

## **Unit 6**

### **Mortgage arrears and post-completion**

After studying this unit, you will be able to demonstrate an understanding of:

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



## Section I

### Further advances and remortgaging

Section I explains the MCOB rules applying to further advances and the process for arranging further advances and transferring mortgages to a new lender; and the section also differentiates between a remortgage and a second charge.

Section I covers part I of the syllabus for Unit 6. Reference should also be made to MCOB.

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

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

- ◆ The lender must send an annual statement to the borrower, covering the mortgage and any tied products purchased.
- ◆ The annual statement must contain:
  - a statement of whether the mortgage is interest-only, repayment or a combination;
  - on an interest-only mortgage, whether the payment includes the premiums on a repayment vehicle and the need to check its performance. Where payments do not include the costs of a repayment vehicle, the firm should give a prominent reminder that the customer should have arrangements in place to repay the mortgage, and that they should check their performance;

- details (since the last statement) of payments made (date and amount); the amount due each time; the rates of interest charged; the amount of interest charged; any other amounts of fees paid;
- a reminder for the borrower to contact the lender if he is having problems making the mortgage payments;
- the amount owed on the statement date;
- the remaining mortgage term;
- the date on which any early repayment charges cease to apply;
- a revised tariff of charges where they have changed.

### **1.1.1 Further advances**

Before the customer submits an application for a further advance, the lender must supply an illustration as required for a new mortgage as described in Unit 4, Section 1.1.2.1 (MCOB 5 – see Unit 4, Section 1.1.2). The illustration must be based on the amount of the further advance only, and must show the total amount of borrowing and the new total payment.

### **1.1.2 Adding or removing a party to the mortgage**

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

### **1.1.3 Changes to the monthly payment**

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

- ◆ the amount outstanding at that point;
- ◆ the new payment due and the date it will start;
- ◆ the new interest rate to be charged and the date it will start;
- ◆ the details of any charges for making the change;

- ◆ if the loan is changed from repayment to interest-only, a reminder of the need to make arrangements to repay the capital at the end of the term.

## **1.2 Further advances**

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A **further advance** is a 'top-up' loan to an existing borrower usually over the remaining term of the existing loan. The FSA Mortgage Conduct of Business rules *apply to further advances as well*.

The lending market is now highly competitive. There is no guarantee that the original mortgage lender will be an automatic choice when additional finance is required. All lenders actively pursue this type of business because their records can often identify high quality lending opportunities.

Lenders will look for customers who want to top up their borrowing, sometimes for home improvements and other matters relating to the property. Mainstream mortgage lenders, especially building societies and banks, can often provide mortgage funds at lower interest rates and fees than these banks. Mortgage advisers should be vigilant in looking for opportunities to secure good quality lending business from existing clients because in many cases, they will be doing these clients a favour by making funds available at lower cost.

In addition to the main retail banks and building societies, there are several other types of institution that are prepared to supply finance, including insurance companies and finance houses.

### **1.2.1 Gathering information**

**Gathering information** is the first stage in the further advance process, as it is in that for a mortgage. There are two aspects:

- ◆ assessment of the ability to repay;
- ◆ adequacy of the security.

The first of these is concerned with borrower status. The second involves reassessing the property to ensure that it continues to offer sufficient security in keeping with prudent lending practice and the policy of the financial institution.

Information can be gathered by:

- ◆ getting the applicants to complete a further advance application form and submitting this in the normal way;
- ◆ interviewing the applicants;
- ◆ accepting the application through a telesales/call centre.

As with a mortgage for house purchase, stringent checks must be in place to confirm the information submitted in support of the application.

### **1.2.1.1 Determining purpose**

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

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

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

### **1.2.1.2 Assessment of status**

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

#### ***1.2.1.2.1 Personal circumstances of the borrower***

It cannot be assumed that the borrower has the same or a better income than when the original advance was granted. Income and occupation must be checked in respect of every party to the mortgage.

