

Lenders' legal rights and remedies

LEARNING OBJECTIVES

In Topic 28 we looked at the responsibilities placed upon the lender when a borrower is in arrears; we emphasised that taking a property into possession must be a last resort. In this topic we look at the legal rights and remedies of lenders and insurers once efforts to address arrears have been exhausted. The legal code in England and Wales differs from that in Scotland.

By the end of this topic, you should have an understanding of the following:

- the lender's legal rights and the legal remedies available;
- procedures for taking possession;
- procedures for selling a property that has been taken into possession;
- the rights of the lender and the insurer where a mortgage indemnity guarantee is in place.

THINK ...



It is likely that most of the content of this topic will be unfamiliar to you, although we did look at mortgage indemnity guarantees in Topic 15. Before you begin studying this topic, think about:

- what a lender might need to do once it has decided to take a property into possession;
- what it might need to consider in relation to selling the property.

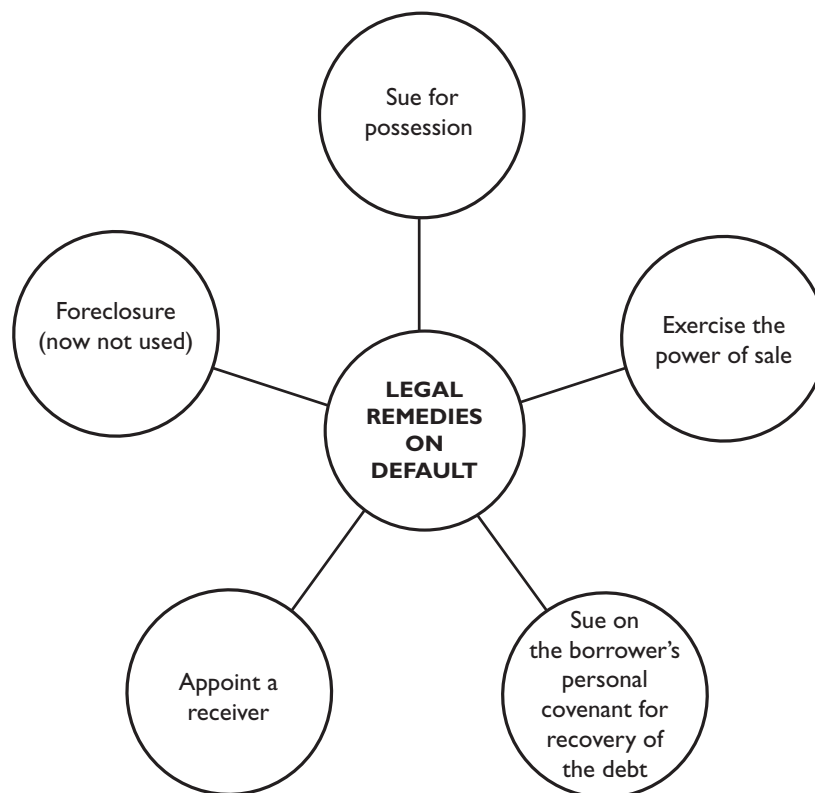
29.1 What legal remedies are available on default in England and Wales?

In England and Wales, legal remedies are laid down by the Law of Property Act 1925. Northern Ireland is not subject to the Law of Property Act, although it has adopted many of the concepts.

LEGAL REMEDIES

Actions laid down in law that a lender can take against a borrower in default.

FIGURE 29.1 WHAT ARE THE FIVE LEGAL REMEDIES?



29.1.1 The right to sue for possession and exercise the power of sale

The most commonly used legal remedies are where the lender sues the borrower for possession of the property and then sells the property in order to recover the debt.

To take possession, the lender must petition the county court for a possession order. Before the county court will consider granting such an order, it has to be satisfied that every other option has been explored by lender and borrower, and that possession is a very last resort. The county court has discretion to take one of three courses of action:

- Grant an **outright possession order**, enabling the lender to take possession, usually within 28 days.

- 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. The court will have to grant a final possession order in this situation.
- **Adjourn or suspend the case** until a future date.

