

Section 2

Arrears, debt management and recovery

Section 2 explains the MCOB rules applying to those in arrears; outlines the options open to lenders when dealing with those in arrears; explains the assistance available from the state and other agencies for those in arrears; explains the implications of using mortgages to consolidate unsecured debts; and also details the lender's legal remedies.

Section 2 covers parts 3, 4, 5 and 6 of the syllabus for Unit 6.

2.1 Mortgage Conduct of Business Rules

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

2.1.1 Principles

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

The procedures should include:

- ◆ using reasonable efforts to reach agreement with the customer over the method of repaying the arrears or shortfall;
- ◆ liaising with a third-party source of advice regarding the arrears or shortfall;

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

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

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

2.1.2 Information

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

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

2.1.3 Procedure before taking possession

Before taking action for possession, the lender must:

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

2.1.4 Pressure

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

2.1.5 Marketing a repossessed property

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

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

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

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

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

2.2 Arrears awareness

2.2.1 Lender assistance to borrowers in arrears

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

Lenders must do all they can to help borrowers try to bring their mortgage accounts to order. The assistance that can be provided can take the form of short, medium or long-term measures.

- ◆ *Short-term measures* are those that are taken prior to litigation, usually when the account is between one and three months in arrears.
- ◆ *Medium-term measures* are those introduced once litigation has commenced and may be applicable for cases with up to 12 months' arrears of repayments.
- ◆ *Long-term measures* are those that attempt to restructure or reschedule the loan over a longer term.

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

2.2.1.1 Payment of arrears over a given period

The borrower may agree to clear the arrears by paying more than the monthly instalment for an agreed period. This may be possible, for example, when a period of unemployment is followed by the borrower taking a job at a salary level that can sustain the increased monthly payments.

Most lenders want to help borrowers but cannot do so indefinitely. It is therefore vitally important to:

- ◆ permit increased repayments, but only where these can genuinely be met and there is a real desire on the part of the borrower to address the problem;
- ◆ increase payments to bring the account up-to-date within a reasonable period of time – many lenders permit a maximum one year period for this to be done.

The courts can take a more generous view of the rescheduling period, sometimes expecting the lender to permit up to four years (or even more) to bring the account to order. Courts have the power to enforce this under the Administration of Justice Act 1973.

The borrower can be helped to put his mortgage account back on track if a representative of the lender works through the household income and outgoings in a thorough and logical way. Many experienced debt counsellors find that borrowers get into financial difficulties because they are unable or unwilling to take time to plan their budgets and prioritise payments due to others. Some lenders have budget factfind aids for use by debt counsellors, others use outside specialists who are either independent and experienced practitioners or established firms working in this field.

If this type of arrangement is permitted, it should be fully documented for internal records and confirmed to the borrower in writing. If the arrangement is not maintained, the existence of such documentation is crucial in enforcing the mortgage through litigation.

2.2.1.2 Full or partial suspension of monthly payments

The full or partial suspension of monthly payments is chiefly used where the mortgage is on a capital repayment basis, where there is already a reasonable amount of equity (and therefore security) in the property and where the lender believes that the borrower's personal and financial circumstances merit it.

It is essentially a short-term measure: the lender grants a payment 'holiday' or partial suspension of monthly payments. Arrears will therefore build up over the period of the 'holiday' or suspension, which the borrower will be expected to make good within a set time after the end of the concessionary period.

The lender will need to be confident of the borrower's ability not only to service the normal monthly payments but also the additional payments necessary to clear his backlog. If he has already fallen behind on the basis of the standard monthly payment, what changes to his income or spending habits will need to be in place to enable him to bear the additional payments at a later stage? If the reason for his having fallen behind relates to a one-off set of circumstances that were beyond his control and which are not expected to recur, the lender may be inclined to be sympathetic – and to be more optimistic for the success of this option.

2.2.1.3 Accepting interest-only payments

If the loan is a capital and interest mortgage, the lender may be prepared to accept interest payments only for a specified period. Many loans are, however, set up on an interest-only basis already, which renders this option inappropriate.

One problem with interest-only payments is that, in the early years of a capital and interest mortgage, most of the monthly repayment is made up of interest. The concession of removing the capital element might be worth very little.

A lender will need to weigh the merits of this course of action: will any real benefit accrue to the borrower on a monthly basis if the capital element of the loan at this stage is only small? What are the prospects for recouping the deferred capital payments at a later stage?

2.2.1.4 Extending the term

The mortgage account can be put back on course by extending the term. This can either be on a short-term or long-term basis. In the longer term, a customer with a ten-year term mortgage could extend it by 15 years to reduce the payments.

This option is used with great care by lenders. The borrower must be genuinely committed to keep the account on course. It cannot be repeated time after time.

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

2.2.1.5 Capitalising the arrears

A lender may also agree to capitalise the arrears: a mortgage of £50,000, but with £2,000 arrears (balance outstanding £52,000) might have the arrears effectively built into the loan, making it now a loan of £52,000 but with no arrears.

This can be suitable where a customer has gone through a difficult period (say unemployment) but is now able to make full monthly payments again, albeit

that they are now slightly higher. Most lenders will regard capitalisation of arrears as a 'one-off' remedy, not usually to be repeated.

2.2.1.6 Surrendering the endowment policy (changing to a repayment mortgage)

In serious default, the surrender of an endowment policy is pursued as a matter of course because many lenders have the endowment policy assigned to them. If the policy has not been assigned, this cannot be done. There will also be a fair chance that the assurance policy will have lapsed already if the borrower is in financial difficulties.

