

MORTGAGES

CEMAP MODULE 2

2005/6 Revision notes

1 Definition of a mortgage

This topic looks at the meaning of the term mortgage

- basic definition of a mortgage;
- methods of effecting a mortgage;
- second mortgage;
- definition of a regulated mortgage.

This topic provides a summary of the key points contained in the study manual; Unit 3, sections 2.2.1 to 2.2.3.

1.1 Definition of a mortgage

A mortgage is any arrangement where an asset is used as security for a loan. The term 'mortgage' has come to be used mainly where the asset used is property (real estate) and where the loan is used to purchase the property.

- The transfer of rights in the property used as security is called 'conveyance'.
- The borrower is the mortgagor.
- The lender is the mortgagee.

Two methods of effecting a legal mortgage

Mortgage by way of legal charge:

- the property is not transferred to the lender, but the property is charged with the debt as security for the lender, by means of a mortgage deed.

Mortgage by demise:

- the property is transferred from vendor to lender until the loan is repaid, and then transferred from lender to purchaser (rarely if ever used).

Second mortgage:

- Borrower who already has a first mortgage against a property raises more money against the same property with a different lender.
- If it is with the same lender it is termed a 'further advance'.
 - Second (and subsequent) mortgagees rank after first mortgagees in terms of security.

Mortgages are regulated by the FSA if they meet the following criteria:

- the lender supplies credit to an individual or to trustees (the borrower);
- the obligation of the borrower to repay is secured by a first legal mortgage

on land in the UK, at least 40% of which is used as a dwelling by the borrower, his spouse, person with whom he has a 'marriage-type relationship', or his grandparent, parent, sibling, child or grandchild.

Test yourself (Test 1)

Check your understanding of this topic by writing brief answers to the following questions.

1. Who is the mortgagee?
2. Are second mortgages regulated by the FSA?
3. Why are buy-to let mortgages not regulated by the FSA?

Answers to Test 1

1. The lender.
2. No, only loans where the security is a first mortgage.
3. Because the property must be at least 40% occupied by the borrower or a member of his close family.

2 The house-buying process

This topic looks at the processes involved in house purchase and the roles of the professionals involved, including:

- estate agents;
- solicitors and conveyancers.

It also covers the nature and contents of two important documents:

- the mortgage offer;
- the mortgage deed.

This topic provides a summary of the key points contained in the study manual: Unit 3, sections 3.1.5 and 3.2 and in Unit 4, section 5.

2.1 Role of the estate agent

Brings the property to the market by private treaty or at auction.

Acts as the agent of the vendor, but can advise both parties on areas where no conflict of interest exists.

Receives offers and advises vendor on acceptance.

Liaises with vendor's solicitors to progress the sale.

Usually paid on a commission basis - typically 1.5-3%, or may be less or a sole agency.

Other services offered by estate agents:

- auctioneering
- property listings
- property management and letting services
- arranging mortgages or insurance
- survey and valuation services.

Property Misdemeanors Act

Estate agents have the responsibility to ensure that advertisements and property particulars are not exaggerated or misleading:

- descriptions must be accurate;
- the overall description must give a reasonable view of the property;
- specific problems, however, do not have to be mentioned;
- mention can be made of special facilities but should carry a qualifying statement unless the agent has seen documentary evidence of fitting/guarantees etc;
- measurements should be accurate to within 10cm;
- photographs should not be misleading.

2.2 Role of solicitors/conveyancers

Investigation of title

To ascertain whether property is:

- being sold by the legal owner who is entitled to sell it;
 - what it purports to be;
 - free from restrictions that would inhibit the sales process.
- It is possible to get insurance to protect lenders against defective title.

Registry searches

- Land registry or land charges registry.
- Local land charges registry.
- Parcels index - checks whether land is already registered.
- Companies register.
- Bankruptcy search.
- Commons registration - checks whether it is common land.

Purchase transaction

- Confirm what is/is not included in the sale.
- Draw up contracts.
- Exchange of contracts - point of no return.

- Ensuring funds are in place - deposit, mortgage funds.
- Assignment of life policies.
- Completion - handover money, receive keys etc.
- Legal advice at all stages.

* Legal costs:

- solicitors' fees
- search fees
- electronic transfer fees.

Professional negligence:

- failure to identify a defect in the title;
- solicitors owe a duty of care
- they can be sued in civil courts;
- they carry professional indemnity insurance.

2.3 Home information packs

Government measure to improve and simplify the house-buying process
Home information pack to be prepared by (or on behalf of) the seller before the sales process begins and includes:

- title documents;
- replies to standard preliminary enquiries and searches;
- copies of building regulations/planning approval;
- draft contract;
- home condition report - based on a professional survey, including an energy efficiency rating.

There is concern as to whether buyers will be able rely on a survey paid for by the vendor.

For leasehold properties it will also include:

- a copy of the lease;
- recent service charges, accounts and receipts;
- details of buildings insurance.

2.4 Mortgage offer

Not a contract - so not legally binding

Can be withdrawn if:

- false or inaccurate information has been submitted by the applicant;
- the applicant's financial position changes;
- a change occurs to the property making it less suitable as security.

Offer letters are standardised and typically contain:

General conditions

- Personal details - applicant's name address etc.
- Property details - address, description, tenure (freehold etc).
- Values - for mortgage purposes and for insurance purposes.
- Requirement for vacant possession.
- Loan details - amount, term, repayment details, interest, special conditions/charges.
- Insurances required.

Warranties and conditions

- Disclaimer: offer to lend does not imply a warranty as to the reasonableness of the purchase price or condition of the property.
- Notification of any additional security required.
- Offer is subject to satisfactory report on title.
- The lender can withdraw the offer at any time.
- The offer is valid for a limited specified period.

Special conditions (that may apply in some cases)

- Obligations of a guarantor.
- Completion of access roads.
- Work to be carried out by applicant, and lender's right to check.
- Rules about stage payments.
- Consent to mortgage form in respect of all occupants aged 17+.
- Redemption of other mortgages on or before completion.

2.5 The mortgage deed/legal charge

The borrower charges the mortgage as security for the mortgage loan. This is done by deed, which is a binding contract between the borrower and lender.

It cannot be varied without the consent of both parties.

Contents of the mortgage deed

- Details of the lender and borrower.
- Description and details of the property.
- Statement that the property is charged as security for the loan.
- Receipt - acknowledgement that the loan has been made.
- Details of capital, interest, fees, charges associated with the loan.

Borrower's covenants

- To make all payments in accordance with the deed.
- To insure the property in accordance with the lender's requirements.
- To comply with all relevant laws and regulations.
- Not to let the property without the lender's consent.
- To keep the property in good repair.
- To comply with the conditions of title.

To comply with the terms of the lease (leasehold).

Lender's rights to:

- charge capital, interest and fees in accordance with the deed;
- insure the property if the borrower fails to do so;
- to apply the proceeds of any claim to the subject of the claim;
- meet any conditions imposed by statute or title if the borrower fails to do so;
- let the property as mortgagee in possession;
- call in the mortgage;
- apply the legal remedies in the event of default by the borrower;
- transfer the mortgage, subject to the borrower's consent;
- make further advances without the need for a new deed.

Test yourself (Test 2)

Check your understanding of this topic by writing brief answers to the following questions:

1. Who is the 'principal' when an estate agent acts in a legal capacity as agent?
2. Who can be held responsible for false misleading statements in a property advert?
3. What is the meaning of clear title?
4. What additional items would be found in a home information pack for a leasehold property?
5. In what circumstances might a lender withdraw a mortgage offer?
6. What disclaimer about the property's purchase price is usually included in a mortgage offer?
7. What is the purpose of the mortgage deed?
8. What can the lender do if the borrower fails to adequately insure the property?

Answers to Test 2

1. The vendor,
2. The estate agent.
3. The property is free from restrictions that would inhibit the sales process.
4. Copy of lease, details of service charges, buildings insurance.
5. Change in applicant's circumstances, change in state of property, discovery that false information has been given.
6. No warranty is given as to the reasonableness of the purchase price.
7. To charge the property as security for the loan, and to set out the legal rights and obligations of the lender and the borrower.
8. The lender can insure the property and charge the cost to the mortgage account.

3 Property defects

This topic looks at the main defects that can affect the value of a property and therefore a lender's decision to lend, including:

- poor construction;
- subsidence;
- heave;
- woodworm;
- failure to meet legal requirements.

This topic provides a summary of the key points contained in the study manual; Unit 3, section 3.3 and Unit 4, section 3.1.3.14.

3.1 Types of defect

Two main general categories

Long standing or non-progressive - may not affect a lending decision.
Recent or progressive - may lead to a further investigation by a structural engineer.

Types of defect

Subsidence - land below the property drops unevenly.
Heave - underground forces cause land to rise unevenly.
Untreated woodworm.
Rising damp.
Removal of chimney breasts.
Work not conforming to building regulations.
Inappropriate materials used.

Quality of construction

NHBC Buildmark scheme:

- protection against defects due to not meeting NHBC standards;
- all defects in first two years;
- next 8 years - insurance against defects in building's structure (over £500)

Zurich Mutual Insurance Co scheme:

- 15 year cover.

Surveyors' recommendations

Undertakings - lender requires borrower to undertake certain repairs or improvements within a specified period, and reserves the right to check.

Retention - lender withholds a proportion of the loan until repairs have been carried out to their satisfaction.

Test yourself (Test 3)

Check your understanding of this topic by writing brief answers to the following questions.

1. Describe 'subsidence',
2. For how long does the NHBC Buildmark scheme provide protection?
3. What is an undertaking?

Answers to Test 3

1. Land below the property drops unevenly.
- 2 For a total of 10 years.
- 3.A promise by the borrower to effect specified repairs within a certain time.

4 Buying property at auction

This topic covers the process of buying a property at auction, including

- reserve price
- deposit
- exchanging contracts.

This topic provides a summary of the key points contained in the study manual; Unit 3, section 3.1.4.

4.1 Buying at auction

A guide price may be given, and there may also be a reserve price - an unpublicised price below which the property will not be sold.

When a bid is accepted (ie on day of auction):

- deposit is paid - normally not refundable;
- contracts are exchanged - so no going back anyway!
- buyer must be sure he has finance in place; » must have had a survey;
- substantial outlay on valuation and legal fees with no guarantee of success;
- many auction properties are from repossessions etc and may need substantial work:
- Lender may therefore impose retention.

Test yourself (Test 4)

Check your understanding of this topic by writing brief answers to the following questions:

1. How soon after a property auction are contracts normally exchanged?
2. What should all serious potential buyers have in place before attending a property auction?

Answers to Test 4

1. On the day of the auction.
2. Deposit, remainder of finance, valuation, contracts.

5 Types of borrower

This topic reviews the different categories of borrower, their requirements and the lenders attitudes to them, including reasons why they may not be able to borrow

- private individuals;
- business partnerships;
- corporate borrowers;
- personal representatives and attorneys;
- trustees
- minors
- those who have mental incapacity.

This topic provides a summary of the key points contained in the study manual; Unit 3 Sections 1.1.2 and 1.1.3.

5.1 Types of borrower

Individuals

Loan amount usually determined by a form of salary multiple.
Joint borrowers: mortgage will always on joint tenants basis, even where ownership of the property is as tenants in common.

Companies

- Lending could be for residential or business purposes.
- The loan is to the company, which is a separate legal entity.

- Company's powers to borrow - in its Memorandum of Association.
- Directors' authority to commit it to borrowing - in its Articles of Association.
- Status as a credit risk - lenders assess its financial position: accounts, etc.
- Limited liability companies (ie most) - lender may need to obtain additional guarantees from directors.

Business partnerships

Unlike companies, most partnerships are not separate legal identities.
 The assets and liabilities are jointly owned by the partners.
 Lender will require to see copy of partnership agreement.
 All partners must sign documents - unless one is authorised to sign for all.

Clubs/associations

Lenders need to see constitution to check its rules; also the authority of its officers to take out a loan; and the accounts to check ability to repay.

Executors/administrators

Lenders can lend to personal representatives of deceased people if the loan is for administering the estate.

Attorneys

People who act legally on behalf of someone else (the donor).
 Lenders can lend to attorneys - power of attorney must be current and must not exclude the power to borrow.

Trustees

Lenders can lend to trustees if the trust deed specifically permits borrowing.

Housing associations

Non-profit organisations providing housing for rent or purchase.
 Regulated by the Housing Corporation.

5.2 Those who cannot borrow

Minors

Under 18 years old.
 Contracts cannot generally be enforced against minors - so no mortgage.

Mental incapacity

Persons who are mentally incapacitated cannot borrow in their own right.
 They cannot make a power of attorney.

If they made an enduring power of attorney (EPoA) in anticipation of later becoming mentally incapacitated, that would then come into force.

An EPoA must be registered with the Public Trust Office and can only be revoked with the consent of the Court of Protection.

Otherwise, the Court of Protection can appoint an attorney to represent them.

Bankruptcy

Undischarged bankrupts are those who are declared bankrupt by a County Court and have not yet been released (discharged) - this is normally after 12 months.

They cannot borrow, apart from nominal amounts, during that period,

They cannot take out a mortgage during that period.

Discharged bankrupts are still required by law to declare their former bankruptcy at any future time when applying for a mortgage.

5.3 Lending policy

Lending policy is broadly concerned with

- to whom loans will and will not be made;
- security that is and is not acceptable;
- product prices, interest rates, fees and charges;
- special conditions attached to each category of loan.

The FSA expects lenders to have a clear written policy for each category of borrower.

This will include following areas of policy and practice:

- geographical catchment area of lending;
- minimum and maximum advances;
- types of security acceptable;
- maximum loan-to-value ratios;
- interest rate structure for different risks etc;
- interest rate calculation basis;
- discounting policy;
- charging structure for fees, penalties, fines, etc;
- acceptable methods of repayment;
- mortgage-related products.

Test yourself

(Test 5)

Check your understanding of this topic by writing brief answers to the following questions:

1. How is responsibility for a mortgage shared between joint mortgagors?
2. What document contains details of a company's power to borrow money?
3. For what purposes can executors borrow money?

4. In what circumstances is it permissible for trustees to borrow money?
5. What is the minimum age at which a person can take out a mortgage?
6. Who can appoint an attorney to act for a mentally incapacitated person wishing to buy a house?
7. How long do bankrupts normally remain undischarged?

Answers to Test 5

1. On a joint tenancy basis, ie both are responsible for the whole loan.
2. Its Memorandum of Association.
3. In order to administer the estate.
4. If the trust deed specifically permits borrowing.
5. Age 18 in England & Wales.
6. The Court of Protection.
7. Twelve months.

6 Legislation affecting mortgages

This topic looks at a range of laws and legal matters relating to mortgages and mortgage providers and advisers, including:

The Mortgage Conduct of Business rules;
Property law.

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This topic provides a summary of the key points contained in the study manual; Unit 3, sections 2.1, 2.2.6 and 2.2.8.

Some related matters are included in other sections of these notes.

These include: NHBC guarantees; Property Misdescriptions Act; rights and covenants under the mortgage deed; legal obligations of, and to, guarantors. Other related matters are covered initially in the CeFA® and CeMAP® Module 1 study text and in the Module 1 Revision Notes. Some of these notes are repeated here for completeness.

6.1 Wills and intestacy

Will - a written declaration of an individual's wishes regarding his estate after his death.

Only comes into effect on death. Can be revoked at any time prior to death.

Modifications can be made, before death, by means of a codicil.

Minimum age for making a will is 18.

Must be signed by the testator in the presence of at least two witnesses, who must not also be beneficiaries or spouses of beneficiaries.

A will is automatically revoked if the testator gets married or remarried.

Deed of variation - a way of varying the terms of a will after death. Only if all possible beneficiaries are over 18 and all agree to the variation.

If carried out within two years of death, inheritance tax will be based on the changed position rather than the original will's terms.

Intestacy

A person who dies without leaving a valid will is said to have died **intestate**.

Intestacy rules: distribution of the estate depends on its size and on the situation regarding surviving family:

- Spouse but no children - spouse gets £200,000 plus half the remainder. Balance goes to the deceased's parents, or if they are dead to brothers and sisters.
- Spouse and children - spouse gets the first £125,000; half the rest goes to the children in equal shares; the other half of the rest goes into trust from which the spouse receives the income for their lifetime; on their death the trust capital is shared among the children.
- Children but no spouse - shared equally among the children.
- No children or spouse - goes to the deceased's parents, or if they are dead to brothers and sisters.

6.2 Law of contract

Basic requirements for a binding contract:

- offer and acceptance;
- consideration - transfer of money or money's worth;
- capacity to contract - legal ability to enter into a contract (eg of sound mind);
- terms of contract must be certain, complete and free from doubt;
- must be the intention to create a legal relationship;
- must not be for illegal or immoral purposes;
- must not have been entered into under duress or misrepresentation.

Remedies for breach of contract (ie failing to carry out the terms of the contract):

- seek damages - financial compensation;
- seek an order for specific performance - requiring the terms to be carried out;
- seek an injunction - preventing someone from doing something.

6.3 Law of agency

An agent acts on behalf of the principal - can conclude contracts on behalf of the principal.

- In law, the acts of the agent are treated as being those of the principal.
- Agents should only act within the authority given by the principal.
- If he exceeds this authority he could be liable, unless...
- *apparent authority* - this happens where an agent acts outside his authority, but something done or said by the principal gives the impression he has authorised the agent;
- *ratification* - if the agent exceeds his authority, the principal can agree to what the agent has done, ie ratify it after the event.

In financial services:

- tied advisers act as the agent of the product company;
- independent advisers act as the agent of the client.

6.4 Consumer credit legislation

Consumer Credit Act 1974:

Regulated by the Office of Fair Trading (OFT).

- Regulates most aspects of lending - except mortgages.
- Covers loans up to and including £25,000, excluding loans for the purchase of private dwellings, which are exempt.
- Also exempt: loans for improvement or repair of private dwellings, if from the same lender as the original loan.
- Suppliers of credit or loans have to be licensed by the OFT. 4 Clients must receive a copy of the loan agreement.
- All borrowers have a cooling off period unless the agreement was signed on the lender's premises.
- Undesirable marketing practices are forbidden, eg misleading advertising.
- Credit reference agencies must disclose information held on request, and must correct it if inaccurate.
- APR must be quoted for all regulated loans - APR takes account of the interest rate and additional costs and fees involved in taking out the loan.

Reform of consumer credit law is currently taking place, partly through a new Consumer Credit Bill that aims to:

- enhance consumer rights and redress.
- improve the regulation of consumer credit businesses by ensuring 'fair practices'.
- make regulation more appropriate for all consumer credit transactions. This follows a number of pieces of secondary legislation:
 - Consumer Credit (Advertisements) Regulations 2004 - they establish a single list of items to be included in all credit advertisements.

- Consumer Credit (Agreements) (Amendments) Regulations 2004 - changes the content and layout of agreements to make them clearer.
- Consumer Credit (Disclosure of Information) Regulations 2004 - they specify what information must be disclosed to borrowers.
- Consumer Credit (Early Settlement) Regulations 2004 - confirming the entitlement of borrowers to a rebate on early repayment.