The lender must be well prepared for the court hearing, because it must present to the court full and itemised details of transactions including credits, debits and transfers. In addition, the lender must be seen to have done everything possible to help the borrower bring the account to order. If the lender is unable to demonstrate this, the court is likely to adjourn the case, or even dismiss it.

Once a possession order has been granted, the lender can proceed to take possession. The court will give a date on which this order is enforceable and, in the majority of cases, the borrower will vacate the property prior to the date of possession. If necessary, however, a court bailiff can enforce the possession order, usually accompanied by a representative of the lender. Even after the date of possession, the lender still owes a duty of care to the borrower and the borrower can still settle the full mortgage account, which includes the capital plus arrears, until the point at which the lender exchanges contracts with a new buyer.

Once the lender has sold the property it must pass on any surplus after the mortgage debt and any costs or fees incurred during the repossession and sale process.

29.1.2 The right to exercise the power of sale

The section of the Law of Property Act on exercising the power of sale has been under review for some years. While it allows lenders to sell a property in specified circumstances, it is rarely, if ever, used for residential property. It theoretically allows the lenders to sell the property in one of the following circumstances:

- the mortgage has not been repaid within three months of the lender serving notice to the borrower requiring full repayment of the loan;
- the borrower is more than two months in arrears;
- the borrower breaches another non-financial mortgage covenant.

If the lender exercises the power of sale, it must obtain a 'proper' price for the property, and must pay the borrower the balance of the proceeds after the outstanding mortgage, interest and arrears, sale costs and other secured loans have been settled.

29.1.3 The right to sue on the borrower's covenant

The right of the lender to sue the borrower on their personal covenant to repay the debt arises from the contractual obligations in the legal charge. Taking this action is often futile because, even if the court makes an award to the lender, the borrower may not have the resources to pay it. 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.

29.1.4 The right to appoint a receiver

The right to appoint a Law of Property Act (LPA) receiver is exercised when there is an income from the property. This happens, for example, when the property has tenants who are paying rent. The LPA receiver collects the rent and any other income from the property on behalf of the lender, and this money is applied to the mortgage account to reduce the overall debt.

An LPA receiver is deemed an agent of the borrower, and acts on their behalf in respect of disbursement of money received and duties of accountability. However, the lender appoints the receiver who, with a few exceptions, can be anybody, including the lender's employees.

If there is an unauthorised tenancy at the property, the lender must do nothing that could be considered as formally recognising that tenancy – this could unwittingly create an overriding interest for the tenant.

29.1.5 Foreclosure

The remedy of foreclosure is of historical importance only. Despite the word being used generically to mean pursuing recovery of a debt, a foreclosure order is never used in the UK today. A foreclosure order results in the borrower forfeiting all rights to the property. The lender is theoretically able to take possession, sell the security and retain any surplus. The borrower loses the right to redeem the mortgage after possession – this is now regarded as unfair.

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

29.2 What legal remedies are available in Scotland?

Under Scottish law, there are three legal remedies available to a lender when a borrower fails to maintain a mortgage. The lender's solicitor will serve the borrower with one of the following:

- a **calling-up notice**, which requires the whole debt to be repaid;

- a **notice of default**, which requires that the arrears be brought up to date or another breach of the mortgage conditions remedied (eg a failure to repair the property);
- a **court warrant** – the lender can apply to court to be given the right to exercise any available remedies, including carrying out necessary maintenance and selling the property to settle the debt.

These remedies are available under the Conveyancing and Feudal Reform (Scotland) Act 1970.

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



MORTGAGE RIGHTS (SCOTLAND) ACT 2001

This Act, which came into force on 3 December 2001, is also relevant. It provides increased protection to debtors and their families from lenders exercising remedies on default. The Act gives the debtor (and certain other parties including a cohabitee) the right to apply to the court for suspension of enforcement proceedings.

A suspension order may be granted in relation to enforcement proceedings where it is considered reasonable in the circumstances, with particular regard to:

- the nature of and reasons for the default;
- the applicant's ability to remedy the default within a reasonable period;
- any action taken by the creditor to assist the debtor to remedy the default; and
- the ability of the applicant and those residing with them to secure reasonable alternative accommodation.