It is not good investment practice to surrender a life assurance policy very early. Nearly all policies are geared to long-term capital growth and perform badly over short periods. Early surrender is a way of obtaining capital in a hurry – but in such cases, financial advice should always be sought.

A disadvantage of surrendering the policy is that the loan is converted to a capital repayment mortgage. Payments will increase and alternative life cover must be arranged.

Some life assurance companies prefer to allow borrowing against the surrender value of the policy rather than see the policy surrendered. Another option can be to sell the endowment policy in the secondary market. This can sometimes be a better option than surrendering the policy. There are now a number of specialist intermediaries who can arrange the sale of *second-hand endowment policies (SHEPs)*, or *traded endowment policies (TEPs)*, as they are sometimes known (or SHEPs and TEPs for short).

2.2.1.7 Trading down

If the borrower has a commitment that simply cannot be sustained, the best option may be to trade down to a cheaper property. Often the lender will suspend litigation proceedings if there is a genuine attempt to sell the property with a view to buying a cheaper one. This action may release equity not only to remedy the arrears situation but also to place a sizeable deposit for a subsequent purchase.

Borrowers in difficulty are not the only ones who trade down.

Until recently, the most common incidence of trading down was older people retiring to a smaller home once the children had grown up. This practice may

be the trigger for several other needs because trading down can release equity for investment or income generation as well as create a whole new set of personal circumstances.

2.2.1.8 Other issues

Before any of these options can be considered, it is necessary for the lender to urge the borrower to take early action to discuss the specific problems relating to the conduct of the mortgage account. Quite often, the borrower will feel intimidated about coming to the office to discuss arrears problems, so the lender may have to follow up standard letters by telephone calls to bring about an early interview. Many lenders are prepared to arrange home visits by trained debt counsellors to discuss the situation in the borrower's own environment.

A lender might also consider allowing a customer to rent out a room of their home, to generate more income, but care must be taken to ensure that a tenancy with rights of occupation is not created.

2.2.2 State assistance to borrowers in arrears

For those who are unemployed, the government provides assistance by way of *Income Support for mortgage interest (ISMI)*. To qualify for this, the borrower must have no more than £8,000 in savings. Only the first £100,000 of a loan qualifies for Income Support assistance.

2.2.2.1 ISMI rules

Income Support regulations were changed radically in October 1995 by the Social Security (Income Support and Claims and Payments) Amendment Regulations 1995. The following key features of the system were introduced:

- ◆ borrowers with a new loan after 1 October 1995 are deemed to have 'new housing costs'; they do not receive Income Support for their mortgage interest during the first 39 weeks of a claim. The full entitlement is paid from week 40;
- ◆ borrowers with a mortgage prior to 2 October 1995 are deemed to have 'existing housing costs'. Income Support is not paid during the first eight weeks of the claim and during the following 18 weeks only 50% of the entitlement is paid. The full entitlement is paid from week 27;

- ◆ all payments of Income Support for mortgage interest (ISMI) are paid direct to the claimant's lender participating in the mortgage direct payment scheme;
- ◆ borrowers over 60 years of age are not subject to these time restrictions but are subject to the standard rate without having to wait 39 weeks;
- ◆ all payments of ISMI are calculated using a standard rate of interest and adjustment is triggered by a 0.25% movement in the official average rate, calculated using the building societies' rate of interest, as reported in Table 7.1 of the Office for National Statistics' Financial Statistics;
- ◆ restrictions are imposed on the payment of interest on loans taken out for major repairs and improvements. ISMI is now payable on loans used to finance work carried out to maintain a property's fitness for occupation. This will rule out the majority of further advances;
- ◆ ISMI is not payable on arrears that accumulate during an exclusion period;
- ◆ from 2 October 1995, claimants have received ISMI at the actual rate charged where this is below 5%. Where the rate is between 5% and the standard rate, Income Support is paid at the standard rate;
- ◆ an exclusion period in respect of ISMI will commence on a claim for either unemployment benefit, statutory sick pay or incapacity benefit, regardless of entitlement to Income Support; in other cases, the exclusion period will start on the date of an initial claim for Income Support;
- ◆ payments not eligible for Income Support include:
 - endowment premiums;
 - buildings and contents insurance premiums;
 - deferred interest in certain cases;
- ◆ where the claimant is receiving ISMI and is about to start a job that will last for five weeks or more, he can claim mortgage 'interest run-on'. This means that the benefit will be paid for a further four weeks rather than stopping immediately.

2.2.2.1.1 The 52-week linking rule

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

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

2.2.3 Sources of advice

There is a range of bodies that provide advice to those who run into difficulties with their mortgages.

Most major towns and cities have a *Citizen's Advice Bureau*, which can provide guidance to those who do not know where to turn when they experience difficulties in paying their mortgage. The advice given is free and bureau advisors will usually be able to spell out the various options available. It is quite common for the borrower to be advised to contact the lender as early as possible in order that the problems do not become worse. In addition to providing guidance on short, medium and long-term arrears problems, the Citizen's Advice Bureau also produces information packs on insolvency and bankruptcy.

In addition to Citizens Advice Bureaux, borrowers can also contact the following organisations:

- ◆ *money advice centres* – many local authorities provide free debt and benefit advice through money advice centres;
- ◆ *the consumer credit counselling service* – a registered charity whose purpose is to assist people who are in financial difficulty by providing free, independent and realistic advice from trained advisers. The CCCS offers advice through its free telephone advice line and eight centres in the UK;
- ◆ *financial advisers* – although not free, the services of a good financial adviser can be of great assistance in sorting out debt problems.