6.5 Unfair contract terms

Supply of Goods and Services Act 1982

In the absence of anything specific in a contract, the following will apply:

- the service will be performed with reasonable care;
- the work will be done within a reasonable time;
- a reasonable charge will be made.

Unfair Terms in Consumer Contracts Regulations 1999

Complaints brought under these are considered by the Office of Fair Trading.

- Applies where the supplier is a business and the contract has not been individually negotiated with the customer. Can apply to the sale of land/property, but not to sales between individuals.
- The main subject matter of a contract is excluded from the regulations, eg in a contract for the sale of a house, the regulations could not be used to determine whether the price being charged was fair.
- Main requirements are that contracts should:
 - be fair;
 - be expressed in clear, easily understood language (if there is a doubt about a meaning, it will be interpreted in favour of the customer);
 - not cause a significant imbalance in rights and obligations, to the detriment of the customer. If it does, this constitutes a breach of good faith. An example would be a term that limited the customer's right to take legal action against the supplier;

One invalid term in a contract does not necessarily invalidate the whole contract - it could continue in force but without the unfair term (if this is possible).

6.6 MCOB rules

The rules relate to 'regulated mortgages' (see 1.1)

The MCOB Sourcebook has 13 chapters.

Application and purpose:

- help in understanding the MCOB rules and other FSA rules that are relevant.

Conduct of Business standards (General):

- communications;
 - inducements.

- Financial promotions:
- contents of promotions;
 - no cold calling.

6.7 Freehold and leasehold estate

Freehold

The nearest there is to absolute ownership.

There are, however, many possible restrictions:

- title restrictions imposed by earlier owners;
- planning and building regulations;
- rights of utility companies and others;
- obligations to those who enter the property or pass by it.

Leasehold

Freeholder creates a lease for a certain period.

Leaseholder has rights over the land for a specific period only and pays an annual ground rent.

Possible terms in the lease

Maintenance and repair of property.

Constraints on use of property.

Restrictions on alterations.

Duties in respect of common areas.

Insurance - possibly through a particular insurer.

Significance for lenders

The lease should not be too restrictive.

The lease should have around 30-40 years left after the mortgage will end. Otherwise the property may be inadequate security as it may be difficult to sell.

Failure by the leaseholder to comply with any term of the lease could result in the lease being terminated and reverting to the freeholder.

This is serious for the lender, whose security would be lost.

Lenders therefore insert clauses in the mortgage deed requiring leaseholders to maintain the lease and enabling the lender to maintain it if they do not.

6.8 Commonhold

Commonhold and Leasehold Reform Act 2004 changed the rules under which leaseholders can collectively buy the freehold:

The building must contain two or more flats.

At least two thirds of the flats must have leases originally granted for more than 21 years.

No more than 25% of the internal floor area (excluding common areas) must be non-residential.

Leaseholders who do not participate can lease their flats from the new freeholders.

Commonhold

The Act introduced a new type of tenure ('commonhold') as an alternative to owning leaseholds in blocks of flats.

The block is known as a multi-unit property, and each flat is known as a unit.

A commonhold association is formed - it is a company and will manage the overall estate.

It must have a commonhold community statement showing the rights and obligations of individual unit-holders, and other essential rules.

The land must be registered as commonhold with the Land Registry.

Each individual owns the freehold of his unit and is a member and ~ shareholder of the commonhold association.

The association collects a 'commonhold assessment' - the equivalent of a management charge from each member.

Common areas in the overall property belong to the association.

6.9 Easements and covenants

Easements and covenants 'run with the land':

- ie they are passed on to subsequent purchasers and can only be removed by the courts;
- if any one person or body objects to their removal, they remain in place.

Easements

The right of one person over the land of another, eg:

- right of way;
- right of light or prospect (view);
- right to ventilation;
- right to hang a sign on another property;

The land that enjoys the right is the *dominant* tenement.

The land over which the right is held is the *servient* tenement.

Covenants

Positive covenants: a condition imposed by an earlier owner, specifying something that subsequent owners must do.

Restrictive covenants: Similar, but this time specifying what must *not* be done.

6.10 Land registration

Now compulsory for all transfers of land.

HM Land Registry - three registers:

Property Register - description, plan, map, title number, beneficial easements.

Proprietorship Register - details of the owner and the nature of the title:

- Absolute title: clear title to the property is established;
- Good leasehold: the leasehold is good but the freeholder's title may not be absolute;
- Possessory title: when the title deeds are missing, or when someone occupies someone else's land without redress (squatter's rights):
right to the land can be claimed after 12 years but the Land Registry will only convert to absolute title after a further 3 years (15 in total).
- Qualified title: there is some defect in the title.

Charges Register - any charges over the property, eg rights of mortgagees or spouse's interests registered under the Family Law Act 1996.

Unregistered land

Rights over unregistered land can be registered at the Land Charges Registry. The most common types of charge registered here are:

Legal mortgages not protected by deposit of title deeds (eg second mortgages).

Spouses interests registered under the Family Law Act 1996.

Title guarantees

Full title guarantee - free from charges and encumbrances.

Limited title guarantee.

No guarantee.

Irrespective of the type of guarantee offered, the vendor is deemed to covenant that:

- he has the right to sell the property;
- he will do all that he can to give the purchaser the title they require.

If the sale is with full title guarantee, he also covenants that he sells free from:

- any charges and encumbrances and from any rights exercisable by third parties.

If with limited guarantee, he covenants that he has not himself created any new charges or encumbrances over the property.

Test yourself (Test 6)

Check your understanding of this topic by writing brief answers to the following questions.

1. What is the purpose of a codicil?
2. What is an injunction?
3. An agent does something which exceeds his authority, but the principal later agrees to what he has done. What is the correct term for this?
4. By whom must suppliers of credit be licensed?
5. A tradesman does some work but the contract does not specify the price. What might prevent him from charging an extortionate fee?
6. Under what circumstances is cold calling permitted for the sale of mortgages?
7. Why do lenders insist that leaseholders meet all the terms of the lease?
8. Who owns the stairway outside John's flat in a commonhold multi-unit property?
9. What is an easement?
10. Where could you find details of the nature of the title of registered land?

Answers to Test 6

1. To make alterations to a will before the death of the testator.
2. A court order preventing some one from doing something.
3. Ratification
4. The Office of Fair Trading,
5. The Supply of Goods and Services Act says that the price must be 'reasonable'
6. Only where an existing customer has agreed to it in advance.
7. If any terms are not met, the lease reverts to the freeholder and the lender's security is lost.
8. The commonhold association.
9. The right of one person over the land of another.
10. The proprietorship register at the Land Registry.

7. Economic and regulatory context

This topic covers the UK property market and the main factors that influence it, including:

- interest rates;
- inflation;
- the economy;
- supply and demand;
- marketing;
- mortgage suppliers and administrators.

This topic provides a summary of the key points contained in the study manual; Unit 3, section 4.

7.1 Factors affecting the market

Interest rates

Mortgage interest rates are linked to the Bank of England's base rate, which is manipulated by the Monetary Policy Committee (MPC) to influence the level of inflation and hence the state of the economy.

When rates are low, people are tempted to borrow more and this can raise prices and lead to a property boom.

The MPC can raise rates to dampen the market and avoid an unwanted boom, but this may cause problems for those with large mortgages.

Inflation

Two elements of inflation in the house price market:

General inflation, ie a decrease in the spending power of money - tends to go together with low interest rates.

House price inflation - may be higher if interest rates are lower, since mortgages seem to be cheaper.

State of the economy

When employment is high, prospects good, interest rates low and stable, more people have the confidence to enter into mortgage transactions.

In times of recession, people are unwilling to increase mortgages and many may be unable to repay them, so house prices tend to fall.

Supply and demand

Clearly the above factors are to some extent linked, and together they may influence the relative demand for houses. If there are fewer buyers than sellers, the prices tend to fall.

Borrowing for other purposes

Another factor influencing the mortgage market is the increasing use of mortgage-secured borrowing for other purposes, eg car finance, holidays, consolidating credit card debts.

7.2 Institutions in the mortgage market

Building societies

The traditional source of mortgage finance.
Deregulation in the 1980s brought them more competition but also opened it to other markets to them.

Banks

Deregulation opened the mortgage market to banks who were quick to see the potential of low risk, high return business with opportunities to cross-sell other products

They often work on both:

- centralised basis - Internet/call centre, or may be reliant on intermediaries;
- de-centralised basis - using their own branch network; gives a good local knowledge.

Specialist mortgage houses

Independent or banking subsidiaries.
Obtain funds from the wholesale market.

Specialist lenders

Niche businesses arranging loans for people who do not fit standard lending criteria (known as 'sub-prime' borrowers), such as:

- impaired credit records;
- County Court judgements;
- self-employed with no business track record.

7.3 Marketing of mortgages

FSA rules for regulating mortgages include the regulation of 'financial promotions'

These are not only advertisements, but also any invitation or inducement to engage in an investment activity.

All financial promotions must be undertaken by an authorised individual, or the content must be approved by an authorised individual.

The only exemption is for promotions which merely publicise a firm without offering any inducement to take up a particular service:

- ie merely a name, contact, logo, factual statement about the business. They must be clear, fair and not misleading.

Real time promotions

Contact by phone or face to face.

Cold calling is not permitted except to existing customers who have agreed to it.

Unsolicited calls only between 9am-9pm on weekdays and Saturdays.

Caller must identify himself and his firm.

Caller must check that customer agrees to continue call and must terminate call if customer does not agree.

Non-real time promotions

All promotions that are not real time.

They must:

- contain full company name and address - or a way of finding it;
- state clearly if the product being promoted is conditional on buying others;
- contain the statement 'Your home may be repossessed if you do not keep up repayments on your mortgage';
- state the APR if it contains price information;
- only use competitor comparisons on a like-for-like basis and must not denigrate or discredit competitors;

Test yourself (Test 7)

Check **your** understanding of this topic by writing brief answers to the following questions.

1. In broad terms, how are interest rates and inflation linked?
2. How, in the UK, is inflation maintained at the required level?
3. Where do finance houses and specialist mortgage houses obtain the funds they lend out?
4. How do mortgage packagers operate?
5. What are real time promotions?

Answers to Test 7

1. Generally, periods of low inflation are also periods of low interest rates.
2. The Monetary Policy Committee of the Bank of England manipulates the level of interest rates to control the money supply.
3. From the wholesale money markets.
4. They tailor mortgage schemes to particular needs (eg sub-prime), operating between lenders who provide the funds and intermediaries who supply the customers.
5. Face to face or telephone conversations that are for the purpose of selling financial products.

8 Role of the mortgage adviser

This topic covers the role of the adviser in assisting the customer to select an appropriate mortgage, including:

- basic principals of affordability, suitability, risk, etc;
- ethical considerations;
- information supplied by customers.

This topic provides a summary of the key points contained in the study manual; Unit 4 Sections 1.1 to 1.7 and Section 2.

8.1 Affordability, suitability, etc

Affordability

The adviser must ensure, as far as possible, that the customer will be able to afford any solution that is recommended. A number of key issues should be covered.

- Customer's occupation, career path that will lead to higher income?
- Monthly disposable income and expenditure.
- How does the customer run his bank account? Usually in credit?
- What effect would increases in interest rates have?

- If money is tight, how would the customer feel about a mortgage that started lower but increased payments later on - a discount or low fix, for example?
- Are there any other likely expenses that will affect affordability?
- Sufficient funds to pay the required deposit and cover expenses and charges?

Suitability

The following issues will need to be considered in assessing suitability:

- the customer's objectives and future plans;
- affordability (see above);
- product is appropriate to customer's needs and circumstances now and later;
- early partial repayments or repay the whole loan early?
- eligibility for the mortgage - income multiples, loan-to-value and so on;
- product structure is the most suitable for that customer from the range of products considered - interest only, repayment, fixed, variable, etc;
- the term of the mortgage meets the customer's needs and circumstances;
- No recommendation should be made where there is not a suitable mortgage product from within the range considered.

Risk

The customer's attitude to, and awareness of, risk eg:

- the home is at risk if the borrower fails to keep up repayments on the mortgage;
- borrowing a high percentage of the value presents the risk of negative equity;
- interest rate risk - rates can increase, making the repayments higher
- fixed rate risk -there is a risk that variable rates could fall below the fixed rate;
- variable rates could rise by the end of a fixed rate or discount term;
- repayment vehicle on an interest only mortgage may underperform.

Mortgage term

Key considerations would be:

- the age at which the customer would like to repay the mortgage:
 - shorter terms require higher monthly repayments;
- if early repayment is planned, avoid mortgages with penalties; avoid mortgages that take customer into retirement.

8.2 Ethical advice

The mortgage adviser has a great deal of responsibility, as his advice will result in the client taking on a large long-term commitment.

Getting it wrong could cause major problems and distress for the customer.

Advisers must take all the necessary steps to be aware of the client's circumstances, needs and objectives before giving advice and recommending a suitable product

It is also important to establish the client's attitude to risk - some mortgage products involve a greater element of risk than others.

The adviser must then be able to show clearly how the product that is being recommended meets the client's precise needs and objectives, without jargon

Customers' interests - a firm must pay due regard to the interest of its customers, and treat them fairly.

The concept of treating customers fairly is central to the FSA's principles, and is a key element of one of its statutory objectives - securing an appropriate level of protection for consumers.

In reality, the FSA has limited ability to deliver 'fairness' through regulation, as the concept of fairness will differ for different products, services and customers.

As a result, the FSA has taken steps to address TCF, by putting measures in place to:

- improve the information provided to customers;
- increase standards of risk management and transparency for customers;
- improve complaint handling;

In many cases the measures seek to improve or clarify what is already in place, rather than develop new rules.

8.3 Advising clients in arrears

Options include:

- capitalising the arrears;
 - reaching an agreement to pay off the arrears over an agreed period;
- paying interest only for an agreed period - repayment mortgage only;
work through income and expenditure with an expert to adjust the budget:
- sources of advice: Citizens Advice Bureau, Money Advice Centres and Consumer Credit Counselling Service;

- increasing the term on a repayment mortgage to reduce the payments; - surrendering the repayment vehicle, eg endowment/ISA:
- The borrower should be warned he may not receive the full value of the product on early surrender - he then has no method of repaying the mortgage at the end of the term;
- trading down to a cheaper property and use the cash raised to settle the arrears.

Handing over the keys

Those who feel this is an option should be warned that:

- they will still be responsible for paying the mortgage until the property has been sold by the lender. This will lead to even more arrears being added;
- the arrears will be taken from the sale proceeds in addition to the original mortgage;
- the price attained for the house is unlikely to be the same as for a normal sale;
- their credit record will be seriously blemished.

Bankruptcy

For those in serious debt, bankruptcy could be a viable solution if there is no other way of settling the debt. There are, however, many potential problems:

- any possessions can be sold to pay off the debts. In a forced sale situation they are unlikely to realise their true value;
- financial freedom is severely restricted before discharge, including the availability of banking facilities and day-to-day matters;
- although bankrupts can now be discharged after 12 months, and can theoretically borrow as soon as they are discharged, few lenders will be prepared to entertain loans and are likely to charge high rates if they do lend;
- the stigma of bankruptcy will stay with the individual for many years.

Bankruptcy should be seen as a last resort, and customers should be advised to pursue all other avenues before contemplating it.

8.4 Mortgage application forms (1)

Name(s) of applicant(s)

To avoid mortgage fraud, the lender has to be sure of the true client's identity.

The lender also has to satisfy his obligations under the Proceeds of Crime Act.

It is now standard practice to require at least two pieces of identification.

Current permanent address and a contact address if different

If this has changed in the last three years, a previous address also.
Basis of occupation, eg are the applicants renting or living with parents.

Nationality and residential status

It is illegal to discriminate on racial grounds, but lenders may only accept mortgage business on normal terms if the borrower is resident in the UK.

Marital (civil) status; number and ages of dependants

Clarifies family situation. Also confirms the ages of dependants - for 'consent to mortgage' form if any are aged 17 or over and not party to the mortgage.

Occupation and income

Occupation.

Nature of employment - permanent, temporary, fixed term, etc.

Employer's name and address -to confirm income and employment details.

How long employed - if short time, details of previous employer.

Basic income.

Average overtime and the extent to which this is 'guaranteed'.

Commission, bonuses and other sales-related income.

Other income, eg from maintenance payments, trusts, etc

If the applicant is self-employed, the lender will require:

name, address and nature of business;

details of corporate form - sole trader, partnership;

business plan;

how long established - if start-up, previous career profile;

accounts for the last three years: balance sheet, profit and loss account.

The important figure for self-employed people is the net profit, which gives an indication of longer-term income prospects.

Outgoings

Existing mortgage(s).

Other loans.

Names and addresses of lenders.

Credit and charge cards.

Other monthly outgoings.

Information on debts, bankruptcy and court judgments.

8.5 Mortgage application forms (2)

Property to be mortgaged

Address or plot number and location.

Purchase price.

Type of property - house, bungalow, terraced/semi-detached/detached.

Method of construction.

Tenure of property - freehold, leasehold (if leasehold, years unexpired).

Number and type of rooms. *—*

Vacant possession - the presence of tenants radically affects market value

Alterations proposed - details, costs, how funded.

Proposed use of the property - residential, business, mixed, etc

If new or less than ten years old, name of builder and whether the builder is a member of the NHBC or similar protection scheme.

If self-build, details of supervising architect if the builder is not NHBC.

The property details are invariably checked when a valuer is sent out to assess the property.

Loan required

Amount of advance and the percentage of the purchase price.

How the balance between purchase price and loan sought will be funded.

Method of repayment and frequency of payments.

Buildings and contents insurance requirements.

Other insurance requirements

Other details

Name and address of solicitor.

Name and address of landlord if currently a tenant.

Vendor.

Selling agent.

Declaration

Signed and dated to confirm that the information given is correct to the best of the applicants' knowledge

It also authorises the lender to make all necessary enquiries relevant to the application and warns the applicant that appropriate action will be taken including referring the case to the police, if it is believed that information given has been used deliberately to defraud the lender

8.6 Corroborating income etc (1)

Failure to make appropriate checks to prevent fraudulent references may invalidate mortgage indemnity guarantee cover.

Employees

Employer's reference:

- on company letterhead;
- recently dated;
- unambiguous;
- signed by person in authority;
- original not photocopy;

Banker's reference or account statements over a reasonable period.

Existing mortgage lender's reference or statements.

Landlord's reference if currently renting.

Self-employed

Accounts for the last three years - balance sheet, profit and loss account, cash flow statement and any notes to explain unusual items, etc.

A bank reference or account statements over a reasonable period.

A reference from an existing mortgage lender.

Details of any other borrowings or substantial outgoings.

A business plan, order book or projections.

A self-assessment tax calculation - produced by HM Revenue & Customs, is will confirm the figure for taxable profit (net profit).

A self-assessment statement of account - shows whether any tax remains unpaid from a previous year.

A business tax computation - showing whether capital allowances have been used to reduce the net profit figure.

Partnerships

A partnership - unlike a corporate applicant - is not a separate legal entity.

Full set of accounts for the last three business years, including the personal drawings made by the partners.

References from any existing lenders both to the partnership and to the partners.

