆ perceived ability to contain cost overruns – this can be done via a contract with the builder;
- ◆ timing of release of funds;
- ◆ intermediate and final inspections.

In addition to first mortgages, it is possible for *further advances* to be released in stage payments. This would generally be where the further advance is for a substantial amount and the borrower needs to make stage payments to the builder as work progresses.

On completion, if not before, details of the repayments required are sent to the borrower together with any other relevant information such as insurance details, direct debit forms and so on.

### **4.3.2 Contents of the mortgage deed**

The **mortgage deed** (also referred to as the **legal charge**) contains the following:

- ◆ names of the parties to the mortgage:
  - lender (*mortgagee*);
  - borrower(s) (*mortgagor(s)*);
- ◆ description and details of the property;
- ◆ that the property is charged to the lender as security for the loan;
- ◆ receipt – acknowledgment that the loan has been made;
- ◆ details of capital, interest and all other fees and charges associated with the mortgage.

The deed may also contain all the conditions of the lending contract; alternatively, it may be a shorter summary, making reference to conditions contained in a separate booklet (mortgage conditions are highly standardised and so lend themselves to this treatment, with a pre-printed booklet containing all the conditions to which lender and borrower are bound).

The conditions will include the following.

#### **Borrower's Covenants**

#### **Lender's rights**

To make payments in accordance with the deed

To charge capital, interest and any other fees in accordance with the deed and conditions (including, for example, redemption fees).

The whole debt becomes due in the event of default, compulsory purchase order or bankruptcy.

To insure the property in accordance with the lender's requirements

To insure the property, if the borrower fails to do so, and to apply the proceeds of any insurance claim, either in reduction of the mortgage debt or to the subject of the claim.

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To comply with legislation and local authority byelaws and regulations	To meet conditions imposed by statute, local authority and title, if the borrower fails to do so and to make appropriate charges.
Not to let (or <i>demise</i> ) the property without the lender's prior consent	To let (or <i>demise</i> ) the property as mortgagee in possession
To keep the property in good repair and to permit access and inspection by the lender	To call in the mortgage. To apply the legal remedies.
To comply with the conditions of title, such as positive and restrictive covenants	To transfer the mortgage, subject to consent by the borrower.
To comply with the conditions of any lease (such as payment of ground rent)	To make further advances without the need for a new deed.
To comply with the rules (if the lender is a building society)	

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### **4.3.3 Consolidation**

**Consolidation** occurs when one borrower has different mortgages on different properties with the same lender. If the borrower wishes to redeem one of these, the mortgagee can insist on redemption of all. This was excluded by the Law of Property Act 1925 unless a contrary intention is set out in the mortgage deed. Most lenders will reserve the right to consolidate.

### Example

Mr Sethna has mortgages on two properties with Lending Bank plc. Property A's value is well in excess of the sum that Lending Bank has lent against it, while property B has fallen in value to below the amount lent against it.

Mr Sethna might, if he only has sufficient money to redeem one of the loans, be keen to pay off the one on property A (because he has some valuable equity in it). Lending Bank is unlikely to be happy to be left with only a poorly performing loan against a property that now represents inadequate security. Consolidation provides a mechanism for the bank to protect itself against the borrower behaving in this way.

Legally, the bank in the above example can consolidate if:

- ◆ it has specifically reserved this power in at least one of the mortgage deeds;
- ◆ the legal date of redemption has passed on both mortgages (this is usually set by lenders as a date very shortly after the mortgage has been completed so that the lender's powers contained in the mortgage deed can be invoked);
- ◆ both mortgages are held in the same names.

In practice, whether or not the lender decides to consolidate will be determined by its overall perception of risk, including conduct of the mortgage accounts and other business relationships with the borrower. A lender must be reasonable in its deciding whether to consolidate or not.

The mortgage deed contains the conditions that bind both lender and borrower: where the borrower fails to meet these conditions, whether by defaulting on the loan or otherwise, there are a variety of legal remedies available to the lender. The remedies are covered in detail in Unit 6.

### **4.3.4 Giving advice on the contractual relationship**

While it is the role of the solicitor to deal with the technicalities of the contract and the sale process, the mortgage adviser has an important role in guiding the borrower at application stage. A mortgage is a very serious financial commitment and likely to be one of the largest made in a lifetime.

The borrower must be made aware of the significance of most of the conditions:

- ◆ under the FSA Mortgage Conduct of Business Rules, lenders undertake to inform the borrower of all obligations in respect of, not only interest and capital, but also of fees, charges and other costs in connection with the mortgage;
- ◆ of particular concern is advice on fees such as redemption and part-redemption fees, clawbacks on early redemption in respect of cashback loans and settlement fees for fixed-rate mortgages;
- ◆ the borrower should be aware that it is necessary to maintain the property in good repair, not only to retain its desirability as a residence but also to preserve the lender's security (in extreme circumstances, lenders will take action for possession if it is felt that the property is deteriorating significantly);
- ◆ although many borrowers do let their properties without permission, it is a breach of covenant to do so – the lender should, therefore, avoid acknowledgment of any proposed tenancy at all costs;
- ◆ the persons signing the mortgage deed are bound by it until all its conditions are met – this applies even if two joint borrowers subsequently separate; it is up to the lender whether to release a borrower from the contract.

Most borrowers simply want to be assured that the conditions of mortgage are reasonable and that there are no surprises in store during the life of the lending arrangement. Having said this, consumers of financial services have become much more financially aware in recent years and are now more likely to ask searching questions in order to get the best deal possible. The adviser, therefore, needs to be able to address the issues raised with confidence.

### **4.3.5 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.

## Test your knowledge and understanding with these questions

Take a break before using these questions to assess your learning across Section 4. Review the text if necessary.

Answers can be found on page [3] 102.

*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.

## Answers

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.