#### **1.2.1.2.2 Outgoings**

The lender must obtain comprehensive details of regular and irregular expenditure. Other borrowings will be of particular concern, as well as normal household expenditure. Lenders will usually reduce the amount they will lend to take account of a customer's other loan commitments.

If a customer's outgoings seem on the high side, one option might be, on repayment mortgages, to consider extending the term of their existing mortgage to reduce monthly payments.

#### **1.2.1.2.3 Family circumstances**

An assessment must be made of overall family circumstances. The number of dependants will often affect the ability to repay the loan.

Since the original advance was made, one party to the mortgage may have left the home or others may have moved in. If the former applies, it is unlikely that the person who has left will take on an additional debt burden with no benefit. In the latter case, the lender will require a 'consent for mortgage' form to be signed by the person who is not a party to the mortgage, to waive rights of residence. This would also apply to children who are 17 or over when the further advance is made and intend to live in the property as their main home.

#### **1.2.1.2.4 Conduct of existing account**

It is necessary to look at any account history to see that the applicant for the further advance has been a good payer – this can be readily established by looking at the records. Many lenders adopt a practice of insisting that arrears be cleared before a further advance is considered, no matter how small or insignificant these might appear. Where the borrower had problems in the past but has since maintained the account in a satisfactory manner for a number of years, it is unlikely to influence the lender's decision if all other factors are satisfactory.

#### **1.2.1.3 Assessment of security**

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

### **1.2.1.3.1 Value**

The size of the loan will be constrained by value. Since the original loan was granted, the property may have increased or decreased in value. Even if work has been done to improve the dwelling, there is no guarantee that this will have automatically enhanced its value. Since the property slump of the 1990s confirmed that the value of property can fall as well as rise, it cannot be assumed that an existing mortgaged property will have increased in value since the original mortgage was granted.

If the original loan-to-value figure was high, it may be necessary to commission a new valuation to determine whether the property offers sufficient security for the higher borrowing commitment. In other cases it may be obvious that the property is adequate as security.

Many further advances are for home improvements. In such cases, the lender may be prepared to consider the enhanced value of the property once the work has been completed. Before doing so, plans and estimates will be required and, in case of some structural alterations, evidence of planning permission. Work may be subject to final inspection by a suitably qualified person.

### **1.2.1.3.2 Loan required**

The overall loan-to-value ratio is the most crucial factor here: this is the outstanding debt plus the further advance as a percentage of the value of the property. The lender will also wish to ensure that total new borrowing will be in line with its standard income multipliers.

### **1.2.1.3.3 Location and neighbourhood**

Property experts regard location as the most critical factor in property value. This needs to be assessed from a long-term viewpoint: is the area new or mature; is it improving or declining; what plans are in place to develop infrastructure and local amenities; are there imminent plans to build roads or housing estates that might increase or reduce eventual value?

### **Example**

In a ten-year period, one village in the Midlands experienced the following changes:

- ◆ a new ring road constructed less than half a mile away;
- ◆ a sewage plant constructed adjacent to the village;
- ◆ a juvenile remand home opened less than half a mile away;
- ◆ high density local authority housing was erected in the village, eliminating its 'exclusive' image to potential purchasers.

#### **1.2.1.3.4 Purpose of the loan**

If the loan is for improvements or repairs, these must be consistent with conditions imposed by local authorities or national town and country planning legislation. Failure to take sufficient account of these factors can result in work being carried out, only to have the local authority impose an enforcement order to undo what has been done.

There are specific obligations for building societies under the Building Societies Act 1986 (as amended by the Building Societies Act 1997) to assess the adequacy of security for each and every mortgage to be secured on land. This does not necessarily mean that a new valuation should be made for all applications; societies can satisfy their statutory obligations as long as an assessment is made, which may or may not require a valuation to be carried out (ie they may be happy to assess the further advance based on the original valuation, if it is not too old). If in any doubt, however, the society will instruct a valuer to make an inspection to make doubly sure that they are in full compliance with the law.

Other lending institutions have no similar statutory duties: their engagement of the services of valuers is purely a matter of prudent lending practice.