There are several other sources of assistance to borrowers in difficulty. Quite often, the local office of the Department of Social Security should be the first port of call. Sometimes borrowers are not aware of the benefits they can claim or with whom they should consult. A typical example might be eligibility for the Working Families Tax Credit.

Some local housing associations are also involved in schemes to assist those in financial difficulties. Several have introduced innovative packages of measures, including schemes offered as mortgage rescue packages.

2.2.4 Mortgage rescue schemes

During the early 1990s, lenders came up with innovative and successful schemes. The schemes are not mortgage products in themselves but are schemes designed to try to assist customers in need.

One *mortgage rescue scheme* was based on the Business Expansion Scheme (BES).

Several lenders set up mortgage rescue schemes where properties belonging to those in financial difficulties would be purchased via a BES company and let to the owner-occupier. The BES approach was pioneered by the Nationwide Building Society.

A different scheme was introduced by the Bradford and Bingley Building Society, enabling people to stay in their own homes on a tenancy basis and pay rent if eligible for benefit.

Some lenders have adopted a partnership approach with housing associations. One such scheme involves the housing association purchasing a whole or part-interest in the property of the owner-occupier, with the latter becoming either part-tenant, part-owner or purely a tenant.

All of these schemes are designed to enable a family to remain in a dwelling they would otherwise lose. Before considering a borrower's eligibility for inclusion in a rescue scheme, however, the lender has to be certain that the owner-occupier is absolutely determined to tackle the difficulties before them and avoid future problems.

2.2.4.1 Mortgage to rent scheme (Scotland)



The Scottish Executive introduced the *mortgage to rent scheme* in 2003. It protects homeowners by allowing them to switch tenure from ownership to Scottish secure tenancy. The scheme is managed by Communities Scotland. Owner-occupiers in mortgage difficulties can arrange for a social landlord – housing association or local authority, etc – to buy the home and can continue to live there as a tenant.

2.2.5 Mortgages and debt consolidation

Mortgages can provide viable options for those who have mounting debt problems. *Consolidating debts* into a mortgage has advantages, particularly because mortgage interest rates are generally well below those for other types of borrowing.

Example

Ricardo and Tina have a mortgage of £80,000 on their house worth £150,000; the mortgage interest rate is 6.5% and the mortgage has 15 years to run. They have debts of £10,000 on credit cards, with an interest rate of 16.9%. The credit cards are costing them £140 a month in interest (this will reduce each month as some of the capital is repaid) and they have to pay at least £200 a month (2% of the balance); this is affecting their cash flow.

If they add the credit card debt to their mortgage by taking a further advance or remortgage, they will pay £54 a month on an interest-only basis, or £89 on a repayment basis, for the additional borrowing. This will save them a significant amount each month and ease their cash flow problem.

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

Consolidating debts in this way can seem a very attractive proposition, but there are a number of additional points to consider:

- ◆ the debt being consolidated will now run for the rest of the mortgage term, rather than for around six or seven years, as would be the case if a borrower kept things as they are;
- ◆ the extended term is likely to mean paying more interest than would be paid by keeping the existing arrangements – a borrower needs to check comparative costs;
- ◆ the new mortgage will have to be within the lender's normal income multiples and loan-to-value limits;
- ◆ a remortgage is likely to involve costs – potentially up to £500. These will have to be offset against potential savings in order to decide if the consolidation is viable;
- ◆ if a borrower is happy to take out a variable rate mortgage, he might consider remortgaging with a cashback offer. Depending on the size of the cashback, he can pay off some of the credit card debt with it and reduce the amount of the further borrowing;
- ◆ moving to a new fixed rate or discount rate might save even more money. The borrower will have to assess if any redemption penalties will impact on the strategy;
- ◆ consolidating the debt will reduce the equity in the property – an important consideration if planning to move in the future;
- ◆ the borrower might be well advised either to overpay the mortgage to clear the consolidated debt more quickly or to set aside some of the savings with a view to paying off some of the new debt early;
- ◆ increasing the secured debt in this way will reduce equity and increase the risk of the repossession.

Having consolidated the debt, a borrower must maintain discipline to avoid putting themselves in the same position a few years later.

2.3 Legal remedies on default

Legal remedies are those actions laid down by law that a lender can take against a borrower in default. There are separate legal codes in England and Wales on the one hand and in Scotland on the other.

2.3.1. England and Wales

In England and Wales, legal remedies are laid down by the Law of Property Act 1925. There are five legal remedies, of which only four are used in practice today:

- ◆ sue for possession;
- ◆ exercise the power of sale;
- ◆ sue on the borrower's personal covenant for recovery of the debt;
- ◆ appoint a receiver;
- ◆ foreclosure (now rarely used).

The first two of these remedies are the most commonly used. Here the lender sues the borrower for possession of the property and then sells the property in order to recover the debt.

In order to take possession, it is necessary to petition the county court for a *possession order*. Before the county court will even consider granting a possession order, it has to be satisfied that every other option has been explored by lender and borrower and that possession is a very last resort. The county court can then take one of three courses of action:

- ◆ it can grant an *outright possession order*, enabling the lender to take possession, usually within 28 days;
- ◆ it can grant a *suspended possession order* imposing on the borrower an obligation to make payment in accordance with the court's decision, with the suspended possession order enforceable if the borrower fails to keep up the repayments;
- ◆ it can adjourn the case until a future date.