Details of any other borrowings or substantial outgoings.

Business plan and/or projections for the partnership business.

Partners' tax returns - to show their income from the partnership and elsewhere.

The partnership agreement, including each partner's share of the profits.
Resolution signed by all the partners resolving to take out the mortgage.
Guarantees from some or all of the partners as security.

8.7 Corroborating income etc (2)

Companies

Letter of authority or minute of meeting sanctioning the application.

Memorandum and articles of association of the company.

Three years' audited accounts.

Business plan and cash flow forecast.

Assessment should take account of both quantitative and qualitative information:

quantitative analysis relates to the accounts and other figures to obtain a good overview of business performance and calculate key business ratios;

qualitative analysis is more subjective and relates to such matters as:

- is the business in an expanding or declining market?
- has the business the resources to compete in future?
- is there a need for capital expenditure and is this provided for in the business plan?
- does the business buy good quality professional advice?

It may be necessary to assess the credit-worthiness of the company's directors when a mortgage to a limited company is considered - the lender may seek the personal guarantees of the directors by way of security.

If guarantees are sought from directors, it may also be necessary to obtain the consent of their spouses if a main residence is offered as tangible security in support of their guarantees.

Corroborating outgoings

It is here that an applicant is most easily able to deceive the lender. By omitting just one regular monthly payment, a completely false picture of the ability to repay the proposed loan can be given.

Similarly, the extent to which the applicant meets his financial obligations each month can critically affect future payment capability.

For a typical household these might include:

- present rent or mortgage repayments;
- credit and charge cards;

- hire purchase commitments;
- other borrowing commitments;
- education fees and associated costs;
- pension contributions;
- maintenance (ie payments to a former partner).

It is relatively easy to identify most of these costs and to corroborate them from bank statements. If in doubt, the lender can always seek additional information.

8.8 Credit assessment (1)

Credit searches

Electoral roll - may not be up to date at all times; typically amended once a year, using 1 October as a cut-off date.

Credit reference searches - can be made through credit reference agencies such as Experian and Equifax; they have vast databases of information in respect of previous bad debts and default, County Court judgments and insolvency.

- Under the Data Protection Act 1998, data subjects have a right to access any information held either on computer or in paper-based files. Credit reference bureaux provide such information for a fee of £2.00.

Credit scoring

Scores are apportioned to various features of the application, based on historical data relating to risk.

Categories that might be taken into account are, for example: whether the applicant is a first-time buyer or not, their age, their occupation, whether the application has come direct or been introduced, and the amount of the loan.

A certain number of points are then allocated in each category and the points for each category are totalled to give the overall score.

Applications that receive more than a certain score (often known as the 'cutoff' score) will be accepted, while those that do not would be declined.

Many systems will allow for individual scrutiny of 'borderline' applications those that achieve a score at or around the lender's agreed cut-off point.

There is no single credit scoring model, and models are not static: they may change with the changing environment.

Credit scoring is especially useful when:

- the institution has a well developed database on its existing mortgages;
- it is built into a centralised processing system, such as a telesales;
- dealing with high volumes of business;

- lending policy is well defined.

8.9 Credit assessment (2)

County Court judgments

When a person is unable to pay his creditors, a civil case can be brought to the County Court. The court can make a judgment against the debtor that then remains in force until such time as the debt is paid.

Mortgage application forms always requires details of such judgments and it is a criminal offence to knowingly conceal them from a prospective lender.

Although County Court judgments (CCJs) do not rule out the ability to get a mortgage, they have to be considered within the context of the application as a whole. A person who has been unable or unwilling to meet obligations in the past may be regarded as less reliable in the future.

Insolvency

Insolvency occurs when a person:

- has liabilities exceed his assets; or
- cannot meet his financial obligations when they fall due;

Insolvency arises when an order is made under the Insolvency Act 1986.

- Under the Enterprise Act of 2002, once made, a bankruptcy order remains in force for 12 months in most circumstances.
- The bankrupt is made responsible to an insolvency practitioner whose primary duty is to ensure that the creditors get as much money back as possible during the period that the order is in force.
- A bankrupt cannot borrow (except very nominal amounts) in his own right.
- Bankruptcy will normally be declared on the mortgage application form - it is a criminal offence not to do so.
- If undeclared, it will usually be revealed by credit searches, and the bankrupt is legally prevented from executing a mortgage deed.

Individual voluntary arrangements (IVAs)

An IVA is an alternative to bankruptcy.

The debtor makes an arrangement with creditors to reschedule outstanding debts over a specified period.

Creditors representing at least 75% of the debt must agree.

Test yourself

(Test 8)

Check your understanding of this topic by writing brief answers to the following questions.

1. What is the FSA's initiative to encourage ethical behaviour towards clients?
2. What are the three main public sources of debt counselling?
3. Who would normally be asked to sign a 'consent to mortgage' form?
4. What figure related to a self-employed person's income is normally used by lenders in determining lending multiples?
5. What is the purpose of the signed declaration on a mortgage application?
6. What are the requirements for an acceptable employer's reference?
7. What items of qualitative information might a lender use to assess a corporate loan application?
8. Name two credit reference agencies commonly used by mortgage lenders.
9. Why is it impossible for an undischarged bankrupt to take out a mortgage?
£

Answers to Test 8

1. Treating Customers Fairly.
2. Citizens Advice Bureau, Money Advice Centers and Consumer Credit Counseling Service.
3. Persons aged 17 or over living in the property but not becoming parties to the mortgage.
4. Net profit
5. Confirms that the information given is correct to the best of the applicants' knowledge and authorises the lender to make all necessary enquiries relevant to the application.
6. Original, on company letterhead, recently dated, unambiguous, signed by a ii'- person in authority
7. Whether the business in an expanding or declining market, whether it has the resources to compete in future; whether there is a need for capital expenditure, etc.
8. Experian; Equifax.
9. Because undischarged bankrupts are prevented by law from executing mortgage deed

9 Gazumping and gazundering

This topic looks at the practices of 'gazumping' and 'gazundering':
This topic provides a summary of the key points contained in the study manual; study manual; Unit 4, section 3.1.2.

9.1 Gazumping and gazundering

Gazumping

Having formally accepted an offer on a property, the vendor accepts a better offer.

Under current legislation this is not illegal and happens often in a buoyant market.

One solution would be to take the property off the market once an offer has been accepted.

However, an offer is not binding until contracts have been exchanged - so vendors generally prefer to keep the property on the market in case the sale falls through.

Gazundering

Having had an offer accepted, the potential buyer finds a reason for reducing the offer.

In some cases this is entirely reasonable - the survey might have identified problems, or other factors might have come to light.

In many cases, however, it is a negotiating tool - the buyer makes a last minute reduction in the offer, gambling on the fact that the sale has almost gone to exchange of contracts and the vendor will not want to start again.

As with gazumping, this practice is not illegal.

Test yourself (Test 9)

Check your understanding of this topic by writing brief answers to the following question.

1. Which party in a property sale situation initiates the process of 'gazundering'?

Answer to 'Test 9

1. The purchaser-- by changing to a lower offer at the last minute.

10 Additional security

This topic covers the nature and purpose of additional security in a mortgage situation, including:

personal guarantees;
life policies;
mortgage indemnity guarantees.

This topic provides a summary of the key points contained in the study manual; Unit 4, section 4.

10.1 Guarantors

A guarantor is someone (individual, company or partnership) who agrees to be responsible for the repayment of a loan if the borrower cannot or will not repay it himself.

He makes a guarantee, which is defined by the Statute of Frauds Act 1677 as a written undertaking to 'answer for the debt, default or miscarriage of others'.

A surety is a guarantor who, in addition, puts up some form of security. There are a number of specific issues that can render a guarantee invalid, as follows.

- **Lack of capacity:** eg the guarantor is a minor with no legal capacity to contract.
- **Undue influence:** may arise where one party is dominant over another eg parent and child, doctor and patient and solicitor and client.
- **Misrepresentation:** terms of the guarantee were misrepresented to the prospective guarantor - whether because of negligence, fraud or accident.
- **Misapprehension:** the guarantor is under an incorrect impression about the nature and effect of the guarantee.
- **Mistake:** the guarantor can show that he has not understood the nature of the document being signed.
- **Duress:** the guarantor has been forced to sign the guarantee document.

In *Barclays Bank plc v O'Brien* (1994), the plaintiff was able to prove that her guarantee given to support her husband's borrowing was invalid due to misrepresentation and undue influence, and that she had not been advised to seek truly independent advice.

- This case led to the inclusion of a provision in the Banking Code whereby lenders agreed that prospective guarantors will be 'encouraged to seek independent legal advice' before entering into a guarantor contract.

This is now an established feature of lending practice in all cases where guarantors are involved.

A guarantor can request to be released from the obligations of the guarantee agreement, but the lender will only agree to this if it is felt that the lending proposition is basically sound without it.

10.2 Mortgage indemnity guarantees

Where the loan-to-value ratio exceeds a certain level, the lender may charge a higher lending charge.

-The charge threshold varies from lender to lender but is usually between 75% and 90%.

The lender may use the higher lending charge to buy an insurance policy called a Mortgage Indemnity Guarantee (MIG), which protects the lender in the event of a property being taken into possession and sold for less than the outstanding debt.

Although the charge is paid by the borrower, the MIG does not actually benefit him, except that without it he would not be able to borrow such a high amount.

Some lenders do not buy an insurance policy, but take the charge as a way of offsetting the potential risk.

Some lenders will allow the charge to be added to the advance rather than being paid up front.

- In recent years, more and more lenders have either dispensed with higher lending charges or paid the Mortgage Indemnity Guarantee themselves. This is one of a range of incentives that lenders make available to attract new business.

If a claim is made by a lender on a MIG policy, the insurer is entitled to exercise its right of subrogation, ie to sue the borrower for recovery of the amount paid to the lender.

For many years, MIG claims were almost unheard of. However, when lending policies were relaxed in the 1980s, followed by a substantial fall in property values, claims became more commonplace.

This situation led to discussions between lenders and MIG insurers resulting in the Association of British Insurers (ABI) issuing guidelines in respect of the handling of claims.

These guidelines allow insurers to insist that lenders adopt certain mortgage underwriting standards before policies are underwritten

10.3 Other types of security

Life assurance policies

Some life assurance policies accumulate a surrender value after a period of time in force - these typically include endowment assurances.

Endowment policies may have no surrender value at all for the first, say, 18-24 months, but thereafter tend to increase in value.

It is possible for a lender to take such policies into consideration as additional security.

The method of taking a policy of assurance as security is by assignment -this is the legal method of transfer from the insured to the lender.

Some lenders take a deposit of the life assurance policy document rather than a deed of assignment, thus saving time.

This gives the lender no legal right to the proceeds of the policy, but does create an equitable right. An equitable right is governed by the practice of equity, or fairness, and indicates an agreement between the two parties.

Collateral deposits

A collateral deposit is simply a sum of money placed with a lender, or an account assigned to a lender, used as additional security for a loan.

The funds are effectively frozen until the debt is repaid or reduced to a level at which the additional security is deemed unnecessary.

Where that collateral deposit (or indeed security in any other form, such as shares, another property, etc) is put up by someone other than the borrower, then the depositor will be known as a surety.

Test yourself

(Test 10)

Check your understanding of this topic by writing brief answers to the following questions:

1. What is a surety?
2. What are the reasons why a guarantee may be unenforceable?
3. Who is protected by a mortgage indemnity guarantee policy?

4. What is the right of subrogation in relation to a MIG policy?
5. What makes endowment policies suitable as additional security for a mortgage?

Answers to Test 10

1. A guarantor who puts up additional security.
2. Lack of capacity; undue influence; misrepresentation; misapprehension mistake; duress,
3. The lender.
4. The right of the insurer to sue the borrower for recovery of the amount paid to the lender.
5. The fact they have a surrender value.

11 Fees and charges

This topic reviews the various fees and charges that may apply to a mortgage, including those payable to:

the lender;
legal advisers;
government bodies
others.

This topic provides a summary of the key points contained in the study manual; Unit 4, section 4.2.2.

11.1 Fees and charges (1)

The main fees involved in buying or selling property are:

Estate agents fees

Estate agents' fees are paid by the vendor once the sale has been completed, and typically amount to a figure between 1.5% and 3% of the sale price, depending on whether the agent has sole selling rights or a joint agency.

- Most agents have a 'no sale, no fee' agreement.

Mortgage fees

Reservation (booking) fee - payable when the borrower wishes to take advantage of a special deal - eg a fixed rate. Typically £100 to £300.

Arrangement fees - typically £50 to £300; may include a basic property valuation.

Mortgage Indemnity Guarantee premium - payable by the borrower through a single premium; taken on completion and cannot be refunded.

Broker's fees - must be stated clearly in the broker's Initial Disclosure Document.

The broker may also receive a procuration fee from the lender.

Valuation and surveys

Typical costs for a £250,000 property are:

valuation only - £250 to £300;

homebuyer's report - £450 to £550;

full building survey - £600 or more, depending on the size and age of the property.

Valuation and survey fees are not refundable once completed.

Lenders' reference fees

Most lenders charge for providing a reference for a borrower.

11.2 Fees and charges (2)

Legal fees

Legal fees typically include the following.

Local authority searches - before exchange of contract and not refundable:

- typical fees vary from £75 to £130;
- these searches identify plans for new roads and developments.

Land Registry search - typical cost £5 to £10. 4

Environmental searches - before exchange of contracts and not refundable:

- they check for history of flooding, mining subsidence. Typically £39.

Electronic transfer fees for transferring funds on completion. Typically £30 plus VAT.

Bankruptcy searches - carried out to ensure that the buyer is not an undischarged bankrupt and typically cost £5 to £10.

Land Registry fees - payable after completion of the sale to register the property in the new owners name.

- The fees range from £40 for a property sold for £50,000 or less to £700 for a property sold for more than £1 m.

Solicitor's/conveyancer's fee - paid on completion to cover the legal work carried out during the purchase process.

Many solicitors now charge a flat fee, regardless of the property value.

Title indemnity fees - title indemnity is required where the title cannot be fully guaranteed.

- It protects the lender and owner from ownership claims made by others.
- The fee is typically 0.10% of the property value.

Stamp Duty Land Tax

Stamp Duty Land Tax is levied on the physical transfer of the property.

It is paid by the purchaser of a property on transfer from the vendor.

The tax is levied on a sliding scale, determined by the sale price of the property, and is payable on the full price.

The rates are:

- 1 % where the price is more than £120,000 but no more than £250,000;
- 3% where the price is between £250,001 and £500,000;
- 4% where the price is more than £500,000.

Test yourself

Test 11

Check your understanding of this topic by writing brief answers to the following questions. :

1. How is an estate agent's fee affected by the existence of a joint agency? |
2. When might a reservation fee be payable?
3. Mortgage funds are normally transferred electronically. How much does this cost?
4. If the title to a property cannot be fully guaranteed, what would be the typical cost of obtaining title indemnity?
5. How much stamp duty is payable on the purchase of a property for £ 300 000

Answers to Test 11

1. The fee will be higher than if there is a sole agency.
2. For a special deal such as a fixed rate mortgage.
3. Typically around £30 plus VAT.
4. Around 0.1 % of the property value.
- 5, £9,000.

12 Property values

This topic covers the factors that affect the value of a property, including

- direct factors such as age, type and location;
- indirect factors such as covenants and rights of way.

This topic provides a summary of the key points contained in the study manual; Unit 4, sections 3.1.3 to 3.6.

12.1 Matters affecting property values (1)

Tenure

The vendor must have title to the property in order to sell.

Land in England and Wales is either freehold, leasehold or commonhold.

Leasehold should have a specified minimum period unexpired on the lease.

Problems can arise in respect of 'common areas' of freehold flats.

Some land has rights attached for the benefit of others (such as rights of way).

Location

Areas of economic prosperity attract population clusters that drive up demand.

Alternatively, exclusivity may lead to higher prices.

The very name of a district can add value to a property, or reduce it.

Type and design of the property

Generally, flats are less valuable than houses, and detached houses are more valuable than terraced and semi-detached houses.

Bungalows are often more expensive than houses with a similar number of bedrooms, although bungalows may appeal to a more limited market.

The design of a dwelling is very much a matter of personal taste.

A property could be so unusual as to be considered unsellable by a lender. - The lender must consider value in a 'forced sale' due to default.

Age of the property

Period property with original fixtures and fittings can often be at a premium over its modern counterparts, providing that it is in sound condition.

Method of construction

Traditional construction: bricks, mortar and tiled roof.

Non-traditional: eg pre-cast concrete panels attached to a steel or timber frame - there may be inherent faults that reduce the potential lifetime of the property.

For new houses, does the builder participate in the 'Buildmark' scheme
Buildings constructed in the traditional way may also be subject to defects.

Many factors impact on the value of the property and costs of maintaining it:
eg a flat, felt-covered roof may need the felt replacing regularly.
Insurers may also impose a higher premium for buildings cover.

The materials used in construction can crucially affect the value and expected life of the dwelling - important if a 25-year loan is secured on the property.

Quality of construction

For new properties, lenders prefer that the builder is a member of the NHBC 'Buildmark' scheme or the Zurich Insurance scheme.

Properties over ten years old are on merit and valuer's recommendation.
Some lenders insist on a detailed survey for properties over a certain age.

12.2 Matters affecting property values (2)

Condition

A prospective purchaser might be willing to invest additional capital in a property to improve it.

This can be an opportunity to lend more if the eventual value is likely to be enhanced by the work to be done.

One factor to consider is whether similar properties in the locality are in better condition. If so, are there any on the market and what are their prices?

Valuers will take special note of necessary repairs and report these back, with recommendations, to the lender - eg a property with untreated dry rot.

Multiple use property

Eg a building containing a shop and a flat above.

The commercial aspect could have a detrimental effect on the flat and some lenders may decline to lend.

Vacant possession

Although quite rare, some properties are sold with a sitting tenant who has a tenancy agreement with the current owner and is protected by law.

A sitting tenant will devalue a property. Most buyers want vacant possession.

Few mortgage lenders will lend on properties without vacant possession.

Insurance issues

Insurability could affect the valuation of a property. Is it insurable?

Some properties are uninsurable, or at best difficult to insure, eg:

- properties on flood plains and near rivers where flooding is common;
- properties on or near cliffs where erosion is evident;
- history of subsidence.

In many cases it will be difficult to obtain a mortgage on these properties.

Planning and building regulations

See Section 7

When a property owner extends or undertakes other building work on the property, he may be required to seek planning permission or follow specific building regulations.

Failure to do so could result in a compulsory order to reinstate the property to its original state.

Failure to obtain the necessary consents will seriously devalue the property and may result in lenders choosing not to lend on the property.

12.3 Matters affecting property values (3)

Environmental factors

A property's environment has a major effect on its desirability and therefore value eg:

radon gas - this is a radioactive gas which is present in high concentrations in certain parts of the UK. It is believed to be highly carcinogenic.

overhead electric power lines - these are also thought by some to cause cancer, though there is little conclusive evidence, but the controversy is sufficient to make some lenders reluctant to accept properties with cables above them or with an electricity substation in the vicinity.

geology of the land, eg homes built on 'London clay' can be prone to slippage and subsidence.

proximity to mobile phone masts.

