

## Section 3

### **Other post completion matters**

Section 3 describes the main changes that may be made to a mortgage contract; explains what is meant by transferring equity and the implications of so doing; details the difference between redemptions and part-redemptions and the implications of each; lists the implications of moving homes and remortgaging; and describes the implications of unauthorised lettings; and how home income and reversion plans may be suitable for certain homeowners.

Section 3 covers part 2 of the syllabus for Unit 6.

#### **3.1 Changes in interest rates and fees/charges**

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The interest rate and charges made in connection with a mortgage can only be changed in accordance with the terms set out in the contract. Over the life of a mortgage, the conditions imposed by the lender on new borrowers are likely to change several times.

Older borrowers will remember times when interest rates on mortgages were almost constant, even though they were permitted to be varied under the mortgage deed. It is now common to expect several rate changes each year. To variable rate borrowers, these changes can have a significant effect on the household budget. For each contract, it is the terms and conditions that are in force at the time of completion that bind both lender and borrower.

In some instances, the lender may be prepared to relax some of the conditions of mortgage, resulting in an advantage to the borrower: one lender has a clause in its older mortgages that six months' interest may be charged on early redemption. When this attracted widespread adverse publicity, the lender introduced a concession that only three months' interest would be charged.

The condition in the mortgage stayed the same but the lender was, in this instance, prepared to forego some of the income that might legally be derived from it.

Older mortgages may also have a minimum period of notice specified before repayments can be adjusted following an interest rate change. Such a period might be three or even six months. This creates a disadvantage for the lender – when interest rates are rising, investors expect to see the immediate benefit of these, but the cost of paying increased interest to investors cannot be passed on to borrowers immediately. The condition cannot be changed retrospectively, so the lender has to wait for these mortgages to be paid off until new conditions can be imposed across the board.

Building societies are mutual institutions whose constitution comprises a memorandum and a set of rules. Historically, many societies had a rule that stated that interest rate changes would be notified to borrowers by post – a time-consuming and costly exercise. This factor can reduce competitiveness when interest rates change frequently, so most societies with this rule have changed it by consent of the members via a special resolution passed at a general meeting.

As most mortgages in the UK are offered on a variable rate basis, at least for the major part of the term, interest rate changes inevitably affect almost every borrower at some time. The lender must have a system in place through which changes in repayment can be formally notified. Most lenders have information systems that bring a high degree of automation to this process.

At each rate change, the lender should also be ready for the increased number of telephone calls and letters from borrowers that the change will generate.

All lenders have a tariff of charges imposed on borrowers as well as an interest rate structure, which sets out the price of each lending product in the portfolio.

Examples of these charges are:

- ◆ late payment fees;
- ◆ redemption fees;
- ◆ part-redemption fees;
- ◆ final inspection fees;
- ◆ clawbacks of discounts and cashbacks.

Mortgage legislation commits lenders to notifying these charges in advance of borrowers incurring them and making sufficient information available to the borrower before he signs up for a product so that an informed purchasing decision can be taken. Changes to tariffs of charges must be notified on an annual basis.

Lenders will consequently make a special point of publishing a scale of charges for all to see, removing any ambiguity wherever possible. Despite these efforts, banks and building societies have had to deal with many complaints from borrowers in respect of charges. Some of these complaints have been referred to the appropriate ombudsman for further consideration.

It is especially important that a borrower is kept fully aware of any procedure that may increase his debt in the future. An example of this may be where a borrower's monthly payment is adjusted annually under an annual review scheme.

At the beginning of a 12-month period, the monthly payment is set at the current interest rate. Any rate changes during the ensuing 12 months will affect the amount of interest charged to the account and a new monthly payment will then be calculated at the end of the period. If the interest rate has increased several times, then the borrower may be faced with a substantial increase in his monthly payments. The good mortgage adviser will explain in detail, at the application stage, how such a scheme operates if the applicant is considering taking it up, because those on annual review schemes can be particularly hard hit in a period when interest rates rise several times.