The lender must be well prepared for the court hearing. It was once possible for an official of the lending institution to swear a single-page affidavit setting out the position on the account. It is now necessary to make available to the

court full and itemised details of transactions including credits, debits and transfers. In addition, the lender must be seen to have done everything possible to help the borrower bring the account to order.

Once a possession order has been granted, the lender can proceed to take possession. The court decides a date on which this order is enforceable. In the majority of cases, the borrower vacates the property prior to the date of possession. If necessary, however, a bailiff of the court can enforce the possession order, usually accompanied by a representative of the lending institution. It is important to note that, even after the date of possession, the lender still owes a duty of care to the borrower and the borrower can still return to the lender to settle the mortgage account right up until disposal of the property.

The right of the lender to sue the borrower on his personal covenant to repay the debt arises from the contractual obligations in the legal charge. This is often futile because the borrower may not have any financial resources. In the event of mortgage loss, the lender may take further action for recovery if it believes the borrower does have the financial means to make good the loss.

The right to appoint a receiver is exercised when there is an income pertaining to the property. This happens, for example, when the property has tenants who are paying a rent. The receiver acts on behalf of the lending institution to collect rents and any other income applicable to the property, and this money is applied to the mortgage account to reduce the overall debt. A receiver in this context should not be confused with the Official Receiver who has a different function.

A receiver acting on behalf of a mortgagee can be an employee or agent of the lender, but serves as agent for the borrower in respect of disbursement of money received and his duties of accountability to the borrower. If there is an unauthorised tenancy at the property, the lender must do nothing that could be considered as formally recognising that tenancy. A receiver might instead be appointed when the statutory power of sale becomes exercisable and will then be able to collect the rent and pay it to the lender while the lender can still formally deny approval of the tenancy.

The remedy of foreclosure is of historic importance only. Despite the word being used generically to mean pursuing recovery of a debt, a *foreclosure order* is never used in the UK today. When a lender forecloses, it takes over ownership of the property and can keep all of the sale proceeds. Today, this is considered to be unfair to the borrower.

A foreclosure order results in the borrower forfeiting the equity of redemption – all rights to the property are be extinguished. The lender is theoretically able to take possession, sell the security and retain any surplus. The borrower loses the right to redeem the mortgage once it has been taken into possession. This is now regarded as inequitable.

The foreclosure procedure is extremely complicated: the petition must be made to the Chancery Division of the High Court of Justice and, in the case of joint borrowers, separate foreclosure orders must be sought.

2.3.2 Scotland



Under Scots law, the remedies available to a lender to which a borrower has granted security fall under the following headings:

- ◆ calling up;
- ◆ notice of default;
- ◆ sale;
- ◆ entering into possession;
- ◆ repair and alteration;
- ◆ pointing of the ground;
- ◆ adjudication;
- ◆ foreclosure.



These remedies are available under the Conveyancing and Feudal Reform (Scotland) Act 1970. Of these, it is only necessary to consider the first four remedies.





The solicitor will serve on the borrower either:


- ◆ a *calling-up notice* – this requires the whole debt to be repaid; or
- ◆ a *notice of default* – this requires only the arrears to be brought up-to-date or another breach of the mortgage conditions to be remedied (eg a failure to repair the property).



Alternatively, if the borrower is insolvent, the lender may obtain a court warrant to sell the property.

 Failure by a borrower to comply with a calling-up notice or a notice of default enables the lending institution to proceed to possession and ultimate sale. If the borrower does not leave the property of his or her own accord, the lender must take court action to seek ejection of the debtor. The principles of possession and sale are similar to those applicable to England and Wales.

 The Mortgage Rights (Sc) Act 2001, which came into force on 3 December 2001, is also relevant. It provides increased protection to debtors and their families from lenders exercising remedies on default. The Act gives the debtor (and certain other parties including a cohabitee of either sex) the right to apply to the court for *suspension of enforcement* proceedings. An order may be granted where it is considered reasonable in all the circumstances, with particular regard to the nature of and reasons for the default, the applicant's ability to remedy the default within a reasonable period, any action taken by the creditor to assist the debtor remedy the default and the ability of the applicant, and those residing with him or her to secure reasonable alternative accommodation.

 The Act also provides for a notice to be issued to an occupier of the property. This allows a tenant the opportunity to give reasons for suspension of enforcement proceedings.