Agricultural holdings

The Agricultural Holdings Act 1948 gave tenants of agricultural land a high degree of security of tenure (ie they could be very hard to evict).

The Agricultural Holdings Act 1986 and the Agricultural Holdings (Amendment) Act 1990 updated the situation but loans against the security of farmland should be approached with care.

Subsidence

Uneven fall in land level - signs of subsidence include:

- new or expanding cracks in the plasterwork or external brickwork;
- rippling wallpaper that is not caused by damp;

It may be that a property with a history of subsidence cannot be insured, and hence would not be considered a suitable security for a mortgage.

Due diligence enquiries

The vendor of a property has an obligation to disclose any disputes with neighbours in the pre-contract information supplied to the purchaser.

If a vendor fails to disclose details of resolved or unresolved dispute with a neighbour, he may be subject to legal action if the next owner learns of it.

Covenants

Positive and restrictive covenants may affect the value of a property.

Test yourself (Test 12)

Check your understanding of this topic by writing brief answers to the following questions.

1. What forms of land tenure are there under English law?
2. Why is the design of a property a difficult factor for lenders to allow for?
3. What is meant by 'traditional' construction?
4. Why do lenders insist on vacant possession?
5. Why would lenders refuse to lend on a property that cannot be insured?
6. Why does the presence of radon gas reduce the value of a property?
7. What is the most common form of 'due diligence' enquiry required for house sales ?

Answers to Test 12

1. Freehold, leasehold and commonhold.
2. Because design is very much a matter of personal taste.
3. Bricks and mortar and a tiled roof.
4. Because the existence of a sitting tenant can make a property unsellable and therefore of little value.
5. Because they cannot be sure of maintaining the value of the property.

6. Because the gas is believed to cause cancer, so the property would be more difficult to sell.
7. Questions regarding disputes with neighbours.

13 Valuations and surveys

This topic covers the different types of surveys available to purchasers and lenders, and the purposes to which the results of the surveys can be put. This will include:

- basic valuation;
- homebuyers' report;
- full building survey.

This topic provides a summary of the key points contained in the study manual; Unit 4, sections 3.1.1 and 3.1.3.15 to 3.1.3.17.

13.1 Basic valuation (1)

Carried out on behalf of the lending institution to assess the adequacy of security for mortgage purposes.

The valuer may be an 'external' professional or an employee of the lender. The task is carried out on behalf of the lender, not the borrower, although the borrower pays the fee.

The contract is therefore between the lender and the valuer. The valuation report forms the basis of the lending decision, eg:

- whether to lend and if so the size of the advance;
- the percentage advance (loan-to-value) which should be made available;
- insurance value (which may be different from the market value);
- the recommended conditions of the advance.

Contents of the report

- Details of the property.
- When the property was built.
- Dimensions of the property (with sketch).
- Tenure and, if leasehold, term unexpired.
- Valuation for mortgage purposes (not the same as the market value).
- Valuation for insurance purposes - the reinstatement value.

- Evidence of subsidence, heave or landslip affecting property or neighbourhood.
- Essential repairs.
- Major defects.
- Recommendation for specialist reports if necessary.
- Recommendation for undertaking or retention.
- A disclaimer notice, which must be prominently displayed:
 - this will stress the limited nature of the valuation as a superficial inspection for assessing the security for mortgage purposes and gives no warranty as to the property's condition;
 - it will also state that the lender is not making any comment upon the reasonableness of the purchase price.

In isolated cases, borrowers have brought actions against valuers, claiming that a duty of care is owed. Now that lenders give specific advice on the limitations of the basic valuation, such cases likely to succeed only where the:

- * lender's disclaimer was insufficiently prominent;
- * borrowers were inexperienced ie first-time buyers.

13.2 Basic valuation (2)

The valuer's recommendations

The valuer can recommend a number of alternative actions:

- accept:** the property is good value as security for the loan sought;
- decline:** the property is not a suitable security for a mortgage;
- conditional recommendations for acceptance:** undertaking or retention.

Undertaking

An undertaking by the borrower to repair or improve - used when the property is basically good security, but certain work needs to be done, eg to decorate internally or externally.

The lender reserves the right to inspect the property after say three months.

In practice, there is little the lender can do to enforce an undertaking, although theoretically the borrower would be in breach of the conditions of mortgage.

Retention

More serious. The lender holds back a sum of money from the advance pending repairs being carried out to the lender's satisfaction.

Such repairs are more extensive and important than those for which an undertaking might be acceptable.

The lender will re-inspect prior to releasing the funds retained.

4 If the valuer recommends a retention, the applicant must be made aware that extra funds will be needed to enable the purchase to be completed.

Lower valuation

If the valuer considers that the property is worth less than expected by the vendor and/or the purchaser, the result may be a smaller mortgage being offered, so:

the purchaser may make a reduced offer to the vendor;

if the vendor will not reduce the selling price, the purchaser will need to meet the balance from personal resources;

the purchase and sale may fall through altogether if the purchaser is put off by the factors which underlie the reduced valuation.

Simultaneous survey and valuation

It can be beneficial for a prospective purchaser to have a full building survey at valuation stage, so that the additional cost of the basic valuation is eliminated.

Any borrower doing this should check first that the surveyor used is acceptable to the lender - otherwise, the valuation fee may be incurred twice.

13.3 Other surveys/valuations

Homebuyer's report

A 'half-way house' between the basic valuation and a full building survey.

The price of a full survey can be prohibitive, so lenders offer the homebuyer's report as a moderately priced option.

The commissioning of a homebuyer's report establishes a contract between the borrower and the surveyor.

The report is limited in focus, and will inspect those things that can be seen fairly easily, eg it will not involve lifting carpets to inspect floors - there is little comeback if serious problems are encountered later.

The borrower does, however, have a good chance that defects will be identified, and could withdraw, make an amended offer or plan necessary expenditure.

Typical defects identified in the homebuyer's report would be:

- dry and wet rot where symptoms can be seen;
- damp-proof course condition and position;
- the interior of the roof space - beams, rafters and the underside of the roof. This may be limited by accessibility;
- pointing.

Full building survey

A thorough and complete inspection of the property carried out by a qualified professional surveyor, engineer or architect.

- It is expensive but worthwhile for many mortgage applicants;
- if the property is defective, this will almost certainly be discovered;
- if it is not discovered, the borrower has some comeback against the surveyor, whose duty of care is to the applicant only.

Such a survey will be more detailed than the homebuyer's report, comprising an inspection of the state of the electrical system, drains, damp-proofing and damp-coursing.

It should be thorough enough to identify any major, and indeed more minor, problems.

It should be carried out to certain standards, and so in the event of later problems the valuer may be liable for any losses as a result of his negligence.

Test yourself

(Test 13)

Check your understanding of this topic by writing brief answers to the following questions.

1. What is the purpose of a basic valuation?
2. What two valuation figures are usually quoted in a basic valuation?
3. What is the purpose of the disclaimer included with all basic valuations?
4. What is an undertaking?
5. A purchaser wishes to commission a full building survey. Why should he check with the lender first?
6. The lender has held back part of the loan pending some repair work. What is this a description of?
7. In the case of a home-buyer's report, who is the surveyor's contract with?
8. A surveyor has been held responsible for a purchaser's losses, due to his negligence. What type of survey did he supply?

Answers to Test 13

1. To assess the adequacy of the property as security for mortgage purposes."
2. One for mortgage purposes, one for insurance purposes.
3. To stress that the valuation gives no warranty as to the condition of the property or to the reasonableness of the price being paid.
4. A promise by the borrower to repair or improve the property - used when the property is basically good security, but certain work needs to be done.
5. To avoid paying two survey fees if the surveyor he chooses is not acceptable to the lender.
6. A retention.
7. With the purchaser.
8. Full building survey.

14 Planning consent

This topic looks at local authority requirements in respect of properties, including planning consent; building regulations.

This topic provides a summary of the key points contained in the study manual Unit 4, sections 3.2 and 3.3.

14.1 Planning consent

All major property developments require consent by the local authority, also many minor changes that individuals make to their homes.

It is most important to consider these at the mortgage application stage. All lenders ask whether substantial changes have been made to a property.

If they have, documentary evidence should be sought to confirm that these have had full consent of the planning authorities.

Examples of matters requiring planning consent are where:
a new building is to be erected:

- sometimes land is sold with outline planning permission for a building -ie a broad agreement, specifying, say, a three bedroom bungalow;
- a structure is to be erected adjacent to a property, such as a garage;
- an extension is to be built;
- the external appearance of a building is to be changed to the extent that it will change the physical appearance of the general neighbourhood;
- the kitchen is to be moved from one room to another;
- changes are to be made to a building which is 'listed' (see 14.2);
- the property will be painted a different colour;
- certain types of trees are to be felled;
- the use of the building is to be changed.

As a matter of principle, local authorities are unlikely to grant planning permission retrospectively, so once a landowner makes unsanctioned changes to the property, they are almost certainly going to be rejected later on

This means:

- if the borrower has reverse the changes that have been made to a property, then it may be worth less than when the advance was made - and so the lender's security is reduced;
- it costs money to reverse the changes made. The borrower will need to find this money somewhere, and this may impact on his ability to service his mortgage

14.2 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.

Such work is covered by statutory legislation - primarily the Listed Building and Conversation Area Act 1990.

The listing applies to the building and anything attached to it and any buildings in the grounds.

Listed buildings fall into three categories:

Grade 1 listed buildings are of 'exceptional interest' and represent about 2% of all listed buildings.

Grade 2 listed buildings are of 'particular importance' and represent about 4% of all listed buildings.

Grade 3 listed buildings are of 'special interest' and represent the remaining 94% of all listed buildings.

Proposed changes to Grade 1 and 2 buildings will involve National Heritage and various historical societies.

The Secretary of State will be informed once a local authority has reached a decision relating to the proposed demolition of a listed building and any alteration to a Grade 1 or 2 building.

Owners may also be required to carry out repairs as dictated by the local authority.

14.3 Building regulations

The building regulations are contained in the Building Act 1984. The majority of building projects must conform to the regulations and their main purposes are to:

- ensure the health and safety of people in and around all types of buildings;
- maximise energy conservation.

Building work covered by the regulations includes:

- the erection of a new building;
- the extension of an existing building;
- cavity wall insulation;
- a loft conversion;
- the underpinning of a building's foundations.

Projects that are exempt from building regulations include:

- a carport extension, open on at least two sides and under 30 square metres in floor area;
- a detached garage under 30 square metres in floor area and built at least one metre from the boundary of the property;
- a new garden or boundary wall.

Test yourself (Test 14)

Check your understanding of this topic by writing brief answers to the following questions.

1. Why do lenders insist on seeing planning permission documentation?
 2. In addition to the local authority, whose permission might be needed for changes to a Grade 2 listed building?
 3. What are the two main purposes of the building regulations?
-
3. What are the two main purposes of the building regulations?

Answers to Test 14

1. Because if unsanctioned changes have to be reversed, their security may be compromised.
2. National Heritage and possibly various historical societies.
3. Health_and safety; energy conservation.

15 Mortgage repayment options

This topic looks at the main ways of repaying a mortgage loan, including:

- Capital and interest repayment mortgages;
- Interest only mortgages;
- Repayment vehicles for interest only mortgages.

This topic provides a summary of the key points contained in the study manual; Unit 5, section 1.

15.1 Capital and interest repayment mortgages

Each monthly payment consists of a capital element and an interest element.

If the borrower makes all monthly payments when they fall due and adjusts them in line with changes in the interest rate charged, the loan is guaranteed to be fully repaid at the end of the mortgage term.

At the beginning of the mortgage term the monthly payment consists largely of interest. The amount of capital owed gradually reduces as the term progresses:

so the interest part of each monthly payment decreases, while the capital element increases.

Advantages:

A gradual reduction in the debt can be seen.

The loan is guaranteed to be fully repaid at the end of the mortgage term, provided that all monthly payments are made when due and amended in line with changes in the interest rate.

No reliance on the performance of an investment product to repay the loan.

Flexibility - eg the borrower usually has the option to maintain his existing monthly payment when the interest rate is increased or decreased.

- If he maintains the payment when the rate decreases, he will shorten the mortgage term because each overpayment will reduce the capital.
- If he maintains the payment when the rate increases, he will lengthen the term due to not paying off the required capital each month.

Disadvantages:

The main disadvantage is that there is no built-in life cover. This must be arranged separately - but decreasing term assurance cover is generally inexpensive.

15.2 Interest-only mortgages

With an interest-only mortgage, the borrower makes monthly mortgage payments consisting of interest only.

The full capital amount remains outstanding during the mortgage term and is repaid in one lump sum at the end of the term.

The responsibility is on the borrower to ensure that he has the means to fully repay the loan at the end of the mortgage term.

The borrower usually arranges an investment vehicle to build up the capital needed to repay the mortgage at the end of the term.

The investment runs alongside the mortgage but is separate from it; the cost should be taken into account when calculating the overall costs of the mortgage arrangement.

In most cases no guarantee is given that the investment will be sufficient to repay the debt in full.

Mortgage repayment vehicles include:

- * full with-profit endowment policy;
- * low-cost with-profit endowment policy; « unit-linked endowment policy;
- * individual savings account (ISA);
- * personal/stakeholder pension plan.

Many endowment policies taken out in the past appear increasingly unlikely to produce enough to fully repay the associated mortgage. For this reason, interest-only loans have become increasingly unpopular with borrowers.

While information on these investment-backed products can be given by mortgage advisers, only those who are authorised to give investment advice under the FSMA 2000 can give advice and make a recommendation.

An endowment policy, whether with-profit or unit-linked, serves two purposes, ie:

- it guarantees to repay the loan in full if the borrower dies during the mortgage term, provided that all policy premiums have been paid and the mortgage account is up-to-date;
- it aims to provide a maturity value that is sufficient to fully repay the loan at the end of the mortgage term.

In other words, an endowment policy provides both protection and investment elements for the borrower.

- Personal/stakeholder pension plans and ISAs, on the other hand, provide investment but do not include built-in life cover.
- This has to be purchased separately, usually as level term assurance.

15.3 With profits endowment

With-profits endowments give a degree of guarantee with potential for capital growth.

The basic structure is:

- Guaranteed Sum Assured (GSA) paid on the earlier of death or maturity;
- the fund invests in a spread of investments, typically shares, gilts, bonds;
- due to the guarantees, fund managers take a relatively cautious approach;
- each year part of the fund's profits are distributed to policyholders;

- profits can be distributed in two ways:
 - Reversionary bonuses - added to the policy each year as a percentage of the plan's GSA. Once added, the reversionary bonus is guaranteed to be paid on death or maturity;

 - Terminal bonuses - may be added at maturity or death. Designed to reward long-standing policyholders, they can form a large part of the final policy value.

Whilst the company will seek to declare bonuses, there is no guarantee that they will be declared or of the amount that will be paid.

- If the plan is surrendered before the end of the term the surrender value is unlikely to represent the full value of the plan at the time of surrender, and may result in a significant loss for the policyholder.

Full with-profits endowment

The guaranteed sum assured (GSA) is equal to the mortgage amount.

This means that the mortgage is guaranteed to be paid off by the GSA, with added bonuses providing a cash surplus.

- The premium is calculated on the guaranteed sum assured at the end of the term. This makes it more expensive than the low cost versions (see 15.4).
- If the full endowment is cashed in, the surrender value may be very low.
- The policy can be made 'paid up'. This means that no further premiums are paid and the policy has a reduced guaranteed sum assured and death benefit.

Advantages

The guaranteed sum assured will be paid on maturity, providing premiums are paid and the plan remains in force - so the mortgage will be paid off.

The guaranteed sum assured will be paid on death during the term - so the mortgage can be paid off.

There is likely to be a significant surplus over the mortgage amount.

Disadvantages

Full endowments are expensive.

With-profits endowments are inflexible.

The term cannot be extended and early surrender is likely to result in a payment below the plan's real value.

15.4 Low cost endowment

The low-cost endowment is a more affordable alternative to full with-profits. Over the next two decades they became a very popular mortgage repayment vehicle.

The guaranteed sum assured (GSA) is typically 30 to 40% of the mortgage amount - depending on the mortgage term.

The GSA plus any bonuses is payable on the earlier of maturity or death.

The premium is worked out by assuming that the GSA plus a percentage of the anticipated reversionary bonuses (typically 80%) will provide sufficient capital on maturity to repay the loan.

If these assumptions prove to be wrong, and the terminal bonus is not sufficient to plug the gap, the maturity proceeds will not repay the loan.

In the event of death during the term the GSA plus accumulated reversionary bonuses will be paid. A form of decreasing term assurance (DTA) is built in to plug the gap between the GSA plus bonuses and the mortgage.

This ensures that the mortgage can be repaid on death before the end of the term.

Advantages

The GSA is paid on maturity, providing premiums are paid - this means there is at least a partial guarantee of the final value.

The premiums are significantly lower than a full endowment.

The guaranteed sum assured will be paid on death during the term, meaning the mortgage can be paid off.

There is the possibility of a surplus over the mortgage amount.

The policy combines investment and life cover.

Disadvantages

The final value is not guaranteed to pay off the mortgage.

It is often difficult to identify product charges.

The policies are inflexible - the term cannot be extended and increasing premiums may not be possible.

Low start version

The premiums in the first five years are lower.

The premiums increase by 20% in each of the first five years (ie doubles)
From the 6th year, the premium is slightly higher than on a standard policy.

15.5 Unit-linked endowments

This policy is designed to accumulate capital by the end of a set term - it differs from with-profits endowments in the way the fund is built up:

- premiums (less expenses) buy units in one or more unit linked funds;
- the value of units is directly related to the performance of the fund.

The value of the policy is the number of units, held multiplied by the current unit price;

- the premium is calculated so that, if unit prices grow at a specified annual rate, the maturity proceeds should be sufficient to repay the loan;
- the only guarantee is that the loan will be repaid in the event of death during the term - using a combination of the plan's value and term assurance.

The charges on a unit-linked plan include:

a policy fee deducted from the premium before investment;
an annual fund management charge, typically 0.5% to 1.5% of fund value; «
an early surrender charge on surrender in the early years;
the sale of units to cover the cost of the death benefit;

Reviews: mortgage related unit linked endowments are subject to policy reviews by the insurer to check the plan's progress in relation to the maturity target, typically after 10 years then every five years, then annually in the last five years.

The range of funds available typically includes the following.

- Cash** - very low risk but relatively low yield.
- Fixed interest** - mainly gilt-edged stocks and corporate bonds.
- Managed (or balanced) fund** - mostly blue chip equities and gilts.
- UK equities** - blue-chip shares on the London Stock Exchange.
- Specialist equities** - companies operating in a specific sector such as technology.

Property - investments in commercial property - can be volatile in the short term.

International - Shares of companies throughout the world.

Advantages

Flexible - premiums can be varied; possible to extend the term.

Wide range of funds to choose from.

The plan's charges are clearly stated and it is simple to value the policy.

The plan combines investment and life cover.

Disadvantages

The final value is not guaranteed.

Unitised with-profit endowments

Combine the security of with-profits the greater growth potential of a unit-linked.