Where discretion is used by lenders, this must be applied fairly rather than in an arbitrary fashion. For example, some lenders waive redemption fees under certain circumstances. The lender must avoid a situation where it is seen to act differently towards one borrower than another.

### **3.2 Variation of mortgage conditions**

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As well as changes in interest rates and the tariff of charges made in connection with mortgages, other conditions of a mortgage may be varied. These include:

- ◆ transfers of equity – where a borrower is added to or removed from the mortgage deed;
- ◆ permission to let the property for a specified period;

- ◆ extension of the mortgage term;
- ◆ change from capital and interest method of repayment to interest-only;
- ◆ change from interest-only method of repayment to capital and interest;
- ◆ release of part-security.

These are all events that affect the contractual relationship between lender and borrower and some are considered in the sections that follow. If formal changes to the contract are to be made, a deed of variation may be required. Other changes can be made without the consent of the borrower, such as changing the interest rate from time to time. As a general rule, contracts cannot ordinarily be altered without the agreement of both parties.

In most cases, where a variation of mortgage conditions is permitted, it is necessary to complete legal formalities to bring about the change in a proper manner. Lenders may also make administrative charges for changes – these charges have to be consistent with the lender’s published tariffs.

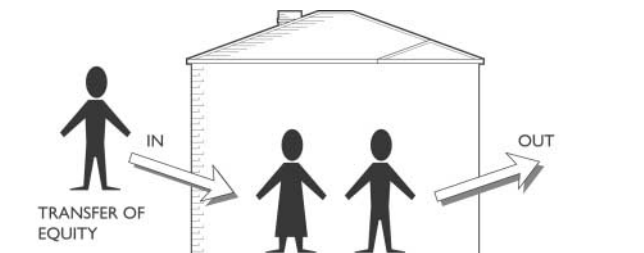
### 3.3 Transfers of equity

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A transfer of equity arises when:

- ◆ a borrower is released from the mortgage contract; or
- ◆ a borrower is added to the mortgage contract.

**Figure 3.1 Equity transfer**



In either case, the lender has the final say on whether this course of action is acceptable or not. The legal charge, or standard security, is made between the parties specified in the original contract – the contract can only be varied by agreement of those parties.

A transfer of equity request is often made at the same time as a request for a further advance (eg the remaining borrower needing to raise finance to buy out the borrower that is leaving the property). It is normally the borrower who originates the request.

The most common reason for a borrower to request to be released from the mortgage is where joint borrowers split up through divorce or separation. About one in three marriages in the UK end in divorce, meaning that this can be a common feature of mortgage administration.

A less common reason for a request to release a borrower from the mortgage contract is where that party is seeking to escape creditors. It is a common fallacy that a person faced with bankruptcy can protect assets by transferring them to a partner or spouse: in practice, the trustee in bankruptcy can seize those assets anyway.

Similarly, a person may wish to be added to the mortgage when a relationship is formed and that person moves in with the existing borrower. This makes little difference to the occupant's rights if the two people legally marry – under the Family Law Act 1996, an occupying spouse has rights whether named on the mortgage deed or not.

The lender must consider many factors when a request for a transfer of equity is made, and these include the following.

### **3.3.1 The purpose of the request**

The purpose of the request may be straightforward or concealed. The lender must investigate the request in order to understand the borrower's motives for the approach.

A request to transfer equity can result in additional business arising from unfortunate circumstances. Often when two people split up, additional mortgage finance is required: by one person to buy out the other, and for the person leaving to buy a new home. There are also other related product needs that a revised factfind for both parties would reveal.

### **3.3.2 Status**

If a person is to be removed from the mortgage, the remaining person's financial circumstances must be examined in order to discover whether his income and outgoings are compatible with the mortgage outstanding. This may involve taking references and/or examining statements, as well as carrying out a credit search for details of any other bad debts.

If the transfer request is due to separation or divorce, the lender must be aware that the borrower remaining might have maintenance payments – these may or may not be finalised at the time of application, but they can substantially affect his ability to repay the loan.