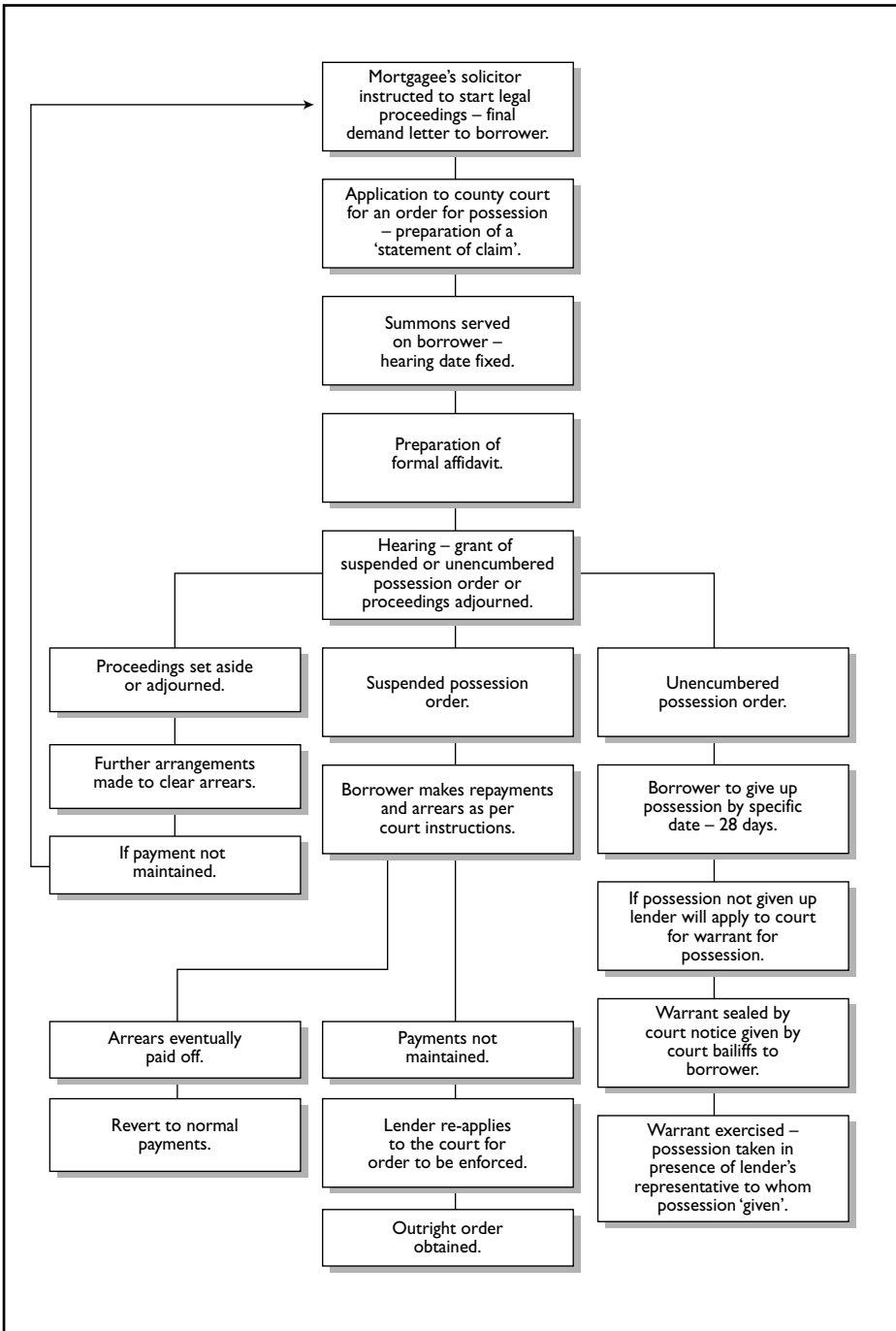
2.3.3 Possession procedures

Possession procedures are described in Figure 2.1 (Figure 2.1 for the procedure in Scotland) below.

The eviction of borrowers often receives high-profile media coverage. In the majority of cases, the property is vacated voluntarily – eviction is comparatively rare and a last resort. Many borrowers simply hand over the keys to the lender.

Once vacant possession has been obtained, it is important to ensure that the borrower cannot regain entry to the property. Arrangements must be made immediately with a locksmith to change the locks of the property and secure all points of entry.

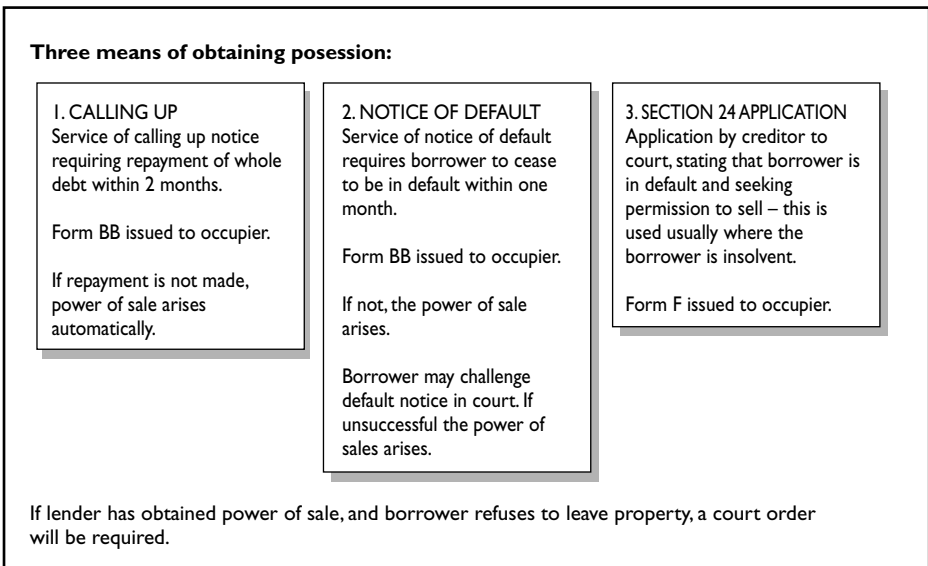
Figure 2.1 Possession procedures



Other matters that must be considered are as follows:

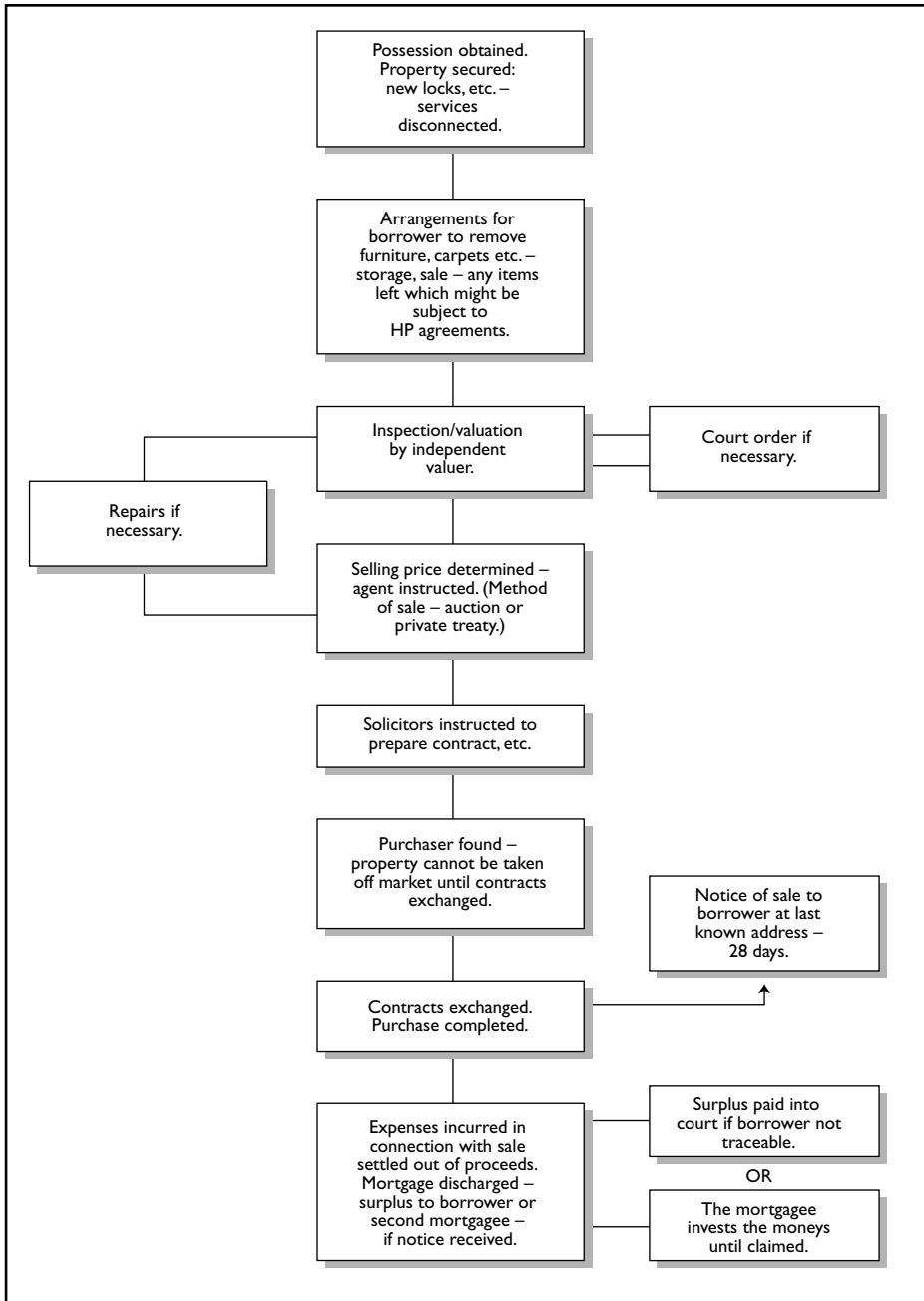
- ◆ utilities such as water, gas and electricity must be disconnected. The local water and sewerage authorities should be advised that the property is empty;
- ◆ gas and electricity meters must be read. The borrower is responsible for payment of these services used prior to the readings being taken;
- ◆ the telephone company must be asked to prepare a statement to include all calls up to the date of possession. All outgoing calls after that date should be blocked or the telephone disconnected altogether;
- ◆ the local police must be advised that the property is unoccupied and informed from whom the keys to the property may be obtained;
- ◆ any fittings left behind by the borrower are held in trust on his behalf and, if not claimed by a specified time, may be disposed of, with any proceeds credited to the mortgage account. If the borrower reclaims fittings, the lender must take care not to readmit him to the property, otherwise a new possession order may be required. A mortgagee in possession can be held to have been negligent if it can be established that a duty of care is owed to a borrower in respect of personal belongings he has left behind in the property.