The investor buys units in a with-profits fund. As bonuses are declared, the value of each unit will increase proportionately and cannot be reduced in future.

Surrenders may incur a 'market value adjustment' (MVA) - the value of units cashed in early is reduced to protect the interests of other investors.

15.6 Endowment shortfalls

Recent performance of endowment policies has been very poor - the reasons are:

- interest rates and investment yields have been lower than for many years;
- the situation was made worse by falling share prices worldwide;
- concern over the standard of advice given by some financial advisers, with the risks associated with investment plans not being adequately explained.

Endowment providers have to review the performance of all endowment plans that are being used as mortgage repayment vehicles at least every two years.

The policyholder must be provided with an illustration of the maturity value based on annual growth rates of 4%, 6% and 8%.

If the annual rate of growth required to fully repay the mortgage is 6% or less, then the policyholder is advised that no action is necessary.

If an annual rate of growth of more than 6% is needed to reach the target amount, then the policyholder must be advised that some form of action needs to be taken.

- **Red letter:** high risk that the policy will not pay the target amount; a strong recommendation to take some form of action is made.
- **Amber letter** significant risk that the target amount will not be met; some action should be taken if concerned - and check future projections. .
- **Green letter:** on track but warns there is no guarantee it will stay on track.

The various courses of action that the policyholder can consider are:

- switch the amount of the shortfall from interest-only to capital repayment;
- repay some, or all, of the mortgage early, either by means of a lump sum or by making additional payments each month;
- convert the whole mortgage to a capital repayment basis;
- accumulate savings and use these to reduce the mortgage debt;
- extend the term of the endowment policy and the mortgage;
- increase the endowment premiums.

The choice of option depends on the individual policyholder.

Grounds for a valid complaint are the:

- adviser did not explain that the policy might not fully repay the mortgage, and the policyholder would not have accepted this risk if he had known about it;
- maturity date of the policy is after the redemption date of the mortgage;
- the maturity date of the policy is after retirement date - and the adviser did not specifically check that the premiums would be affordable after retirement;
- the adviser recommended that an existing endowment policy be surrendered and replaced with a new one.

15.7 ISA mortgages

Interest only is paid to the lender; the entire capital remains outstanding. Investment is made into an ISA on a regular basis.

Separate life cover may be needed to repay the loan on early death.

4At the end of the mortgage term the ISA fund is used to repay the capital.

Equity ISA

An Equity ISA can contain any or all of the following investments:

Shares.

Unit trusts, investment trusts and OEICs.

Certain types of life assurance.

Gilts and corporate bonds.

Cash ISA

Deposit accounts offered by banks, building societies and NS&I.
Not commonly used for mortgage repayment due to the low relative returns.
ISAs are further divided into Maxi and Mini ISAs.

Maxi ISA

All the investment is under the control of one manager.
Maximum investment £7,000 a year - up to £3,000 can be held in cash.

Mini ISA

Each mini ISA category can be held with a different manager.
Investment limits: £4,000 for equity mini ISAs and £3,000 for mini cash ISAs.

An investor cannot invest in a mini and a maxi ISA during the same tax year.

The main rules

Individuals must be aged 18 or over (16 for cash ISAs) and UK resident
Not available on joint or third party basis.
Income and capital growth are free from tax, although managers are unable to reclaim tax credits on share dividends.
Can only be offered by approved ISA managers.
Withdrawals can be made at any time without affecting the tax-free status.
There is no limit on the total value of ISA holdings. **Advantages**
No liability to income tax on interest, or capital gains tax on any gains made.
No contractual term, contributions can be varied; no penalties for early closure.

Disadvantages as a mortgage product

No guarantee that the fund will be sufficient to fully repay the mortgage.
No life cover is included - this must be arranged separately.
No guarantee is given that the product will be available beyond 5 April 2010.
Investment limits might not be sufficient for larger or short term mortgages.

15.8 Pension mortgages

A personal or stakeholder pension plan can be arranged by, or for, almost any UK resident under the age of 75.

Exception: occupational scheme members earning over £30,000 a year.
The main personal/stakeholder pension rules are:

The maximum annual contribution is the greater of £3,600 or a percentage of net relevant earnings. The percentage is determined by the individual's age:

35 and under	17.5%
36-45	20%
46-50	25%
51-55	30%
56-60	35%
61-74	40%

Benefits can be taken at any time from the age of 50 to the 75th birthday.

Up to 25% of the fund can be taken as a tax-free lump sum, with the balance used to provide an income for life:

- with a pension mortgage the tax-free cash is used to repay the mortgage. This means the projected fund must be at least 4 x the mortgage amount.

- Tax-free cash and income must be taken at the same time.
- Contributions qualify for tax relief at the individual's highest rate.
- Contributions are paid net of basic rate tax, regardless of tax status.
- Higher rate tax payers can claim an additional 18% through a tax return.
- Income received will be taxed as non-savings income through the PAYE system.
- Personal pensions cannot be in joint names and cannot be assigned to a lender.

Advantages

- Tax relief on contributions to the plan and premiums for pension term assurance.
- Tax-free lump sum.
- Fulfilment of three financial needs - pension, mortgage and life assurance.
- Wide fund choice.

Disadvantages

Limits on contribution size may make it inappropriate for larger mortgages.

Funds needed to repay the mortgage will result in a lower pension

No guarantee that the final lump sum will be sufficient to repay the

mortgage.

If contributions are discontinued, the funds are locked in until retirement. Benefits not available until age 50.

Test yourself (Test 15)

Check your understanding of this topic by writing brief answers to the following questions.

1. How are the repayments in the first year of a repayment mortgage made up?
2. Whose responsibility is it to ensure that in interest only mortgage is repaid at the end of the term?
3. Why do very few borrowers choose a full with profits endowment to repay their mortgage?
4. What are the components of a low cost endowment?
5. Why are mortgage related unit linked policies subject to regular reviews?
6. What is the significance of an 'amber' letter?
7. Maria saves £50 per month in a mini cash ISA. What is the most she could contribute each year to her equity ISA mortgage?
8. Joe is an employed higher rate taxpayer who contributes £200 per month to a stakeholder pension. What will be the actual amount of his monthly direct debit to the pension provider?

Answers to Test 15

1. Mostly interest, plus a small amount of capital.
2. The borrower.
3. Because the policy is more expensive than other repayment vehicles.
4. With profits endowment and decreasing term assurance.
5. To check if they are on track to repay the mortgage.
6. There is a 'significant' risk that the policy will not repay the mortgage; some action should be taken by the policyholder if he is concerned - and/or he should check future projections.
7. £4,000.
8. £156.

16 Mortgage products and interest rate options

This topic looks at the nature of mortgage interest, the main interest schemes available, and related mortgage products, including:

- interest rate bases;
- variable rate and tracker mortgages;
- fixed/capped rates etc;
- flexible/offset mortgages;
- CAT standard mortgages.

This topic provides a summary of the key points contained in the study manual; Unit 5, sections 1.4 and 2.1 to 2.3.

16.1 Interest rate bases

Annual basis

Interest is calculated on an annual basis, generally on 1 January. It benefits the lender as interest is charged on the balance on 1 January - no adjustment for capital that is paid off each month over the year.

Monthly basis

The monthly payment each month is made up partly of capital that reduces the outstanding debt. This reduced figure is used to calculate the interest to be charged for the following month.

Daily basis

One day's interest is added each day, based on 'capital plus interest' outstanding.

Any payments result in an immediate reduction in the interest charged. The above comments are relevant to repayment mortgages only.

Annual review schemes

These enable the borrower to fix his monthly *payment* for a year based on the interest rate being charged at the beginning of the period.

The capital outstanding is debited/credited with interest overpaid or underpaid in line with changes to the actual interest rate charged during the year.

The account is reviewed at the end of the year to calculate a new monthly payment for the next year, based on the capital outstanding and the interest rate applicable at the time.

Annual Percentage Rate (APR)

To enable a comparison of the true cost of borrowing from different lenders.

All adverts showing interest must also show the APR - more prominently. APR is a 'rate of charge' that takes into account some of the costs of setting up loans.

In calculating APR, the following assumptions must always be made by the lender, the:

- same interest rate will apply throughout the loan;
- borrower will make all payments on time;
- loan will run for its full term.

As well as interest, the following costs are included in an APR calculation:

- arrangement fees, administration fees and valuation fees;
- conveyancing fees relating to the mortgage transaction;
- higher lending charges;
- redemption fees, eg a fee for sealing the mortgage deed on redemption;
- buildings insurance premiums if no choice of insurer is offered by the lender.

The following costs and charges are excluded:

- redemption penalties;
- endowment and other life assurance premiums;
- charges levied in respect of any default by the borrower.

16.2 Interest rate schemes (1)

Variable rate

The interest rate varies with market rates in general - an increase in the Bank of England base rate usually leads to lenders increasing their variable rate.

Fixed rate

The rate to be charged is linked to the rate paid by the lender on a tranche of funds raised on the wholesale money markets.

The main benefit of a fixed rate to the borrower is that it helps him to budget.

Drawbacks:

- No reductions if variable rate goes down during the fixed rate period.
- An arrangement fee may be payable, typically £100 to £500.

An early repayment charge may apply if the loan is redeemed during the fixed rate period.

- This is to deter the borrower from redeeming his fixed rate mortgage to take a cheaper rate with another lender. The funds would then have to be lent to another borrower, possibly at a lower profit.

- the loan may be subject to the compulsory purchase of an associated product such as buildings and contents insurance, buildings.

If rates rise during the fixed rate period, repayments increase when that period ends.

Discounted rate

A true discount off the lender's standard variable rate for a given period.

Drawbacks include:

- an arrangement fee may be payable and is generally non-refundable;
- an early repayment charge is likely to apply to deter early redemption;
- the loan may be subject to the compulsory purchase of an associated product;
- there is no protection against increases in the lender's standard variable rate.

Although a discounted rate mortgage is a variable rate product, the borrower does have an assurance that for a given period he will be paying less than the lender's standard variable rate.

16.3 Interest rate schemes (2)

The capped rate mortgage

A variable rate mortgage with an upper interest rate limit:

- there is likely to be an arrangement fee payable;
- there will probably be an early repayment charge during the capped period;
- there may be a requirement for the purchase of an associated insurance product.

Some capped mortgages come with a 'collar': the minimum interest rate payable.

Base rate tracker

Variable rate mortgage where the rate charged closely follows the Bank of England base rate for a given period:

The rate charged is generally fixed percentage above the base rate.

The main advantage:

A guarantee that the interest rate charged will be reduced immediately following a reduction in base rate, irrespective of whether the lender's variable rate falls.

Drawbacks:

There may be an arrangement fee and/or early repayment charge. Purchase of an associated insurance product may be required.

LIBOR mortgage

London Inter-Bank Offered Rate - rates at which banks borrow from each other.

Several rates may be quoted, ie for three, six and nine months.

Sub-prime lenders often offer mortgages linked to the three month LIBOR rate.

The rate is usually reviewed quarterly when the three-month LIBOR rate is set.

The low-start mortgage

Enables the borrower to reduce the initial monthly outlay in mortgage repayments.

Eg a typical 25-year low start mortgage with the first three years' payments made on an interest only basis.

After three years, the repayments are re-calculated to ensure that the capital and interest is repaid by the end of the original 25 years term.

In effect, it is now a 22-year repayment mortgage, with higher monthly payments.

Deferred interest

These schemes defer some of the interest for an initial period - typically three years - after which the rate reverts to normal.

Interest deferred in the initial period is added to the mortgage at the end of that period, and future payments will be based on the larger amount.

16.4 Other mortgage products (1)**Flexible mortgage**

Incorporates the following three basic features:

- interest calculated on a daily basis;

- the facility to make over/under-payments without incurring a penalty; - including the facility to take a payment holiday.

Other possible features:

- Chequebook drawdown facility enabling additional amounts to be borrowed and debited to the mortgage account as further advances.
- Easier administratively than normal further advances. The wording of the mortgage deed is such that all further advances automatically take priority over any other charges registered against the property.
- So the need for a subsequent mortgagee to postpone its charge in favour of the further advance is eliminated.

Current account mortgage

In addition to the drawdown facility, some lenders now offer other benefits that have resulted in a particular kind of flexible mortgage - the current account mortgage.

This has the ability for it to receive salary payments and pay direct debits and standing orders in exactly the same way as a current bank account.

The main advantages of a current account mortgage are:

- all personal financial transactions can be carried out under one account;
- the combination of salary credits and interest on a daily basis considerably reduces the amount of interest paid over the term of the mortgage.

Offset mortgages

Similar in most ways to a flexible mortgage, the main difference being that account holder's mortgage and savings are held in the one account.

The savings held in the account are 'offset' against the mortgage, which means that interest is only paid on the balance.

The savings are not tied into the account and can be taken out at any time. Early repayment charges and or arrangement fees are likely to apply.

More sophisticated and complex offset mortgages are available which enable a borrower to offset interest payable on various savings accounts against the interest charged on his mortgage and other secured and unsecured loans held with the lender.

16.5 Other mortgage products (2)

Hybrid products

Hybrid mortgage products are a recent innovation, offering increased protection to borrowers against future interest rate changes.

With a hybrid mortgage product, the borrower may be able, for instance, to arrange half of his loan on a fixed rate basis and half on a discounted basis.

He will be protected against interest rate increases on the fixed rate element, but also be able to take advantage of any reduction in the standard variable rate on the discounted rate element.

Of course, he is still exposed to increases in the standard variable rate to which the discounted rate is linked.

A number of combinations are possible with a hybrid mortgage, for example:

- fixed rate/discounted rate;
- fixed rate/capped rate;
- discounted rate/tracker;
- fixed rate/tracker.

Some lenders may specify the ratio of each element - others may be more flexible.

Arrangement fees and early repayment charges are likely to apply to most hybrid mortgages, although different criteria may apply to each element.

A borrower with a hybrid mortgage who is contemplating making a part redemption payment can therefore choose to apply this to that element that will incur the lowest early repayment charge.

16.6 CAT-standard mortgages

CAT-standard mortgages were introduced to give clear guarantees in respect of the charges, access and terms that are applied.

There is, however, no guarantee that a CAT-standard mortgage will be the most appropriate mortgage for a particular borrower.

Charges

Intermediaries must not charge clients a fee. 4 Interest must be calculated on a daily basis.

Full credit must be given for all payments as soon as they are made.

There must be no separate charge for a mortgage indemnity guarantee.

Any other fees to be charged must be disclosed at the outset.

Intermediaries cannot charge fees to their clients.

For variable rate loans:

- there must be no arrangement fee payable;
- interest rate must never be more than 2% above the Bank of England base rate;

- there must be no early repayment charge levied at any time.

For fixed and capped rate loans:

- any arrangement fee payable must not exceed £150
- maximum early repayment charge: 1% of the outstanding balance for each remaining year of the fixed or capped rate period;
- no early repayment charge payable after the fixed or capped rate period;
- no early redemption charge if the borrower stays with the same lender.

Access

The minimum loan for CAT-standard status must not be more than £10,000.

Any customer must be allowed to apply.

The lender's normal lending criteria must apply.

The borrower can continue his CAT-standard mortgage if he moves home.

The borrower can choose which day of the month he will make his payment.

Early repayments can be made at any time.

Terms

All advertising and documentation must be clear and straightforward.

No requirement to purchase any other mortgage-related products.

The lender must give at least six months' notice if he intends to withdraw the CAT-standard status of the mortgage.

If the borrower is in arrears, he must not be charged more than the normal rate of interest on the outstanding debt.

Test yourself

(Test 16)

Check your understanding of this topic by writing brief answers to the following questions.

1. What assumptions are made in calculating the APR?
2. What are the possible disadvantages of a discounted interest rate?
3. A mortgage has variable interest between 5% and 8%. How would this be described?
4. How does a base rate tracker mortgage differ from a variable rate mortgage?
5. On a deferred interest mortgage, what happens to the interest in the initial period?
6. How do offset mortgages work?
7. What is the main benefit of hybrid mortgage arrangements?
8. What is the maximum early redemption fee on a £50,000 CAT standard fixed rate interest only mortgage with two years of the fixed period

remaining?

Answers to Test 16

1. The same interest rate will apply throughout the loan; the borrower will make all payments on time; and the loan will run for its full term.
2. Arrangement fee; early redemption fee; compulsory related products.
3. Cap and collar.
4. A guarantee that the interest rate charged will be reduced immediately following a reduction in base rate.
5. It is added to the capital.
6. Savings held in the account are offset against the mortgage, so that interest is only paid on the balance.
7. They increase protection for borrowers against future interest rate changes.
8. £1,000.

17 Other types of mortgage

This topic continues the look at variations in the types of mortgages available in the UK, including:

- foreign currency mortgages;
- sharia mortgages;
- equity release plans;
- commercial mortgages;
- equity share and shared ownership schemes;
- right-to-buy;
- buy-to-let mortgages.

This topic provides a summary of the key points contained in the study manual; Unit 4, Section 2 and Unit 5.

17.1 Other types of mortgage

Foreign currency mortgages

The key points relating to a foreign currency mortgage are:

- the mortgage is in a foreign currency but secured on a UK property;
- the capital owed is denoted in the foreign currency;
- each repayment is made in that currency - converted from sterling;

- the interest rate will be that applicable to the foreign country;
- there is usually a very high minimum loan - typically £250,000
- loans are usually available only on a repayment basis.

Sharia mortgages

Muslims wishing to buy property are faced with a religious dilemma, as Sharia law forbids the payment or receipt of interest.

- Sharia (or Muslim) mortgages have been developed to allow Muslims to raise the finance to buy property without compromising religious principles. There are two types of arrangement available:

Ijara

The lender buys the client's selected property and then sells the property to the client for the same price under a 'promise to purchase' agreement, with the repayment spread over the chosen term (up to 25 years).

The monthly payment is reviewed to allow for adjustments to the rental element

- this will usually reflect changes in interest rates.

At the end of the term the property is transferred to the client, although early repayment is possible during the term.

Murabaha

The bank buys the property at an agreed price and then sells it immediately to the client at a higher price.

- The exact price depends on the repayment term, which can be up to 15 years.
- A first payment, typically around 20% of the property value is required, and then the client makes monthly fixed payments to the bank during the term.
- As the property has been transferred to the client, the property is registered in his name rather than that of the bank.
- Properties purchased under local authority 'right to buy' schemes cannot qualify.

With both methods, Stamp Duty Land Tax is paid once, when the property is initially purchased by the lender.

17.2 Equity release schemes

Home Income Plan

Also known as lifetime mortgages.

The homeowner takes out a mortgage on their home.

Maximum loan typically 25%-55% of the property value, depending on age.

The loan is covered by normal mortgage rules and regulations.

The capital released can be used to buy an annuity, or invested in an income producing vehicle, or as capital to meet the borrower's needs.

The client(s) are entitled to remain in the home until death

On death the loan is repaid from the sale of the property.

On the vast majority of modern home income plans, no interest payments are made to the lender during the clients' lifetime.

Instead, interest rolls up and is repaid, along with the original loan, when the property is sold on the death of the borrower, or the borrower moves house.