Impairment of the status of the borrower may also take the loan outside the criteria acceptable for mortgage indemnity guarantee cover.

Evidence of impairment of the loan (that is, where the ability to service the loan has deteriorated) may necessitate making a provision for potential loss, whether or not a transfer of equity is sanctioned.

### **3.3.3 New occupier**

If a person is moving in, it must be established whether he intends to become a party to the mortgage contract. If so, normal status enquiries should be made before the legal procedure is carried out.

If the new occupier is already living in the property at the time of transfer and the lender is aware of this, it is necessary for the non-owning occupier to complete a 'consent to mortgage' form, waiving rights of residence should the lender have to pursue vacant possession. Failure to do this can result in the occupier enjoying a right of residence that overrides the mortgage under s 70 of the Land Registration Act 1925 (England and Wales only). In effect, the lender will not be able to obtain vacant possession following litigation for possession unless the consent has been obtained.

### **3.3.4 Track record**

The track record of the account to date is important but the lender needs also to ascertain which of the parties has been paying the mortgage up to this point. If it is the person seeking to be released, the individual who is to remain in the property must be made aware of the serious obligation that the mortgage

entails – the borrower may have no idea what he is taking on board. It is very important that the person remaining is fully aware of the consequences of releasing the other party to the mortgage.

Less can be learned from looking at the track record if the loan is relatively new. If, on the other hand, the borrowers have a long-standing relationship with the institution, it may be possible to learn quite a lot from examining the past conduct of the account, as well as (sometimes) the adviser's knowledge of the individuals concerned.

### **3.3.5 Guarantee**

If the loan is supported by a guarantee, any proposed changes in the terms and conditions of the guaranteed mortgage must be sanctioned by the guarantor(s).

### **3.3.6 Life assurance policies**

If the mortgage is interest-only, there may be a life assurance policy in existence, the proceeds of which were originally intended to repay the loan on maturity of the mortgage. Quite often these policies are in joint names.

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

### **3.3.7 Value of the property**

The borrower's ability to repay must be considered alongside the current loan-to-value ratio on the mortgage. Only by looking at these two factors will the lender better identify the risk. A revaluation of the property may be necessary.

### **3.3.8 Costs and methods**

The lender will charge a fee for the transfer of equity, which will be borne by the borrower.

The method of transfer will be by **deed** (**deed of variation** in Scotland). It is normal to take legal advice and arrange for a solicitor to act.

For a lender, a transfer of equity is both an opportunity and a risk: an opportunity to review needs and address new, or additional, needs; a risk in that the release of a borrower may impact on the reliability of payments.

## **3.4 Early redemption**

It is the right of any borrower to redeem any loan at any time. The law does not permit lenders to obstruct this right, although they are at liberty to make a reasonable charge to cover their lost income.

The borrower might take the opportunity to make early redemption (provided there are sufficient funds) if, for example:

- ◆ a legacy is received;
- ◆ there is a desire to move and take a new mortgage with the same, or different, institution;
- ◆ it is felt that personal wealth in the form of savings and investments will be better used to clear the loan.

Early redemption may not always be the best course of action for the borrower. The borrower should be encouraged to take an overall view of his financial circumstances to decide whether there are more efficient ways of using the funds.

On receipt of a request for early redemption, many institutions now have systems designed to try to capture further lending business. A major reason for loss of mortgage business is that a borrower may see a 'better deal' elsewhere and pursue this without consulting his existing lender. It is likely that the lender will maintain contact with the borrower to promote further borrowing, provided that the borrower has been a regular payer.

For early redemption to be made, a *date of redemption* is required – the information systems of the lender will provide details of what amount is

necessary to pay off the loan, as well as daily interest to be debited should the redemption be delayed.