Figure 2.2 Possession Procedure – Scotland



2.3.4 Sale procedure including mortgagee obligations

Figure 2.3 Sales procedure



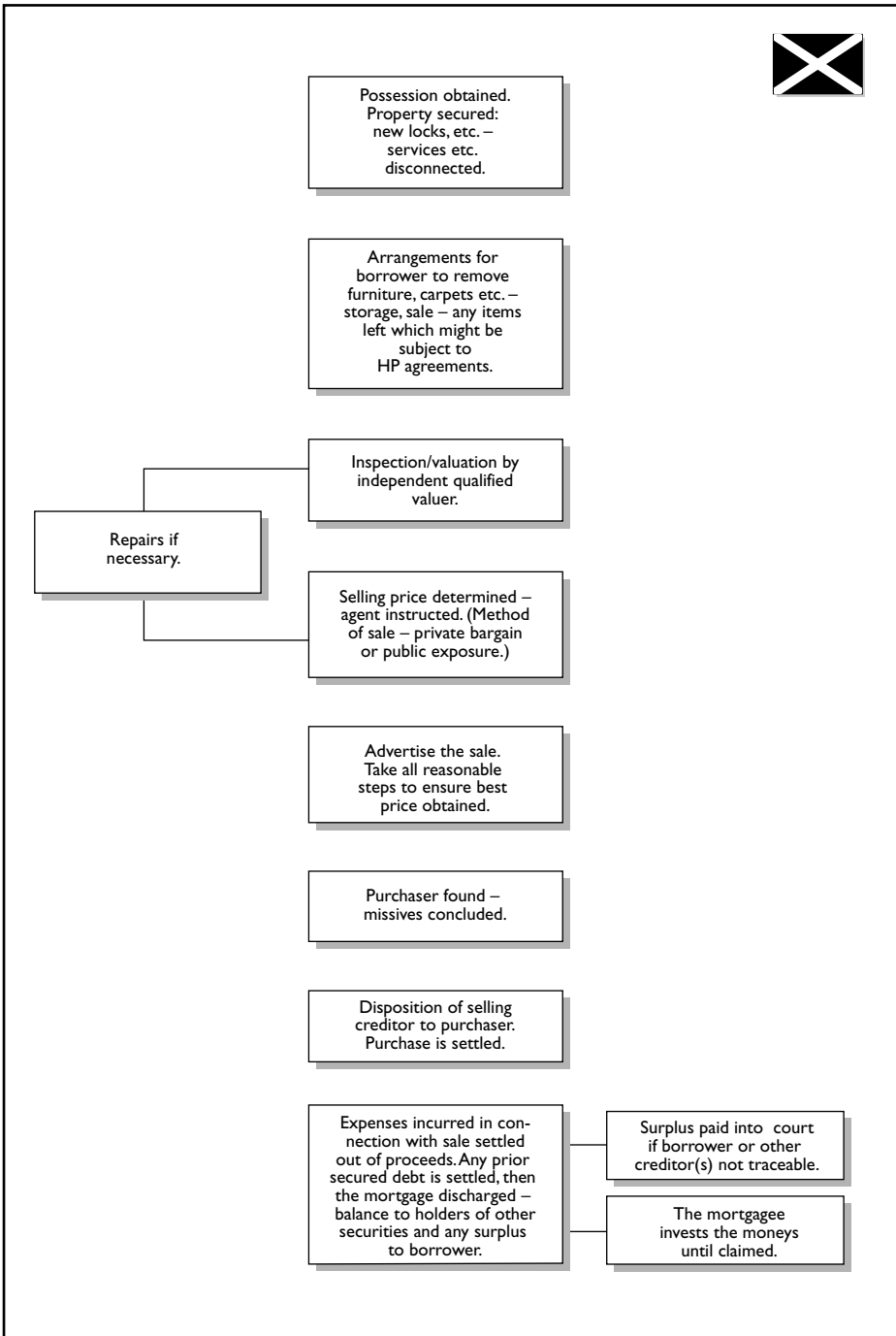
Once a property has been taken into possession, the lender will seek to dispose of it as quickly as possible in order to recoup the funds advanced. Valuation will be necessary in order to determine an appropriate selling price. Some lenders use property disposal agencies who specialise in bringing properties to market that are in the hands of mortgagees in possession. Other lenders rely on their own internal resources.

In dealing with properties in possession, lenders have obligations to their former borrower. In the eyes of the law, the borrower retains what is called an **equity of redemption**. This is a right to settle the mortgage debt at any time. In addition, the lender has a duty of care to obtain the best price reasonably obtainable, although it does not necessarily have to look after and maintain the security indefinitely to obtain a higher price. In order to establish that this obligation has been fulfilled totally, many lenders in England and Wales will, having obtained an acceptable offer for the property, place an advertisement in a newspaper seeking last and final offers by a particular date.

In the 1944 court case of *Reliance Permanent Building Society v Harwood-Stamper*, it was held that the lender, while having an obligation to get the best price reasonably obtainable, is not obliged to 'nurse the security' indefinitely. In the 1991 Scots case of *Dick v Clydesdale Bank*, it was held that a lender, being in the position of a quasi-trustee for the seller when exercising a power of sale, was required to take account of the potential 'development value' of land when conducting the sale.

When in possession, a lender still needs to ensure that it is acting reasonably and not in a way that might prejudice the borrower's rights: fixtures (ie items that are permanently fixed to the property) pass to the mortgagee; fittings (items like furniture that are not fixed) are retained by the mortgagor. The mortgagor should have removed all fittings before leaving the property but, if this has not been done, it is wise for the lender to produce a list of any such fittings and to document how the items are dealt with. It might allow the borrower back into the property to remove them, or it might arrange for them to be removed and placed in storage. The lender needs to be careful because it can be liable if it acts negligently.

Figure 2.4 Sale procedure – Scotland





In Scotland, the debtor may redeem the mortgage at any time up to conclusion of missives of sale. In respect of disposal of the mortgaged property, the Conveyancing and Feudal Reform (Scotland) Act of 1970 imposes a duty on the lender to advertise and to meet a specified minimum standard of advertising.