Since a 60-year-old borrower is likely to accumulate more unpaid interest over the rest of his life than a 70 year old, younger clients will not be able to borrow such a high percentage of the value of his property as older ones.

The main providers of home income plans are members of a trade association called Safe Home Income Plans (SHIP), which has established a Code of Practice:

- the applicant must be encouraged to seek independent legal advice to ensure that he fully understands the risks involved;
- the provider will give a 'no negative equity' guarantee. The amount that has to be repaid will not be more than the price obtained when the property is sold;
- the borrower(s) will be entitled to remain in the home for the rest of their life;
- the plan must be portable to another property.

Shared appreciation mortgages

Similar to home income plans, except that the rate of interest charged is reduced from the standard rate and, in some cases, no interest is charged at all.

- In exchange, the lender takes a share in any future increase in the property value.

-Some of the property value increase is therefore lost by the estate.

Home reversion schemes

The client sells all or part of his property in return for a capital sum.

The amount depends on property value and life expectancy.

The client enters into a lifetime lease agreement with the provider, usually at nominal annual rent, which guarantees him (them) lifetime occupation.

The capital can be used as the homeowner wishes - some schemes use the cash released to buy an annuity, thereby increasing the individual's income.

Although not covered by **mortgage regulations, they will be FSA regulated.**

Most home reversion schemes are covered by the SHIP Code of Practice.

17.3 Commercial mortgages

Business partnerships

- A partnership is an arrangement between people carrying on a business in common. Unlike a company, it is not a separate legal entity, and the assets (and liabilities) of the partnership are jointly owned by the partners themselves.

- Lenders may make mortgages available to partnerships (eg solicitors' practices to purchase office accommodation).
- Lenders will need to look not only at the partnership business itself as a credit risk, but also at the financial standing of the partners.
- Lenders will check that they are not at risk due to different legal rules apply to partnerships by, for example, obtaining a copy of the partnership agreement.
- All partners will be required to sign the documents, or, if a lesser number, they must be authorised to sign on behalf of all.

Corporate borrowers

Because the borrower is a company and not an individual, and because it is a separate legal entity from its shareholders, there are some additional considerations:

- **Borrowing power:** in its memorandum of association (its constitutional document setting out what it can/cannot do) must include the power to borrow.
- **The authority of its officers:** the company's articles of association must include the powers of the directors to bind the company to loans (and how much).

- The company's status as a credit risk: ie its financial status; how long it has been in business, how it compares with similar companies and its trading record.
- including an examination of the company's recent audited accounts.
- It is sensible to look not only at the company's status as a credit risk, but also to consider taking personal guarantees from the directors of the company.

Although banks can lend considerable funds to limited companies, building societies are restricted by the Building Societies Act 1986 (as amended by the Building Societies Act 1997), to 25% of assets being held in commercial mortgages.

Commercial borrowers

A commercial mortgage is one where the security for the loan is a commercial property (eg a shop or a factory) as opposed to a residential one.

- A commercial mortgage could be made to an individual, company or partnership.
- When assessing a request for commercial lending, the lender will consider both the status of the borrower (often a business organisation) and the viability of the lending proposition.
- Where it is intended to rent the property, the assessment will include the type of tenant, the length of their lease, the type of the contract and the likelihood of getting a replacement tenant if necessary.

17.4 Equity share and shared ownership

Equity share schemes

These enable the borrower to obtain a lower rate of interest in return for giving the lender an equity stake in the property.

Typically this might involve the borrower paying the standard variable interest rate on, say, 70% of the agreed loan and a reduced (or nil) rate on the remainder.

In return for this, the lender might take 20% of the equity in the property when sold.

Such a scheme appeals mainly to first-time buyers who may be borrowing at the maximum and who wish to keep their monthly payments to a minimum.

Drawback: it can make it difficult for the borrower to trade up in the property market as the available equity is reduced when the lender takes its share.

Shared ownership schemes

Developed through cooperation between housing associations, local authorities and mortgage lenders.

They are designed to help people on a low income who are not able to obtain a conventional mortgage elsewhere.

They combine rent to a housing association or local authority with mortgage payments to the lender. Total outgoings are less than for a standard mortgage.

The rent charged is kept as low as possible so that the total outgoings are not much more than they would be for renting a property in the normal way.

Individuals normally purchase only a 25% or 50% share of the property and rent the remainder from the housing association or local authority.

'Staircasing': purchasing further shares in the property when income is sufficient to meet the increased payments.

The borrower is responsible for all property maintenance except common areas.

Stamp duty land tax is payable on the *full* price of the property.

The situation may then be reached where the borrower owns 75% of the property and makes rental payments on the remaining 25%.

Some schemes will allow the property to eventually be purchased outright, whereas others impose a limit of, say 75% on the share that can be owned.

On sale, if the property is not owned outright by the vendor, he may be required to offer it back to the housing association or local authority, which will then find a suitable purchaser from its own list.

17.5 Right to buy

Introduced by the Housing Act 1985, revised in the Housing Act 2004, it enables a secure tenant of a District Council, a London Borough Council or a registered social landlord to purchase his property at a discounted price.

For the purposes of the right to buy legislation, there are two categories of tenant.

Those whose secure tenancy started before 18 January 2005, who we

will refer to as existing tenants, and those whose tenancy started on or after 18 January 2005; these are called new tenants.

Existing tenants (those in a secure tenancy before 18 January 2005):

- gain the right to buy their property after two years of that tenancy;
- the discount after two years is 32% for houses and 44% for flats;

- for houses: a further 1% for every additional year of tenancy, maximum 60%;

- for flats: a further 2% for every additional year of tenancy, maximum of 70%.

New tenants (those whose secure tenancy started on or after 18 January 2005):

- acquire the right after five years;

- the discount after five years is 35% for houses and 50% for flats;

- for houses: a further 1% for every additional year of tenancy, maximum of 60%;

- for flats: a further 2% for every additional year of tenancy, maximum of 70%.

There is also a monetary limit on the actual amount of discount that can be given

This varies from region to region: at present from £16,000 in London to £38,000 in some other parts of the UK, reflecting the housing stock available.

Selling the property

If the property is sold within a certain period after purchase, some or all of the discount may be repayable, depends on when the right to buy was exercised:

Right to buy exercised before 18 January 2005

- In first year after exercising the right - 100% of the discount must be repaid.

- Second year - 2/3rds of the discount must be repaid.

- Third year - 1/3rd of the discount must be repaid.

- After three years - no repayment.

Right to buy exercised on or after 18 January 2005

- In the first year after exercising the right - 100% of the discount must be repaid.

- Second year - 4/5ths of the discount must be repaid.

- Third year - 3/5ths of the discount must be repaid.

- Fourth year - 2/5ths of the discount must be repaid.

- Fifth year - 1/5ths of the discount must be repaid.

- After five years - no repayment.

Post-18 January 2005 purchasers who sell within ten years must offer the property first to their former landlord or another social landlord at full market price.

17.6 Buy-to-let

A buy-to-let mortgage scheme is designed to enable the purchase of a property for investment purposes, ie for letting rather than for owner occupation.

- They are not regulated by the FSA.
- Investors wish to take advantage of the continuing rise in property prices and the shortage of property for rent in the private sector.
- Rental income and possible capital gain to be realised when the property is sold represent an alternative to equities, which fell markedly in the early 2000s.

A buy-to-let mortgage presents a greater risk to the lender because:

- there is no guarantee that the property will always have tenants;
- lengthy periods during which no rental income is received may affect the borrower's ability to maintain monthly repayments;
- the borrower may treat the commitment less seriously than if the property were his own home;
- the value and saleability of the property may be adversely affected if it is badly treated by tenants and not adequately maintained by the borrower.

Lenders could offset this increased risk by charging a higher rate of interest, but as demand for these schemes has grown interest rates have fallen.

- Buy-to-let mortgages are now available on a fixed or discounted basis:
- these usually incorporate an arrangement fee/early repayment charge.

Lenders do not usually employ income multiples when deciding how much to lend a buy-to-let applicant.

The amount of the advance is usually calculated on the basis of the monthly rental income being around 125% of the monthly repayment.

The lender will also want to ensure that a suitable form of tenancy agreement is used so that it is not prevented from obtaining a possession order in the event of default.

An assured shorthold tenancy agreement is used as this also gives the landlord the right to take possession of the property when the lease expires.

Lenders may require that a reputable letting agent should be appointed to manage the tenancy.

Test yourself

(Test 17)

Check your understanding of this topic by writing brief answers to the following questions.

1. Peter has a property in the UK, bought with a mortgage designated in euros. Will his repayments depend on UK interest rates?
2. During the term of an Ijara mortgage, to whom does the property actually belong?
3. What is the **FSA's** new official name for home **income plans**?
4. If a property subject to a home income plan increases in value, to whom does the additional equity belong on the death of the borrower?
5. What guarantee do SHIP members give with regard to negative equity?
6. How would you define a commercial mortgage?
7. How do equity share mortgage schemes work?
8. What is staircasing?
9. Daniel has been the tenant of a council flat for five years. What percentage discount can he obtain if he now buys the flat?
10. How do lenders determine maximum loan amounts for buy-to-let mortgages?

Answers to test 17

1. No, his interest rate will be related to rates in the eurozone.
2. To the lender, which receives rent from the client.
3. Lifetime mortgages.
4. To the late borrower's estate.
5. The amount that has to be repaid including accumulated interest will not be more than the price obtained when the property is sold.
6. One where the security for the loan is a commercial property as opposed to a residential property.
7. The borrower pays a lower rate of interest on part of the loan in return for giving the lender an equity stake in the property.
8. Purchasing a further share in property under a shared ownership scheme.
9. 50%.
10. The amount of the advance is usually calculated on the basis of the monthly rental income being a certain percentage of the monthly repayment, typically 125% to 150%.

18 Life assurance and other insurances

This topic covers the various kinds of insurances that are related to mortgages, including:

- buildings cover;
- term assurances;
- sickness and accident insurances;
- mortgage indemnity guarantee insurance.

This topic provides a summary of the key points contained in the study manual; Unit 5, section 3.

18.1 Buildings insurance (1)

It is important to both the lender and the borrower that the mortgaged property is adequately insured.

- The property is the lender's prime security for the loan, and it is essential that it is insured against any event that would adversely affect its value.
- Many policies are index-linked, ie the cover is automatically increased annually in line with a recognised index of house-building costs. Some policies do not actually provide a specified level of cover for a particular property, but instead to insure it for an upper limit of, say, £500,000.
- For larger and more expensive properties, it will be necessary to determine a specific level of adequate insurance cover.

The rights of the lender

Because of the importance of buildings insurance, the lender has the right to:

- insist that a mortgaged property is continuously insured, to its requirements;
- have its interest as mortgagee noted on the policy by the insurer;
- insist that the proceeds of any claim made by the borrower are used either to remedy the subject of the claim, eg repair any damage, or to reduce the debt.

Risks covered

The following standard perils are covered by almost all policies:

- fire and resultant smoke damage;
- lightning, explosion and earthquake;
- storm and flood;
- subsidence, landslip and heave;

- impact caused by:
- any vehicle, train or animal;
 - falling trees, telegraph poles and lamp posts
 - aircraft and articles dropped from them;
 - television and radio aerials, masts and satellite dishes
 - theft and attempted theft;
 - vandalism and malicious damage caused by riots, strikes and civil disturbances;

18.2 Buildings insurance (2)

The principle of averaging

Under-insurance is less of a problem now due to index-linked policies.

However, if a property is under-insured, the insurer is unlikely to meet in full any claim that it has agreed to accept, and will apply the principle of averaging, ie reduce the claim payment in proportion to the level of under-insurance.

Block policies

The cover provided and premium rate are agreed between the lender and the insurer.

Instead of issuing each borrower with an individual policy, a master policy is set up, with both the lender and insurer having copies.

The relevant property address and borrower details are sent to the insurer.

A document setting out which risks are and are not covered and how to make a claim is sent to the borrower immediately after the mortgage is completed.

A lender will have a block policy arrangement with a number of different insurers, mainly because the Office of Fair Trading requires that the borrower should be given a choice of at least three insurers.

Advantages for the lender include:

- commission is received from the insurer for each property insured;
- cover is guaranteed to remain in force as premiums are debited to the borrower's mortgage account and transferred to the insurer.

Advantages to the borrower include:

- the premium can usually be paid on a monthly basis and combined with the mortgage repayment;

- because the insurer and the type of policy have been selected by the lender the cover will be comprehensive;
- the cover will not lapse through non-payment of premiums, as these are automatically debited to the mortgage account;
- any claim will normally be dealt with initially by the lender, who will then send all the paperwork and a recommendation to the insurer - the borrower will not usually need to deal directly with the insurer.

Some properties may be excluded from cover under a block policy, eg those of non-standard construction and those of a particularly high value. Commercial and semi-commercial properties are also usually excluded.

18.3 Buildings insurance (3)

The borrower's right to choose an insurer

Apart from the choice of block insurer that must be given under the Office of Fair Trading guidelines, borrowers now have the right to choose their own insurer.

- However, the lender has some say in the matter and is entitled to inspect the proposed policy to ensure that it meets its minimum requirements - and is recognised as being reputable, eg a member of the Association of British Insurers.

The risk to the lender is increased where agreement is given to the borrower to arrange his own insurance. The lender will therefore request that:

- the insurer either notes its interest in its records or actually places the policy into the joint names of the borrower and the lender;

it is notified if premiums are not being maintained, and before any action is taken to cancel the policy - in these circumstances the lender is likely to pay the outstanding premiums and debit the borrower's account;

it is advised whenever the borrower submits a claim - in the case of a substantial claim the lender may ask for the claim monies and then make the necessary payment to the contractor who carried out the remedial work.

To cover the cost of this additional administration, many lenders charge the borrower a one-off fee, typically around £25.

Leasehold properties

Neither the lender nor the borrower usually have much say in the arrangements made for insuring a leasehold property.

- This is because the freeholder will probably have organised cover through his own insurer and included all relevant details in the lease.
- This is often the procedure followed by the freeholder of a block of flats. Only one policy is taken out covering the whole building, with the cover relating to each individual flat being shown on the policy schedule
- With an individual leasehold house, the freeholder may allow the leaseholder to arrange their own insurance cover, but may want to approve the policy

Where the freeholder insists on arranging the insurance cover, the lender is in a difficult situation if the policy does not meet its minimum requirements.

The offer of advance may have to be withdrawn if the freeholder will not agree to arrange improved cover to satisfy the lender (the wishes of the freeholder take precedence over those of the lender).

The borrower will normally be required to pay buildings insurance premiums on a regular basis direct to the freeholder, along with service charges and ground rent.

18.4 Life assurance protection products

A mortgage protection policy is designed to cover the repayment of a mortgage in the event of a borrower's death

These products are referred to as term assurances, the main ones being decreasing, level and convertible.

All term assurances share the same characteristic, ie the sum assured is payable only on the death of the life assured within the policy term. If the policyholder survives to the end of the policy, no return is payable

Policies can be taken out on one or more life, and joint borrowers often arrange a joint policy payable on first death, thus protecting the surviving borrower

Decreasing term assurance

The most common form of decreasing term assurance is a mortgage protection policy used in conjunction with a capital repayment mortgage

The sum assured decreases in line with the reducing mortgage balance and the policy therefore guarantees to repay the outstanding debt, provided that premiums have been maintained and the mortgage account is not in arrears

The advantages of using a decreasing term assurance policy to protect a mortgage:

- it is the cheapest form of life cover
- it can easily be arranged by the lender, often on a block basis
- a minimal health declaration is adequate, except at older ages

Level term assurance

Some borrowers prefer this as there would be a surplus available after the mortgage has been repaid which would benefit the surviving borrower

Level term assurance can be arranged to accompany an ISA or personal pension plan as the mortgage repayment vehicle, as neither has any built-in life cover

Convertible term assurance

A level term assurance policy that provides an option to convert it into whole-of-life or endowment assurance, without the need for further evidence of health

The premium would be 10% to 15% higher than for a standard term policy
The option allows the term to be extended, but the cover cannot be increased

Pension term assurance

Allows the plan holder to benefit from income tax relief on premiums in the same way as on pension contributions. The amount of cover that can be purchased is limited by the contribution allowed as follows:

For plans taken out before 6 April 2001: maximum premium payable of 5% of net relevant earnings

For plans taken out on or after 6 April 2001: maximum premium is limited to 10% of the gross contributions made to the pension plan
In both cases, the premium counts as part of the overall contribution limit

18.5 Mortgage payment protection insurance

An MPPI policy covers the borrower's mortgage payments for a period of up to two years if he is unable to work due to accident or sickness, or has been made redundant

Also called accident, sickness and unemployment (ASU) insurance, although this is not a particularly accurate description as unemployment is only covered if it results from involuntary redundancy

Key features:

- benefit is payable after a deferred period, usually 28 days, and for a maximum period of up to two years;
- the level of benefit is usually sufficient to cover the monthly mortgage payment and any associated insurance premiums, although it may be increased to include an allowance for some essential living expenses;
- all benefit payments are tax-free.

Typical exclusions and restrictions

- the proposer must have been continuously employed for a specified period before the proposal can be accepted
- any redundancy which the proposer has reason to believe was imminent when the policy was taken out will be excluded
- no benefit is likely to be paid if the policyholder is made redundant within a specified period of the date of the policy
- no benefit is payable if the policyholder becomes unemployed as a result of disciplinary action
- redundancy cover may be excluded if the proposer is self-employed

The need for mortgage payment protection became more urgent after the Income Support for Mortgage Interest (ISMI). Regulations were amended for all new mortgages completed after 1 October 1995

These borrowers have to wait 39 weeks from the acceptance of a claim before any benefit is payable - lenders are not always prepared to wait this length of time before any payments are received and may decide to commence possession proceedings before the 39 weeks have elapsed

The government strongly encourages borrowers to take out MPPI and discussions with the main providers and the Association of British Insurers has resulted in most policies now having standardised, and fewer, exclusions and restrictions ,

18.6 Permanent health insurance (PHI)

A PHI policy provides a monthly tax-free income when the policyholder is unable to work due to accident or sickness.

- It does not cover redundancy or unemployment.

- It is 'permanent' as there is no limit to the number of claims that can be made while the policy is in force. The insurer cannot cancel the policy or increase the premiums simply because several valid claims have been made and met.
- The benefit will continue to be paid until the policyholder is able to return to work, retires or dies, whichever event happens first.
- Benefit payments normally commence after a deferred period agreed at the outset by the policyholder - usually between 4 and 52 weeks.
- A longer deferred period will reduce the premium and may be selected according to the insured's financial situation and ability to maintain mortgage payments and meet other essential expenditure from savings.

The usual maximum level of benefit is approximately 60% of the insured's average net monthly income, less state incapacity benefit.

- The maximum benefit applies to the benefit received from all PHI policies held by an individual.
- The existence of any other policies must be declared when a proposal for a new policy is made and also when any claim is made.

The level of premium payable is based on a number of factors, eg:

- occupation
- gender
- hobbies and pastimes
- exclusions

The usual standard exclusions are:

- self-inflicted injury, including drug and alcohol abuse;
- medical conditions of which the insured was aware when the policy started;
- injury arising from the participation in any criminal act;
- complications arising from pregnancy and childbirth.