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

29.3 Possession procedures – England, Wales and Northern Ireland

Possession procedures are described in Figure 29.2. In the majority of cases, the property is vacated voluntarily – eviction is comparatively rare and a last resort. When it does occur, it sometimes attracts media coverage, which may be unfavourable to the lender.

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

Before starting formal possession proceedings, the lender must follow the Ministry of Justice's Pre-Action Protocol for Possession Claims based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property. The protocol aims to:

- ensure the lender and borrower act fairly and reasonably in resolving any arrears-related matters;
- encourage greater pre-action contact to reach an agreement out of court, or, when an agreement cannot be reached, to enable efficient use of the court's time and resources;
- encourage lenders to check who occupies the property before starting possession proceedings.

The protocol applies to first- and second-charge residential mortgages, but not to buy-to-let mortgages, and a repossession claim should be the lender's last resort. When a borrower falls into arrears, the lender must provide them with specified information, including the total amount of arrears and sources of independent debt advice. It must complete a number of actions, including discussing with the borrower any proposals for settling the arrears.

If, after all reasonable attempts to resolve the problem have failed, the lender wishes to repossess the property, it must give 15 days' notice in writing of its intention.

The lender cannot instigate the possession process if the borrower can demonstrate that:

- a claim has been submitted for an SMI loan, for Universal Credit, for an MPPI policy or for help from a mortgage rescue scheme;
- there is a reasonable expectation of a payment from the DWP, an insurance policy, a local authority or a charity;
- they have financial or specific personal difficulties affecting affordability and so need time to seek independent debt advice;

- their financial circumstances should improve in the foreseeable future;
- they have made a legitimate complaint about the possession claim to the FOS; or
- they are taking active steps to market the property at an appropriate price and have given the lender specified information.