## **1.2.2 The risk decision**

The lender must balance two sets of factors that can conflict:

- ◆ the need to obtain good quality lending business and sales of related products; and
- ◆ the need to lend within acceptable risk parameters.

Generally, it is necessary to consider further advances in the context of the overall risk exposure of the institution. This implies treating the application in much the same way as the original loan.

Although marginal mortgage applications can often be appealing to the lender because of the prospects of lucrative future cross-sales of mortgage-related services, this is not necessarily a good reason to lend in itself. Short-term gains from commission earnings can quickly be eroded by longer-term losses arising from default.

## **1.2.3 Other factors**

There are a number of other factors that a lender must consider when looking at an application for a further advance.

### **1.2.3.1 Variation of conditions**

When a further advance is made, it enables the lender to reconsider the conditions applicable to the entire lending agreement. Such conditions might include:

- ◆ interest rates;
- ◆ fee and charge structure;
- ◆ conditions applicable to the parties to the mortgage;
- ◆ covenants concerning the property.

### **1.2.3.2 Postponement of second charges**

A second charge is a right over the mortgaged property exercised by a lender subsequent to the first mortgagee. A legal mortgage that does not enjoy the security of the deposit of title deeds is known in law as a *puisne* (pronounced 'puny') mortgage. Most of these loans are made by banks and finance houses.

Building societies are constrained by law on the amount they can in respect of properties subject to second and subsequent charges.

### **1.2.3.2.1 Priority**

The priority of legal mortgages is governed by the Law of Property Act 1925, which states that the priority is determined by the date of registration.

#### **Example**

If lender A advances £20,000 on a property worth £40,000 on 1 August 1993 and lender B enters into a secured arrangement for £10,000 the following year, clearly lender A's mortgage has priority over that of lender B. In the event of default, A will be repaid first and so incurs lower risk.

If lender A makes a further advance of £5,000 two years after the original one, however, this £5,000 will take third priority after the original two loans – effectively, a higher risk than both.

Lender A may not be prepared to take his place in a line of mortgagees due to the increasing risk of being paid out last. In some instances, Lender A will persuade lender B to postpone its prior charge in favour of the new one – if it does not agree, lender A may offer a mortgage to consolidate the whole debt and lender B will lose out altogether.

To set aside a second charge, a **deed of postponement** must be executed. The process of adding a subsequent mortgage to an original one having postponed an intervening second charge is called *tacking*.

The only exception to the priority rule occurs when an original mortgage deed **obliges** the lender to make subsequent loans. Here the original mortgagee takes priority, irrespective of dates of subsequent charges.

### Example

A relatively new type of loan permits a form of revolving credit to be drawn down over and above the amount of the main mortgage. For example, borrower X obtains a mortgage from lending institution Y comprising:

- ◆ £25,000 towards purchase of the property, which is worth £40,000;
- ◆ £10,000, which can be drawn down at will, provided the overall indebtedness on this separate account does not exceed the £10,000 agreed.

As the mortgage deed commits the lender at the outset to a whole series of subsequent advances, they are all first mortgages and lender Y will have priority over second charge holders.



The ranking of securities in Scotland is governed by the Conveyancing and Feudal Reform (Scotland) Act 1970. The holder of a first security receives notice of a second or subsequent (postponed) security. The previous ranking of the prior lender is then restricted to cover his existing advances, interest and expenses. The provisions of the Act may, however, be varied between the debtor and creditor by a ranking agreement.

### 1.2.3.3 The higher lending charge

If the existing mortgage exceeds the loan-to-value ratio threshold (typically 75%) for the higher lending charge, a further advance will increase the exposure of the lender, requiring a new higher lending charge to be written. This will require an additional premium to be paid by the borrower (or debited to the mortgage account).

The further advance may take a loan that is not currently subject to a higher lending charge above the threshold. In this instance, it will be necessary for the lender to require a higher lending charge policy to be written, with the premium payable by the borrower or debited to the account.