Many employers now offer group PHI schemes and pay the premiums on behalf of their employees.

- However, HM Revenue and Customs regards the provision of such schemes as a taxable benefit-in-kind as far as the employees are concerned.
- A major advantage of a group scheme is that each member is entitled to a certain level of cover that does not depend on a health declaration. This is particularly beneficial to those who would have difficulty arranging their own policy because of poor health.

18.7 Critical illness cover

Pays a tax-free lump sum on the diagnosis of any one of the serious illnesses specified in the policy. These generally include:

- most forms of cancer
- stroke
- heart attack
- kidney failure
- multiple sclerosis
- rheumatoid arthritis

None of these illnesses are covered if they are related in any way to HIV or AIDS.

Any illness of which the insured was aware when the policy was arranged would also be excluded.

The lump sum benefit is paid only if the policyholder survives for a specified period, usually 28 days, from the date of diagnosis.

The benefit does not have to be repaid even if a full recovery is made from the illness:

- however, it can only be paid once, after which the policy is cancelled.

Critical illness cover can be either a stand-alone policy or as an 'add-on' to an endowment or term assurance policy.

In the latter cases, the lump sum is payable either on diagnosis of one of the prescribed illnesses or on death, whichever occurs first.

The main benefit of this type of policy is that it can be used either to fully repay or partly repay an outstanding mortgage, or replace lost income during a lengthy period of sickness.

18.8 Mortgage indemnity insurance

A mortgage indemnity guarantee (MIG) is a single premium policy that is sometimes arranged by a lender if the loan-to-value ratio exceeds a certain level.

This threshold varies from lender to lender but is usually between 75% and 90%.

The policy is additional security to protect the lender in the event of a property being taken into possession and sold for less than the outstanding debt.

- Although the premium is usually paid by the borrower, the policy does not actually benefit him:
- except that without it he would be unlikely to be able to borrow such a high proportion of the value of the property.

- Under the Mortgage Conduct of Business (MCOB) Rules, the premium for a MIG policy must be described to applicants as a *higher lending charge*.
- Some lenders allow the higher lending charge to be added to the advance rather than having to be paid up front.

- In recent years, more and more lenders have met the cost of the MIG policy themselves or even dispensed with this form of security altogether.

This is one of a range of incentives that lenders now offer to attract new mortgage business.

- If a successful claim is made by a lender on a MIG policy, the insurer is entitled to exercise its right of *subrogation*:
- ie to sue the borrower for recovery of the amount paid to the lender under the claim.

An insurer has the right to impose a 20% excess on any MIG claim made without having to give a reason.

A claim can be declined outright if the insurer has reason to believe that the lender had not applied sound underwriting principles when approving the loan.

Test yourself (Test 18):

Check your understanding of this topic by writing brief answers to the following questions.

1. What are the three legal rights that a lender has over the buildings: insurance policy relating to a mortgage loan?
- 2 Explain the principal of 'average' as applied by insurance companies.
- 3 Why might a freeholder's insistence on a particular buildings insurer cause IK 11 problems for a mortgage lender on a leasehold property?
- 4 What is the main characteristic that defines all term assurance policies?
5. What is the usual maximum period for the payment of a claim on mortgage payment protection insurance?
6. What are the main standard exclusions from a permanent health insurance policy?

7. What triggers the payment of a claim on a critical illness policy?
8. Explain what is meant by subrogation in relation to a mortgage indemnity guarantee policy.

Answers to Test 18

1. To insist that a mortgaged property is continuously insured, to it; requirements; to have its interest as mortgagee noted on the policy; and to insist that the proceeds of any claim made by the borrower are used either to remedy the subject of the claim, eg repair any damage, or to reduce th(debt.
2. If a property is under-insured, the insurer will not meet any claim in full but will reduce the claim payment in proportion to the level of under-insurance.
3. Because the chosen insurer's policy might not meet the requirements of the lender.
4. The sum assured is payable only on the death of the life assured within the policy term.
5. Two years
6. Self-inflicted injury, including drug and alcohol abuse; medical conditions which the insured was aware when the policy started; injury arising from the participation in any criminal act; complications arising from pregnancy an« childbirth.
7. The diagnosis of one of the serious illnesses specified in the policy.
8. The right of the lender to sue the borrower for recovery of the amount paid to the lender under the claim.

19 Raising additional money

This topic looks at the principles and procedures associated with raising additional funds, including:

- further advances;
- remortgages;
- bridging loans

Other related topics, such as methods of releasing equity, are covered in the Revision notes for Unit 5.

This **topic provides a summary of the key points containe manual; Unit 6 Section 1 and Section 3.1.13.**

19.1 Further advances (1)

A further advance is a 'top up'¹ loan to an existing borrower.

Whilst 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 as their records can often identify high quality lending opportunities

The FSA Mortgage Conduct of Business rules apply to **further advances**.

Most of these loans are made by banks and finance houses.

Building societies are limited by law as to how much they can lend overall on properties subject to second and subsequent charges.

Gathering information

As with the initial loan, this is the first stage in the further advance process:

- assessment of the ability to repay;
- adequacy of the security - reassessing the property to ensure that it continues to offer sufficient security.

Determining purpose :

The Consumer Credit Act 1974 requires lenders to determine the purpose of any loan of £25,000 or less in order to ascertain whether it is regulated by the Act or not.

If the loan is for £25,000 or less, it is regulated unless exempt*.

If the loan is over £25,000, it is unregulated.

*A loan is exempt if:

- it is for purchase, improvement, enlargement, alteration or repair of a main dwelling house; and *
- the original loan is with the same lender. «• The Act only affects loans to personal borrowers.

Loans for mixed purposes are usually separated into regulated and non-regulated elements, as the procedures are different for each.

Assessment of borrower's status

- Income - it cannot be assumed that the borrower has the same or a better income than when the original advance was granted.
- Outgoings - other borrowings as well as normal household expenditure.

- Circumstances - eg overall family circumstances - since the original advance was made, people may have left or moved in. 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.

Conduct of existing account - it is necessary to look at the account history to see that the applicant for the further advance has been a good payer - some lenders insist that arrears be cleared before a further advance is considered.

19.2 Further advances (2)

Assessment of security

Since the original loan, 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 automatically enhances the value.

-If the original loan-to-value ratio was high, a new valuation may be needed to determine whether the value is sufficient for the higher loan.

If the loan is for home improvements, 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.

Building societies are required by law 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 mayor 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).

Loan required

The overall loan-to-value ratio is the most crucial determinant here, ie the outstanding debt plus the further advance, as a percentage of the property value.

Location

This needs to be re-assessed from a long-term viewpoint.

The risk decision

The lender has to balance two sets of factors that can conflict the need to:

- obtain good quality lending business and sales of related products;
- 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.

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.

19.3 Further advances (3)

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 where the title deeds are not held by the lending institution is known in law as a puisne (pronounced 'puny') mortgage.

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

Priority of mortgages

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.

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.

One example is the type of loan that permits a form of revolving credit to be drawn down over and above the amount of the main mortgage.

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

Higher lending charge

If the existing mortgage exceeds the loan-to-value ratio threshold (typically 75%) for a higher lending charge, any further advance will increase the exposure of the lender, requiring a new higher lending charge to be written.

The further advance may take a loan that is not currently subject to a higher lending charge above the threshold.

19.4 Further advances (4) - planning permission

Further advances for home improvements or alterations are made subject to the ability of the borrower to obtain all necessary planning consents. Anything that changes the external appearance of a property substantially is likely to require approval.

Typical work that would requiring planning permission includes changes that:

- mean the property will be closer to a road, lane or footpath than before unless there is at least 20 metres away;
- are higher than the roof of the original building;
- are more than four metres high and within two metres of a boundary;
- mean more than half the land surrounding the original building is covered by buildings;
- are to terraced houses where the extension is more than the greater of 10% of the original house or 50 cubic metres;
- are to other houses where the extension would be more than the greater of 15% of the original house or 75 cubic metres;
- would increase the property by more than 115 cubic metres;
- would involve dividing a single property into separate homes.

The general procedure for seeking planning permission is:

- contact the local authority/council planning department with an outline plan;
- if they require planning permission an application form should be completed;

- submit an outline plan or detailed plan - an outline plan saves money and enables the council to give an idea of acceptability;
 - * the application is placed on the application register for public inspection;
 - notices posted on or near the site to inform neighbours;
 - * planning committee makes the decision.
- A serious situation would arise if a borrower made substantial alterations to a property, funded by a further advance, only to find that the local authority does not accept the work and forces the borrower to change the property back to how it was.

- If the borrower defaults in the meantime, the lender can be left with a property that is not saleable because it does not comply with planning laws and is subject to an enforcement order.
- This can result in heavy expenditure by the lender, which it may not be able to recoup from the borrower.

New (additional) occupants

When a further advance is made the lender has two options:

- it can insist that any new resident signs a consent to mortgage form;
- it can permit the new occupant to become a party to the mortgage, subject to status - this requires a variation of the mortgage deed.

19.5 Remortgaging

A remortgage is simply a replacement loan for one already in force, usually from a different lender.

Matters to consider when a remortgage is required to repay a different lender

- Purpose of the loan - this determines whether the loan:
 - falls within 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 includes:
 - details of the existing mortgage have to be confirmed;
 - the lender should check whether the information given at application stage is consistent with evidence presented by the existing lender;
- the borrower should obtain a redemption statement in order that financing needs are fully known;

- the lender should be aware that once the existing lender knows that a redemption is likely, it will take action to try to retain the business (if the loan is perceived to be of good quality);
- if the borrower wishes to proceed, the conveyancing work can commence;
- the solicitor acting for the borrower will arrange to pay off the existing mortgage from the proceeds of the advance cheque, along with any other costs, fees or expenses involved.

Issues facing the borrower

- There may be tie-in conditions with financial penalties for early redemption, or other conditions.
- Replacing an existing mortgage with an increased loan to consolidate other debts: the borrower should consider the impact of this route over the long term.
- He will be paying interest on the consolidated debt until the end of the mortgage term, which will invariably 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.

19.6 Second mortgages

A second mortgage is one secured on the same property by a lender other than the first mortgagee.

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.
- 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.

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.

Second mortgages tend to have higher rates of interest, reflecting the higher level of risk carried by the second charge.

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

19.7 Bridging finance

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, as there is no guarantee that the latter will be sold within a reasonable period of time;
- closed bridging arises when the person buying already has a firm purchaser for the existing property - this is less risky.

Bridging finance is offered by all banks and some of the larger building societies.

Lenders are much more prepared to lend in closed bridging situations than for open bridging

Advantages of bridging

- There are few advantages of open bridging, other than enabling the borrower to complete the purchase of the new property more quickly otherwise.
- Closed bridging provides a valuable service - it enables a purchase to go ahead, which otherwise might break down as a result of the purchase/selling chain being disrupted.
- Despite the cost disadvantage, bridging finance can usually be obtained at a reasonable rate.

Disadvantages of bridging

Open bridging 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 which is on the market.

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 yourself (Test 19)

Check your understanding of this topic by writing brief answers to the following questions.

1. Are further advances covered by the MCOB rules?
2. What is the legal requirement for building societies regarding valuation of properties offered as security for mortgage loans?
3. What is the benefit to the lender, in relation to mortgage terms and conditions, of a further advance?
4. Why is a second mortgage always a 'puisne' mortgage?
5. A property is to be split into two separate homes, but no structural alterations are involved. Is planning permission required?
6. What document should a borrower obtain in order to determine the exact amount of loan required on a remortgage?
7. What is closed bridging and how does it differ from open bridging?
8. In what circumstances might a second mortgagee's security prove to be worthless?

Answers to Test 19

1. Yes - unless they are regulated by the Consumer Credit Act 1974.
2. They are required by law to 'assess the adequacy of security' for mortgages secured on land.
3. The lender can reconsider the conditions applicable to the entire original loan agreement.
4. Because the second lender does not have possession of the title deeds to the property.
5. Yes.
6. A redemption statement.
7. Closed bridging is when the person seeking the bridging loan already has a firm purchaser for his existing property - this is less risky than open bridging, where purchase of a new property goes ahead without a definite

sale of the existing property.

8. When the value of the property is insufficient to repay the first mortgagee's loan

20 Transferring mortgages

This topic covers a range of circumstances and events that can take place after a mortgage contract has commenced, including:

- changes to interest rates and to charges;
- addition or removal of borrowers;
- part redemption and early redemption;
- changing the term;
- transferring mortgages;
- letting mortgaged property;
- death of a borrower.

This topic provides a summary of the key points contained in the study manual; Unit 6, section 3. 4

20.1 Changes to interest rates/fees/charges

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.
- For each contract, however, it is the terms and conditions which are in force at the time of completion that bind both lender and borrower. Older mortgages may have a minimum period of notice before repayments can be adjusted following an interest rate change.
- This creates a disadvantage for the lender but the condition cannot be changed retrospectively, so the lender has to wait for these mortgages to be paid off.

Historically, some building societies had a rule that interest rate changes would be notified to borrowers by post - a time-consuming and costly exercise - so most societies with this rule have changed it by consent of the members via a special resolution passed at a general meeting.

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 - such as:

- late payment fees;
- redemption fees;

- part redemption fees;
- final inspection fees;
- claw-backs of discounts and cash-backs.

Mortgage legislation commits lenders to:

- notifying these charges in advance of borrowers incurring them;
- 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.

There are certain schemes for which it is particularly important for changes to be notified to borrowers, eg:

- those on annual review schemes, who can be particularly hard hit in a period when interest rates increase several times - 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.

20.2 Transfers of equity (1)

NOTE: The mortgage contract cannot be varied from the terms and conditions applicable on the completion date without the sanction 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.

Transfers of equity

A transfer of equity arises when a borrower is:

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

In either event, the lender has the final say on whether this course of action is acceptable or not.

The legal charge is made between the parties specified in the original contract -and can only be varied by agreement of those parties.

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

- 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.
- * A less common reason for a request to release a borrower from the mortgage contract is where it is an attempt 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.

20.3 Transfers of equity (2)

Factors for a lender to consider when a request for a transfer of equity is made:

The purpose of the request

The purpose may be straightforward or concealed. The lender has to get behind the request in order to understand the borrower's motives.

Status

- If a person is to be removed from the mortgage, the remaining person's financial circumstances have to 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 divorce, the remaining borrower might have maintenance payments which could affect ability to repay the loan.

New occupier

If a new person is moving in where an existing mortgagor has left and been removed from the deed, it must be established whether the new person wishes to be party to the mortgage contract.

- If so, normal status enquiries should be made.
- If not the non-owning occupier must complete a 'consent to mortgage' form.

Track record

The lender needs to ascertain which of the parties has been paying the mortgage.

If it is the person seeking to be released, the individual who is to remain in the property must be made aware of the obligations that the mortgage entails.

Guarantee

Any guarantor must agree changes in the terms and conditions of a mortgage.

Life assurance policies

A life assurance policy supporting an interest only mortgage might be 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.

Value of the property

The remaining borrower's ability to repay has to be considered alongside the current loan-to-value ratio. A revaluation of the property may be necessary.

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. It is normal to take legal advice and arrange for a solicitor to act.

20.4 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 could take the opportunity to make early redemption (provided there was a sufficiency of funds) if for example:

- a legacy was received;
- there was 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 would be better used to clear the loan.

A major reason for early redemption is that borrowers see a better deal elsewhere and go for this without consulting their existing lender.

It is likely that the lender will contact the borrower to promote further borrowing - provided of course the borrower has been a regular payer.

For early redemption to be made, a date of redemption is required.

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 or fees to offset loss of anticipated interest from the loan.

- This would have been expressed in the mortgage deed or conditions at the time the mortgage was completed.
- These fees may be expressed in terms of so many months interest, or as a flat charge.
- The amount can be a significant sum and must be taken into consideration by borrowers in their overall calculation.

In rare circumstances, a court may 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, thus allowing early redemption.

20.5 Redemption and part redemption

Redemption

Once a borrower has made all payments in accordance with the conditions of the legal charge, the loan is redeemed.

When the lender is satisfied that all charges to the account - interest, capital, fees, costs, charges and so on - 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.
- 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 itself.
- A release fee is sometimes charged.

Part redemption

The borrower pays a lump sum to reduce the mortgage balance.

When a part redemption is made, if the lender agrees, the borrower can either:

4 continue repayments at the same amount and reduce the mortgage term;
or

* reduce the amount of monthly payments and keep the same term.

Most lenders set down a minimum amount that will be accepted by way of capital reduction. This can be as little as £500.

4 This stipulation is mainly in place to enable the transaction to be recognised 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.

The lender should be specifically told to apply the amount as an immediate capital reduction.

20.6 Changing the mortgage term

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

Reduction

- 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.

Extension

The term of the mortgage can also be extended - this is sometimes an option for borrowers who have run into financial difficulties.

- This has the effect of reducing the monthly repayment and hence making the mortgage more affordable.
- Lenders will generally agree to extend the term only 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 would be to give the associated investment vehicle more time to grow.

20.7 Changing the mortgage

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.
- In this situation, most of the process relating to buying a house will apply.
- This means that the costs of moving the mortgage will be similar to those of buying the house.

Charges will include:

- valuation;
- legal fees - conveyancing, etc;
- arrangement fee;
- local authority searches;
- possible redemption charges.

In a highly competitive mortgage market, many lenders offer packages that pay for some or all of these costs - either through a specific arrangement or through a cash-back incentive.

- If such a package is accepted, however, there may be penalties for redemption in a specified term. The borrower should take all of these potential costs into account when deciding if the proposed deal is actually as good as it looks.

20.8 Transfers of mortgages

Transferring of mortgages takes place when a lender sells its mortgage book (its mortgage business) to another organisation.

- Either the mortgage deed will have a clause allowing the lender to transfer the mortgage to another, or the lender will seek the consent of the borrower.
- Whichever way permission is given, it will normally be subject to conditions, including a condition that the borrower will not be prejudiced by it.
- Transfers of mortgage are subject to a Statement of Practice to which most lenders subscribe. In essence, this states that:
 - a lender will not transfer a residential mortgage to a body outside of the company group without the borrower's consent;
 - the lender must provide the borrower with sufficient information to enable the borrower to make an informed decision.
- There is little effect on the borrower if the mortgage is transferred, as the original conditions of the contract remain in force.

- A lender must not rely solely on any consent to the transfer of mortgage that is contained in legal documents, unless it drew this to the borrower's attention before the mortgage was completed.
- A lender may seek the borrower's general consent, but notwithstanding any general consent that the borrower may have given, the lender will seek the borrower's specific consent on any transfer under which the lender would cease to:
 - exercise discretion in the setting of the mortgage interest rate; or
 - determine the conduct of relationships with borrowers whose mortgage payments are seriously in arrears.

Advantages of transfers

- Reduces or removes administration in respect of loans in default.
- The lender is able to buy its way into a particular market.
- The lender can get out of a market which now provides insufficient margin.
- The lender exchanges an illiquid asset (the mortgage book) for a liquid one (cash), so adjusting its liquidity position.