Some lenders consider auction as well as private treaty to ensure that the highest price possible is obtained for the property. If a lender sells a property and fails to obtain an appropriate selling price due to error or omission from the sale particulars, it can be sued for damages by the former borrower. In a case that occurred in 1971, one lender had to pay in excess of £10,000 damages to the former borrower because the sale particulars omitted any reference to planning permission that existed on the property that would have substantially increased the potential selling price.

Recent court cases have emphasised the need for lenders to take great care in this area. In one recent case, a county court judged that a higher potential purchase price could be obtained by allowing the borrowers to remain in the property, provided that there was a serious effort to bring the property to market and eventual sale. In another case, a borrower was able to establish in court that the lender was taking too long bringing the property to market and that the mortgage debt was accumulating faster than necessary.

2.3.5 CML Possessions Register

The increase in the number of possessions during the 1990s has made it necessary for lenders to collaborate in order to ensure that information on a borrower's debt history can be shared. Lenders experience a fairly high level of fraud – in a survey by the Police Federation in the early 1990s, it was found that 1 in 20 mortgages had been subject to some kind of fraud. The nature of fraud varies from simple overstatement of income to highly organised attempts to obtain thousands of pounds from financial institutions.

The **CML Possessions Register** is a database holding information on those borrowers who have had their properties repossessed by the Council of Mortgage Lenders (CML) members. A CML member can consult this database when considering any mortgage application in the same way that orthodox credit searches are carried out. The CML Possessions Register is fully computerised and maintained by the secretariat of the Council of Mortgage Lenders at its London headquarters.

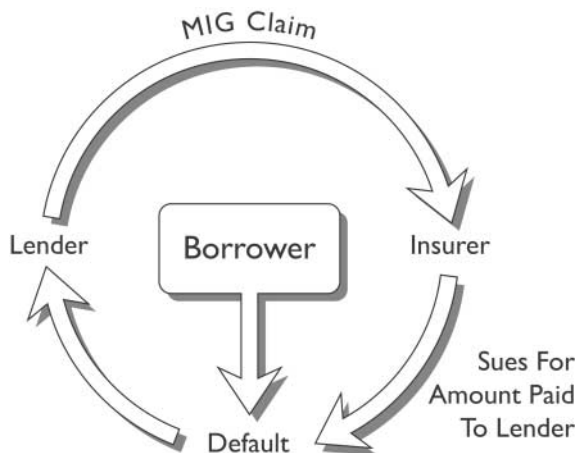
2.3.6 The right of subrogation

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

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

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

Figure 2.5 Procedure on default where a MIG is in place



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 [6] 49.

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

Answer true or false to the following questions.

3. Lenders are under no obligation to contact borrowers about mortgage arrears.
4. Accepting interest-only payments is a way of helping repayment mortgage borrowers in financial difficulties.
5. Extending the term in order to reduce mortgage repayments is not appropriate for low-cost endowment mortgages.
6. Income Support mortgage interest is not available to people whose savings exceed £4,000.
7. People with post-1995 mortgages are entitled to have half of their mortgage interest paid after 39 weeks of claim.
8. Income Support mortgage interest does not assist with the payment of contributions to the repayment vehicle on an interest-only mortgage.

9. An outright possession order granted by a court gives the lender immediate possession of a property on which the mortgagor is in default.
10. A suspended possession order automatically becomes an outright possession order if the borrower fails to keep up the agreed repayments.
11. Appointing a receiver is a legal remedy available where a property is let to tenants.
12. When a property has been taken into possession, the borrower has the right to repay the arrears at any time until the property has been sold.
13. Lenders have a legal obligation to sell a repossessed house for at least the amount of the mortgage.
14. A register of persons who have had their properties repossessed is maintained by the Financial Services Authority.
15. The right of subrogation enables insurers to sue borrowers for any amount paid out on a mortgage indemnity guarantee policy.

Answers

1. A lender must write to a borrower within 15 days of it becoming aware of the account being in arrears. The letter must contain:
 - ◆ the current FSA information sheet on mortgage arrears;
 - ◆ a list of due payments either missed or paid in part;
 - ◆ the total of the shortfall;
 - ◆ the total outstanding debt, excluding charges that may be made on redemption;
 - ◆ an indication of the nature and level (if possible) of charges likely to be incurred unless the shortfall is cleared.
2. He has 'new housing costs', which means he will not receive any benefit until 39 weeks have elapsed.

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

He will receive benefit for interest payments only.

The benefit will be paid directly to Gavin's lender.
3. **False:** a lender must contact a borrower within 15 days of becoming aware of arrears.
4. **True:** making interest-only payments will reduce the monthly payment, although it should only be seen as a temporary measure.
5. **True:** the term of with-profit endowments cannot normally be extended.

6. **False:** the ISMI may be reduced where savings exceed £4,000, but is not removed altogether until £8,000.
7. **False:** the full ISMI entitlement is paid after 39 weeks to people with post-1995 mortgages.
8. **True:** ISMI will not cover endowment or other similar payments and neither does it cover other expenses such as buildings insurance.
9. **False:** an outright possession order can normally be executed after 28 days.
10. **False:** a suspended possession order, if enforced, requires that the borrower make payment. If he does not, the lender can return to court to seek possession.
11. **True:** the receiver applies rental income to ensure that the mortgage payments are maintained.
12. **False:** until sale, the borrower has only the equity of redemption, which is the right to repay the whole debt.
13. **False:** the lender must sell a repossessed property at the best price reasonably obtainable.
14. **False:** the possessions register is maintained by the Council of Mortgage Lenders.
15. **True:** the right of subrogation has been tested in the courts and confirmed.