Many lenders charge *early redemption interest* to offset loss of anticipated interest from the loan. This will have been expressed in the mortgage deed or conditions at the time the mortgage was completed, and is readily available information on request. These fees are usually expressed in terms of so many months' interest or a flat charge. This fee can amount to a significant sum and must be taken into consideration in the overall calculation.

In extremely rare circumstances, a court can decide that a redemption penalty is a 'clog on the equity of redemption'. This means that the court feels that a condition has been imposed deliberately to prevent a borrower from paying back the loan. In such cases, the court can set aside the clause in the mortgage allowing the borrower to make early redemption.

### **3.4.1 Redemption and part-redemption**

Once a borrower has made all payments in accordance with the conditions of the legal charge, the loan is redeemed. If the lender is satisfied that all charges to the account – interest, capital, fees, costs, charges etc – have been paid in full, the borrower can be released from the mortgage. The lender's action in doing so is called vacation of the mortgage (or *discharge* in Scotland).

In order to vacate or discharge the mortgage, an officer of the lending institution signs a receipt to this effect. This is either a form specially used for the purpose, or a part of the legal charge or standard security document itself. A solicitor then completes the legal work. When completed, the borrower is released from the mortgage to the lender. A release fee is sometimes charged.

As an added service, some lenders hold a small amount (usually £1) as a debit balance on the mortgage account so that the mortgage is still in force. Basically, this provides a free safe custody facility for the borrower in respect of the title deeds.

Sometimes a borrower may wish to pay a lump sum to reduce the mortgage balance. This is called a *part-redemption*.

When a part-redemption is made, subject to the agreement of the lender, the borrower can either:

- ◆ continue repayments at the same amount and reduce the mortgage term; or
- ◆ reduce the amount of monthly payments and keep the same term.

The most common reason for making lump sum repayments is because the borrower wishes to pay off the mortgage earlier than the agreed redemption date.

Most lenders set down a minimum amount that will be accepted by way of capital reduction. This can be as little as £500. This stipulation is mainly in place to enable the transaction to be completed as a capital reduction rather than an earlier-than-scheduled monthly repayment. As more lenders move towards daily interest systems of calculating interest, the need to differentiate between capital reductions and other payments becomes less important.

It is important for the borrower to make sure he knows the lender's attitude towards part-repayment. Some lenders will not apply the money to the account until the end of the year, which means it will have no effect until then. Many lenders will accept part-repayment but need to be told to use it immediately to reduce the capital – otherwise it will sit in an account until the year end. Where the part-repayment represents part of a special deal mortgage – fixed-rate, discount, etc – a *proportional penalty* may apply.

### **3.5 Changing the mortgage term**

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It is possible for a mortgage term to be reduced or extended.

To reduce the mortgage term, the borrower can make larger monthly repayments than those in the mortgage contract. This reduces the total amount of interest payable on the mortgage. Some borrowers leave their monthly repayments unchanged when interest rates are falling, based on the idea that they have been able to make the payments up to now and can continue to do so. This reduces the mortgage term.

The term of the mortgage can also be extended. This is sometimes an option for borrowers who have run into financial difficulties. It has the effect of reducing the monthly repayment and so makes the mortgage more affordable.

Lenders will only agree to extend the term if it is felt that it represents a genuine solution to the problems of the borrower. If the lender feels that the ability to repay the loan will not be helped, an extension of the term will not be allowed.

No money will be saved directly by extending the term of an interest-only mortgage. The only time this may be of benefit will be to give the associated investment vehicle more time to grow.

### **3.6 Changing the mortgage**

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

These may include:

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

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

### **3.7 Transferring to a new lender**

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

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

### **3.7.1 Property moves**

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

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

#### **3.7.1.1 The property**

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

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

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

### **3.7.1.2 The costs**

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

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

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

## **3.7.2 Remortgaging**

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

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

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

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

### **3.7.2.1 Issues facing the borrower**

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

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

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

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

### **3.7.3 The mortgage**

Implications for those considering transferring to a new lender include:

- ◆ *redemption penalties on the existing mortgage.* Those who took advantage of a special deal in the past – a fixed rate, for example – might be subject to a charge if they transfer the mortgage to another lender during the term of the special deal. The typical charge will apply until the end of the fixed rate term but some deals are subject to an 'overhang', where the penalty continues beyond the term. Many lenders offer a portability option, where an existing mortgage can be transferred to a new

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

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

### 3.8 Lettings – authorised and unauthorised

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All lenders specifically exclude, in the legal charge, the right to let the mortgaged property. Anyone who lets a property without permission from the lender is in breach of the mortgage and is in default.