Quite apart from higher lending charge considerations, many lenders have different policy criteria applicable to mortgages in excess of a specified loan-to-value figure.

#### **1.2.3.4 Planning permission**

Further advances for home improvements or alterations are made subject to the ability of the borrower to obtain all necessary planning. As we saw earlier, planning regulations are contained in a number of pieces of legislation, primarily the Town and Country Planning Act 1990. If changes are made, it is unlikely that the local authority would grant retrospective planning consent, leaving both lender and borrower in a potentially disastrous position.

##### **1.2.3.4.2 Listed buildings**

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

##### **1.2.3.4.2 Architect's certificates**

If work is not being carried out by a member of the NHBC, the lender will require work to be signed off by a professionally qualified architect. This confirms that the job has been done to a required standard. Typically, either an architect or surveyor will be appointed to oversee the work whether or not the work is carried out by an NHBC member.

The architect's costs can be substantial and are, of course, the responsibility of the borrower. A typical fee is 12.5% of build cost. This can increase as the level of supervision increases.

#### **1.2.3.5 New (additional) occupants**

When a new person moves into a property they are not usually party to any existing mortgage. Consequently, when a further advance is made the lender has two options:

- ◆ it can insist that any new resident signs a 'consent to mortgage' form to waive rights of residence to prevent the creation of an overriding interest;
- ◆ it can permit the new occupant to become a party to the mortgage, subject to status, and hence become jointly and severally responsible for the debt – this requires a variation of the mortgage deed if the new occupant is prepared to take on the obligations imposed by the deed.

If the mortgage adviser becomes aware of a tenant living in the property, under no circumstances should the status of the tenancy be recognised formally – this can affect the ability of the lender to obtain vacant possession in the event of default.

### **1.2.4 Other alternatives**

If a customer wishes to borrow further money there may be options other than a further advance: if a customer has a drawdown mortgage, it may be possible to draw down the required funds; if he has a flexible mortgage, it may be possible to miss some mortgage payments and accumulate the money in this way.

## **1.3 Remortgaging**

A **remortgage** is simply a replacement loan for one already in force. The existing loan may be with the lender carrying out the remortgage or with a different lender.

The need for a remortgage from the same lender is rare. Nearly all mortgage deeds have clauses allowing a further advance to be made without having to draw up a new deed. Where such a clause does not exist, it is often possible to create a deed of further charge supplementary to the original.

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

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

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

### **Example**

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

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

If another lender is approached for additional finance, a questionnaire will be received by the existing lender making enquiries about the conduct of the account and details of the mortgage. In applying for the second mortgage, the applicant will have given consent for this information to be released. A lender is not obliged to supply information to the second lender and a fee is normally charged for supplying the information.

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

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

The existence of a second charge can be an early warning sign of problems, especially if the borrower has already been turned down for a further advance

by the first lender. In particular, finance houses tend to charge higher rates of interest, commensurate with higher risk, indicating that the borrower may be more than anxious to secure a lump sum urgently. Alternatively, the borrower may be capable of taking on the extra debt without the risk of inability to service both loans.

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

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

## 1.5 Bridging finance

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

There are two types of bridging finance:

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

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

### **1.5.1 Advantages and disadvantages of bridging**

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

Closed bridging, however, provides a valuable service:

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

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

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

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



## Test your knowledge and understanding with these questions

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

Answers can be found on page [6] 21.

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

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

3. Any loan of up to £25,000 for a property extension is exempt from regulation by the Consumer Credit Act 1974.
4. If an application for a further advance shows that a borrower's income has greatly reduced, the lender can call in the original loan.
5. The value of the security should be reassessed if a further advance is requested.
6. A 'puisne mortgage' is one where the lender does not have possession of the title deeds.
7. A 'remortgage' is a replacement loan for one already in force and is always with a different lender.
8. Closed bridging is seen as riskier than open bridging.

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9. A £10,000 loan to buy a car, secured on a first charge basis, would be covered by consumer credit regulations.
10. Listed building consent will be required where the owner wishes to demolish a listed building.

## Answers

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