Disadvantages of transfers

- Once a transfer is made it will normally not be reversible.
- Some transfers have received some criticism by accountancy bodies as being 'quick fixes' to remedy the shortcomings of short-term financial performance.
- Time and effort is involved by the organisation which is buying in - to carry out a due diligence exercise to ascertain how good is the portfolio of mortgages to be transferred, including the bad debt history.

20.9 Lettings - authorised and unauthorized

All lenders specifically exclude the right in the legal charge to let the mortgaged property.

- Anyone who lets a property without permission from the lender is, therefore, 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 the market value with vacant possession.

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

For example:

- 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 could 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.

20.10 Death of a borrower

A death certificate is required so that the institution can formally amend its records.

Most institutions require an original copy issued by the Registrar or a copy certified by a solicitor.

It is essential to amend the lender's records immediately because:

- cheques written before death but not cleared cannot be negotiated;
- the lender will want to avoid sending out inappropriate marketing material;
- if the mortgage account is already in arrears, it may not for the time being, wish to threaten litigation against a person recently bereaved.

Joint borrowers

- If the mortgage is held in joint names, the debt becomes the responsibility of the surviving party.
 - * The records can be amended and the mortgage account can continue in the sole name of the survivor.
- If there is a life assurance policy in place, this should cover most, if not all, of the debt, enabling the mortgage to be redeemed if desired.

Sole borrowers

- If the mortgage was in a sole name, the lender must await completion of legal formalities.
- In due course, it will be notified as to who is the executor or administrator, depending on whether the deceased made a will or not.
- On the death of the sole borrower the property is vested in the personal representatives of the estate. They also have the responsibility to continue

with obligations under the legal charge until grant of probate or letters of administration are issued, following which the property may be sold if desired.

- Generally, the outcome to the lender will be redemption of the mortgage by the successors of the deceased selling the property or, alternatively, from the proceeds of a life assurance policy.
- In rare cases, a lender has to take action against the estate of the deceased if payments cease for a protracted period and nothing is done about the situation.

Intestacy rules

- Surviving spouse, no issue or other family - surviving spouse gets the whole estate.
- Surviving spouse and children - spouse gets £125,000 plus a life interest in 50% of the balance; children share 50% of the balance.
- Surviving spouse and surviving parents, siblings (or their issue) - spouse gets £200,000 plus 50% of the balance; family get the other 50% of the balance.

This is particularly relevant where the property is a significant part of the estate - in cases of intestacy the property may have to be sold to pay off other relatives. It may be possible to apply for a postponement to allow the surviving spouse to continue living in the property.

Test yourself (Test 20)

Check your understanding of this topic by writing brief answers to the following questions.

1. How often must changes in a lender's tariff of charges be notified to borrowers?
2. What is the technical term for the process of removing a borrower from a mortgage deed?
3. What enquiries would a lender make before agreeing to remove a borrower from a mortgage deed?
4. What is the 'equity of redemption'?
5. In mortgage terms, what is 'Vacation'?
6. What effect does extending the term have on the interest payments on an interest only mortgage?
7. A borrower has agreed to possible future transfers of his mortgage by signing -the mortgage deed, which includes this. Why might it still not be possible to effect the transfer?
8. What should a borrower do if he wishes to accept tenants in his property?
9. What happens to a mortgage taken out by a sole borrower who has just died?

Answers to Test 20

1. Annually.
2. Transfer of equity.
3. Valuation of the property; assessment of the financial status of the remaining borrower.
4. The right of the borrower to redeem the mortgage loan at any time.
5. The action of the lender in releasing the borrower from the mortgage when it has been fully repaid.
6. None.
7. Because that term in the deed had not been specifically pointed out to him
8. Seek the permission of the lender - this is a requirement of the mortgage deed.
9. Responsibility for the loan passes to the late borrower's personal estate.

21 Debt consolidation arrangements

This topic looks at the principles of using mortgages within debt consolidation schemes.

This topic provides a summary of the key points contained in the study manual; Unit 6, section 2.1.5.

21.1 Debt consolidation and mortgages

Mortgages can provide viable options for those who have mounting debt problems.

Consolidating debts into a mortgage has advantages, particularly as mortgage interest rates are generally well below those for other types of borrowing (especially credit card debts).

If credit card and/or other debts are added to a mortgage by taking a further advance or remortgage a significant amount can be saved each month in total repayments.

This can be a very attractive proposition, but there are a number of points to consider:

- The credit card debt will now run for the rest of the mortgage term.

- The extended term is likely to mean paying more interest overall than by keeping the existing arrangements.
 - The new mortgage would have to be within the lender's normal income multiples and loan-to-value limits.
- # A remortgage is likely to involve costs - these should be offset against - potential savings in order to decide if the consolidation was viable.
- If a cashback mortgage is used some of the credit card debt could be paid off.
 - Moving to a new fixed rate or discount rate could save even more money, subject to how any redemption penalties would impact on the strategy.
 - Consolidating the debt reduces the equity in the property.
 - Loans have been moved from an unsecured to a secured basis, increasing the danger of losing the property in the event of default.
 - It may be advisable 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.
 - Discipline is required to avoid falling into the same position a few years later.

Check your understanding of this topic by writing brief answers to the following questions:

1. What is the main advantage of consolidating other debts into a mortgage?
2. What are the main drawbacks of consolidating other debts into a mortgage?

Answers to Test 21

1. The mortgage has a lower rate of interest
2. Equity in the property is reduced; loans are transferred from unsecured to secured, putting additional pressure on avoiding default.

22 Implications of non-payment of mortgages

This topic looks at the implications for the borrower of non-payment of mortgages and other breaches of the mortgage deed, including:

- FSA requirements for the treatment of those in arrears;
- possible courses of action such as: suspension of payments; extending the term; etc.

This topic provides a summary of the key points contained in the study manual; Unit 6, section 2.1 and in the summary of the MCOB rules.

22.1 FSA requirements regarding arrears

Chapter 13 of the MCOB rules deals with how firms must treat customers whose mortgages are in arrears.

The requirements include the following:

- Firms must have a written policy, which must include:
- trying to reach an agreement over how to repay any arrears;
- liaising with a third party source of advice;
- allowing a reasonable time for repayment of arrears, allowing for the borrower's circumstances;
- allowing borrowers to change the monthly date of payments or the payment method;
- considering allowing borrowers to remain in the property to effect a sale;
- repossessing a property only as a last resort;

If borrowers fall into arrears, firms must provide the following information within 15 business days of becoming aware of the arrears:

- the FSA information sheet on arrears;
- a list of missed payments;
- the total amount of arrears;
- the charges incurred as a result of the arrears;
- the total outstanding debt excluding redemption charges;
- the nature and amount of charges to be incurred if arrears are not cleared.

Before commencing action for possession, the firm must:

- clearly state the possession procedure;
- inform the borrower of the need to establish eligibility for re-housing;
- the firm must not put pressure on the borrower by excessive contact or by contact during unsocial hours.

When a property has been taken into possession, the firm must:

- market the property as soon as possible;
- obtain the best price reasonably obtainable.
- If the proceeds are insufficient to repay the debt, the firm must:
- tell the borrower the amount of the shortfall;
- explain if the shortfall may be pursued by the MIG insurance company;
- if the firm itself decides to recover the shortfall from the borrower, it must do so within 6 years.
- If the proceeds are more than the outstanding debt, the firm must take reasonable steps to pay the balance to the borrower, subject to the claims of other subsequent mortgagees.

22.2 Assistance to borrowers in arrears (1)

Payment of arrears over a given period

The borrower agrees to clear the arrears by paying more than the monthly instalment for an agreed period.

- This may be possible if a period of unemployment is followed by the borrower taking a job at a salary level that can sustain the increased monthly payments.

This is appropriate only when:

- there is a real ability and desire by the borrower to address the problem;
- this can be done within a reasonable period of time - say a maximum of one year.

Courts have the power under the Administration of Justice Act 1973 to take a more generous view of the rescheduling period.

- They make expect the lender to permit up to four years (or even more). 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.

Full or partial suspension of monthly payments

Mainly used for capital repayment mortgages 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 where the lender grants a payment holiday or partial suspension of monthly payments.
- Arrears will therefore build up over the period, which the borrower will be expected to make good within a set time after the end of the period.

Accept interest only

If the loan is a repayment mortgage, the lender may be prepared to accept interest only payments for a specified period.

- One problem with this is that in the early years most of the monthly repayment is made up of interest, so the concession of removing the capital element is worth very little.
- A lender would therefore need to weigh the merits of this course of action: what are the prospects for recouping the deferred capital payments at a later stage?

22.3 Assistance to borrowers in arrears (2)

Extend the term

The mortgage account can be put back on course by extending the term.

- This could be on either a short-term or long-term basis.
- In the longer term, a customer with a ten-year term mortgage could extend it to, say, 35 years so as to reduce the payments.
- It is important not to extend the term past the borrower's expected retirement.
- It may not be possible to extend mortgages supported by with-profits endowment policies as they cannot usually have their term extended as they mature on a particular date.
- Newer versions of the product, including unit-linked and ISA mortgages, can usually have the term extended without difficulty.
- This is because the investment products are open-ended and do not rely on a set maturity date.

Capitalising the arrears

This might be suitable where a customer has gone through a difficult period but is now able to make slightly higher monthly payments than before.

Surrender the endowment policy and change to a repayment mortgage

Can only be done if the policy has been assigned to the lender.

- The policy may have lapsed already if the borrower has financial difficulties.

It is not good practice to surrender a life assurance policy very early as surrender values are very low over short periods - financial advice should be sought.

- Another option is to sell the endowment policy in the secondary market. A disadvantage of surrendering the policy is that the loan is converted to a repayment mortgage. Payments will increase and alternative life cover needs to be arranged.

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 will release equity to not only remedy the arrears situation but also perhaps place a sizeable deposit for a subsequent purchase. 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.

Test yourself (Test 22)

Check your understanding of this topic by writing brief answers to the following questions.

1. How quickly must a lender contact a borrower if it discovers that the borrower's mortgage payments are in arrears?
2. What rules apply to the marketing of a re-possessed property?
3. What is the maximum period over which the court can order a plan to repayment of arrears to be spread?
4. For what type of mortgage might the method of accepting only interest payments provide a reasonable way of helping a borrower in financial difficulties?
5. Why is surrendering a mortgage-related endowment policy not usually

Answers to Test 22

1. Within 15 business days.
2. The property must be marketed as soon as possible and the price obtained should be the best that can reasonably be expected.
3. No maximum period is established under the Administration of Justice Act
4. A repayment mortgage that has been running for a number of years.
5. The surrender values are very low for a considerable period; the loan will in any case have to be converted to the repayment basis, which will increase the cost.

23 The legal remedies and lenders' rights

This topic covers the rights and courses of action available to the lender in respect of non payment by the borrower, including:

- sources of advice;
- lenders' rights of possession;
- possession procedures..

This topic provides a summary of the key points contained in the study manual; Unit 6, sections 2.1.3 and 2.2.

23.1 Sources of advice and help

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

- Citizens Advice Bureau - provides 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 advisers will usually be able to spell out the various options available.
- In addition to providing guidance on arrears problems, the CAB also produces information packs on insolvency and bankruptcy.

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.

- Department of Social Security (now incorporated in the Department for Work and Pensions). Some borrowers are not aware of the benefits they can claim, eg possible eligibility for the Working Families Tax Credit.
- Local housing associations - may become involved in schemes to assist those in financial difficulties. Several have introduced innovative packages of measures, including schemes offered as mortgage rescue packages.

Mortgage rescue schemes

- During the early 1990s, lenders came up with innovative and successful schemes. These are not mortgage products in themselves, but are schemes designed to try to assist customers in need.
- One such method was based on the Business Expansion Scheme (BES).
- Several lenders set up mortgage rescue schemes whereby properties belonging to those in financial difficulties would be purchased via a BBS company and let to the owner-occupier. This was pioneered by the Nationwide Building Society.
- A different scheme, introduced by the Bradford and Bingley, enabled 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, typically involving the housing association purchasing a whole or part interest in the property, with the latter becoming partly or wholly a tenant.

23.2 Legal remedies (1)

Legal remedies are those actions laid down by law that a lender can take against a borrower in default

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

The first two are the most common and are normally used together:

Sue for possession and exercise the power of sale

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 avenue available has been explored by lender and borrower and that possession is a very last resort.

The lender must be seen to have done everything possible to help the borrower bring the account to order.

The county court can take one of three courses of action. It can:

- grant an outright possession order, enabling the lender to take possession, usually within 28 days;
- Once a possession order has been granted, the lender can proceed to take possession;
- If necessary a bailiff of the court can enforce the possession order, usually accompanied by a representative of the lending institution;
- grant a suspended possession order imposing on the borrower an obligation to make payment in accordance with the court's decision;
- the suspended possession order becomes enforceable if the borrower fails to keep up the repayments;
- adjourn the case until a future date.

Even after the date of possession, the lender still owes a duty of care to the borrower, and the borrower can, in fact, still return to the lender to settle the mortgage account right up until disposal of the property.

Sue on the borrower's personal covenant for recovery of the debt

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 as 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.

23.3 Legal remedies (2)

Appoint a receiver

The right to appoint a receiver is exercised when there is an income pertaining to the property, 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 apply them to the mortgage account to reduce the overall debt.
- The receiver could be an employee or agent of the lender, but serves as agent for the *borrower* in respect of disbursement of money received.
- 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, however, could be appointed when the statutory power of sale becomes exercisable and could then collect the rent and pay it to the lender while the lender could still formally deny approval of the tenancy.

Foreclosure

The remedy of foreclosure is of historic importance only. The word has a specific meaning in this context: the lender takes over ownership of the property and can keep all of the sale proceeds.

- Today this would be considered to be inequitable to the borrower who would forfeit the equity of redemption and would lose the right to redeem the mortgage once it had been taken into possession.

23.5 Possession procedure (2)

It is important to ensure that the borrower cannot regain entry to the property.

- Arrangements are made immediately to change the locks of the property and secure all points of entry.

Other matters that have to be considered are as follows:

- utilities such as water, gas and electricity have to be disconnected;
- gas and electricity meters should be read;
- the borrower is responsible for payment of these services used prior to the readings being taken.
- requested a telephone statement to include all calls up to the date of possession;
- subsequent outgoing calls should be blocked or the telephone disconnected altogether.

- the local police should be advised that the property is not occupied and informed from whom the keys of 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 could 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 had left behind in the property.

3.7 Sale procedure (2)

Once a property has been taken into possession, the lender will seek to dispose of it as quickly as is practicable in order to recoup the funds advanced.

- Valuation will be necessary in order to determine an appropriate selling price.
- Lenders have obligations to their former borrower:
 - in the eyes of the law, the borrower retains an equity of redemption - ie the 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, though it does not necessarily have to look after and maintain the security indefinitely to obtain a higher price -particularly in view of the fact that delay increases the borrower's debt:
 - in order to establish that this obligation has been fulfilled totally, many lenders place an advertisement in a newspaper seeking last and final offers by a particular date;
 - some lenders consider auction as well as private treaty to ensure that the highest price possible is obtained for the property.
 - when in possession a lender still needs to ensure that it is acting reasonably and not to prejudice the borrower's rights;
 - for example, 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 not the lender should produce a list of any such fittings and to document how the items have been dealt with.

It is a fact that properties held by mortgagees in possession do not attract the same prices as those sold by their owners:

- when borrowers run into financial difficulties they are likely to neglect essential maintenance, which would maintain the value of the property.

For this reason, the court may decide to allow borrowers in default to stay in the property, provided that serious efforts are made to bring about a sale.

23.8 Higher lending charge and subrogation

The higher lending charge is the most common form of additional security accepted for a residential mortgage.

- It is a single premium to pay for a mortgage indemnity guarantee (MIG) insurance, a general insurance policy written in order to protect the lender's interest on higher percentage loans.
- The borrower pays the fee for this policy but the policy protects the lender.

In the event of mortgage loss the lender can sue the borrower for the outstanding debt under the personal covenant made in the mortgage deed.

- In turn, the insurance company that has underwritten a MIG can sue the former borrower for the amount that has been paid to the lender under its right of subrogation.

It is reasonable that a borrower should be expected to meet the costs of the MIG insurance company.

- The mortgage deed commits the borrower to meet all payments due under contract.
- He should not expect to be able to insure away this obligation with a one-off insurance premium.

Test yourself (Test 23)

Check your understanding of this topic by writing brief answers to the following questions.

1. What are the three main sources of free advice for people whose mortgage payments are in arrears?
2. What are the four main legal remedies for lenders when borrowers are in default?
3. What responsibility does a lender have for possessions left in a repossessed property?
4. What principles apply to the sale of a re-possessed property?
5. What is the term for the principle under which a MIG insurer can attempt to reclaim from the borrower the sum paid to the lender?

Answers to Test 23

1. Citizens Advice Bureau; Money Advice Centres; **Consumer Credit Counselling Service.**
2. Sue for possession; exercise power of sale; sue on borrower's persons covenant; appoint a receiver.
3. Items left behind by the borrower must be held in trust on his behalf. If not claimed by a specified time they may be disposed of and the proceed; credited to the mortgage account.
4. The lender should obtain the best price that can reasonably be obtained; thi:
- 5 .Must take account of the fact that any delay increases the borrower outstanding debt.

24 State assistance for payment difficulties

This topic covers the provisions of Income Support for Mortgage Interest (ISMI), the main state help for people in difficulties with mortgage interest payments.

This topic provides a summary of the key points contained in the study manual; Unit 6, sections 2.1.2.

24.1 Income Support - mortgage interest

The key features of the system are:

- 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 ISMI;
- loans that began after 1 October 1995 do not receive ISMI during the first 39 weeks of a claim;
- the full entitlement is paid from week 40;
- loans that began before 2 October 1995 do not receive ISMI during the first eight weeks of the claim;
- during the following 18 weeks only 50% of the entitlement is paid;
- the full entitlement is paid from week 27.
- ISMI payments are paid direct to the claimant's lender;
- 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;
- ISMI payments are calculated using a standard rate of interest, not the borrower's actual rate - except that the actual rate charged is used if it is below 5%. Where the rate is between 5% and the standard rate, ISMI is paid at the standard rate;
- ISMI is payable on loans used to finance work carried out to maintain a property's fitness for occupation, but not for other repairs or improvements;

- a borrower who has already served the waiting period and then ceases to claim benefit for up to 12 weeks will not have to serve a further waiting period at the start of the second claim;
- ISMI is not payable on arrears which accumulate during an exclusion period;
- an exclusion period in respect of Income Support for mortgage interest will commence on a claim for jobseeker's allowance, statutory sick pay or incapacity benefit, regardless of entitlement to income support, or in other cases the date of an initial claim for income support.

ISMI is not available for;

- endowment premiums;
- buildings 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.

Test yourself (Test 24)

Check your understanding of this topic by writing brief answers to the following questions.

1. What is the maximum amount of loan on which ISMI can be claimed?
2. How long must a borrower wait to receive ISMI if his mortgage commence* in 2001?
3. Is ISMI payable for: low cost endowment premiums?; building insurance premiums

Answers to Test 24

1. £100,000.
2. 39 weeks.
- 3 No not for any insurance or assurance premiums.