Tenants can represent a serious risk to the lender. There are many cases where the condition of properties has deteriorated significantly as a result of the actions of tenants. The most important reason for caution is that a tenancy can, under certain circumstances, become binding on the lender as well as the borrower. When a property has to be sold with a 'sitting tenant', its value will be a fraction of its market value with vacant possession.

Lettings requests are not always rejected out of hand. In some cases, it can be beneficial to have a tenant living in a mortgaged property.

- ◆ if the property would otherwise be empty, the buildings insurance cover could be adversely affected or even become invalid;
- ◆ there can be a greater risk of an empty property being subject to vandalism;

- ◆ if a borrower falls on hard times, income from a tenant can mean the difference between keeping up the repayments and losing the property.

Any requests to establish a tenancy must be referred immediately to the lender. Each lender will have a policy relating to lettings and these must be followed strictly in order to avoid later problems.

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

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

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

There are two alternatives in this situation:

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

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

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

The advantages of a lifetime mortgage include:

- ◆ with an interest roll-up plan, no monthly payments are required. This means that all the cash or income raised can be used as the borrower(s) wish;

- ◆ most lifetime mortgages offer a no-negative-equity guarantee, which means that the debt will never exceed the value of the property;
- ◆ the borrowers will be able to benefit from the additional finance without having to move house;
- ◆ the borrower retains ownership of the property;
- ◆ if the property increases in value at a higher rate than the interest accrues, the borrower's estate will benefit;
- ◆ an annuity-linked home income plan fixes the interest rate payable and the annuity received. The interest is paid from the annuity, which alleviates the need for interest roll-up.

Their disadvantages, however, include that:

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

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

The advantages of the home reversion scheme include that:

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

The disadvantages of the home reversion scheme include:

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



## Test your knowledge and understanding with these questions

**Take a break before using these questions to assess your learning across Section 3. Review the text if necessary.**

**Answers can be found on page [6] 73.**

1. Alan and Ann are divorcing and Ann will take over their mortgage. The joint endowment can be left as it is.

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

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

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

## Answers

1. **False:** the endowment should be assigned or transferred to one party.
2. **False:** contract terms can only be changed with the consent of both parties.
3. **True:** for a cashback scheme, for instance, changes to a tariff or charges would include details of possible clawback.
4. **False:** changes in a lender's tariff must be notified at least once a year.
5. **False:** transfer of equity is the addition or removal of a borrower from the mortgage deed.
6. **True:** removing a borrower from the deed may result in a fundamental change in the remaining borrower's ability to pay the mortgage.
7. **True:** changes to terms and conditions may affect the likelihood of a guarantee being called in.
8. **False:** on the contrary, offering a further loan instead of early redemption makes good business sense because mortgages are often redeemed in order to obtain a better deal elsewhere.
9. **True:** a penalty that is too high might be said to be a 'clog on the equity of redemption'.
10. **True:** vacation is the technical term in England and Wales for the release from obligation at the end of the term ('discharge' in Scotland).
11. **False:** only borrowers with capital and interest mortgages can reduce the term and maintain the same payments.
12. **True:** the new lender will wish to receive any surplus after the first mortgage has been paid off on repossession and sale.
13. **True:** Fees and costs can often amount to a sum in excess of £8,000.

14. **True:** this is different from a spouse living in the property, who can establish right of occupation.
15. **False:** any sale may reduce the property value to less than the outstanding loan and a borrower cannot sell without the lender's consent.