FIGURE 29.2 POSSESSION PROCEDURES – ENGLAND, WALES AND NORTHERN IRELAND

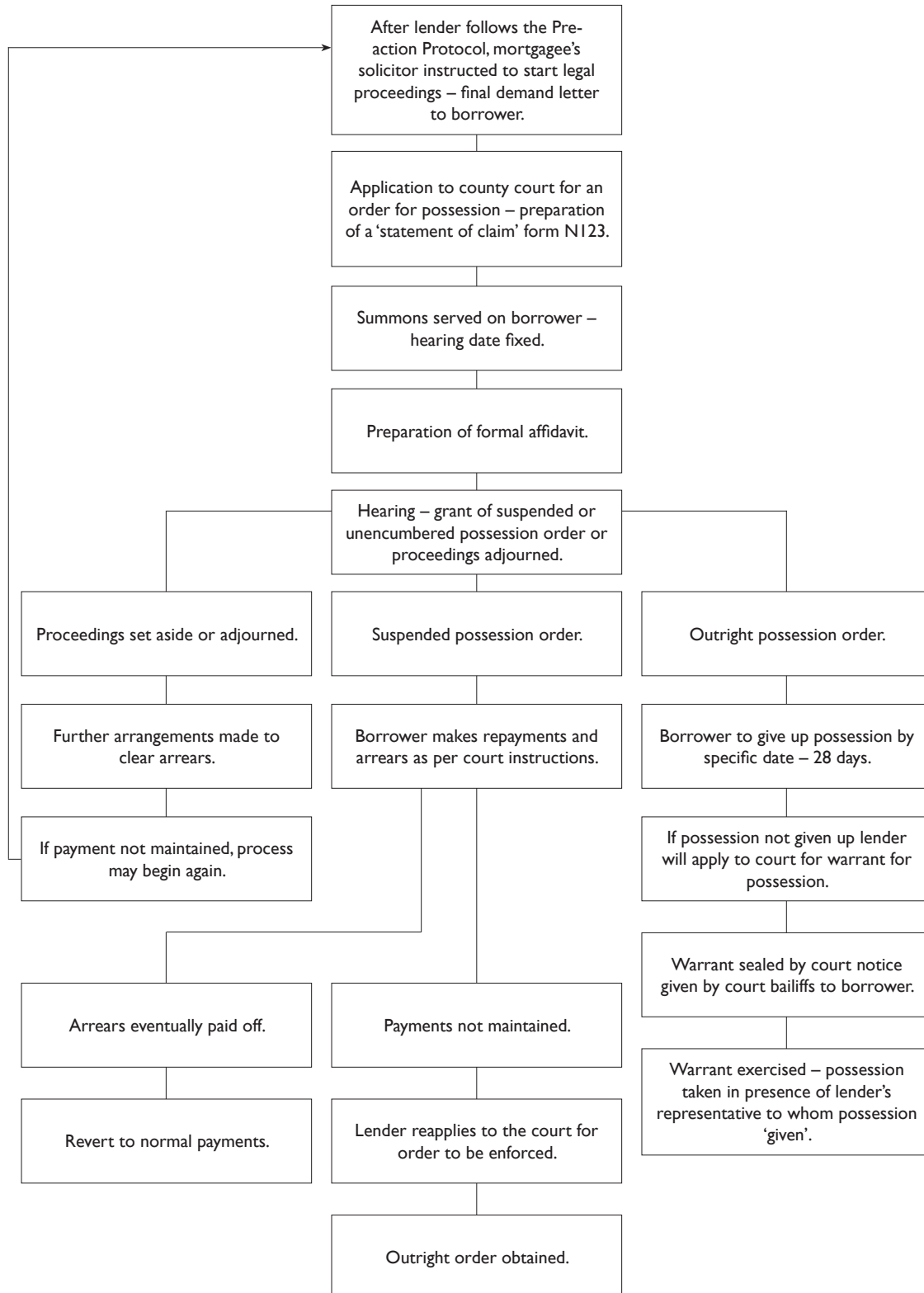


FIGURE 29.3 POSSESSION PROCEDURE – SCOTLAND

1. Calling up	<ul style="list-style-type: none">• Service of calling-up notice requiring repayment of whole debt within two months• If repayment is not made, power of sale arises automatically
2. Notice of default	<ul style="list-style-type: none">• Service of notice of default requires borrower to cease to be in default within one month• If not, the power of sale arises
3. Section 24 application	Application by creditor to court, stating that borrower is in default and seeking permission to sell. This is usually used when the borrower is insolvent.

OTHER CONSIDERATIONS WHEN TAKING POSSESSION

- Utilities such as water, gas, electricity and telephone must be disconnected, and gas and electricity meters must be read. The local water and sewerage authorities should be advised that the property is empty. The borrower is responsible for payment of services used before the readings were taken.
- Fixtures pass to the lender but any fittings left behind by the borrower are held in trust on their behalf. If the borrower reclaims them, the lender must take care not to readmit them to the property, or a new possession order may be required. The lender should list the items involved and document how it has dealt with them, eg by arranging removal and storage. A mortgagee in possession can be held liable if it can be established that it has been negligent towards the borrower's belongings.
- If the borrower's fittings are not claimed by a specified time, they may be disposed of, with any proceeds credited to the mortgage account.

29.4 Sale procedure and mortgagee obligations

Once a property has been taken into possession, the lender seeks to dispose of it as quickly as possible in order to repay the mortgage, so a valuation is necessary to set an appropriate selling price. Some lenders use asset management companies that specialise in managing and marketing repossessed properties. Other lenders rely on their internal resources.

In dealing with properties in possession, lenders have obligations to their former borrower. Legally, the borrower retains an 'equity of redemption' until the lender exchanges contracts with a new buyer. In addition, the lender has a duty of care to obtain the best price reasonably obtainable, although it does not have to look after and maintain the property indefinitely to obtain a higher price. In order to establish that this obligation has been fulfilled, many lenders in England and Wales will, having obtained an acceptable offer for the property, place an advertisement in a local newspaper seeking best and final offers by a particular date. The lender must have regard for the borrower and balance achieving the best price reasonably possible with the impact of delay on the borrower's position.

EQUITY OF REDEMPTION

The borrower's right to settle the mortgage debt in full at any time up to the point of sale. 'In full' means the settlement must include any arrears.

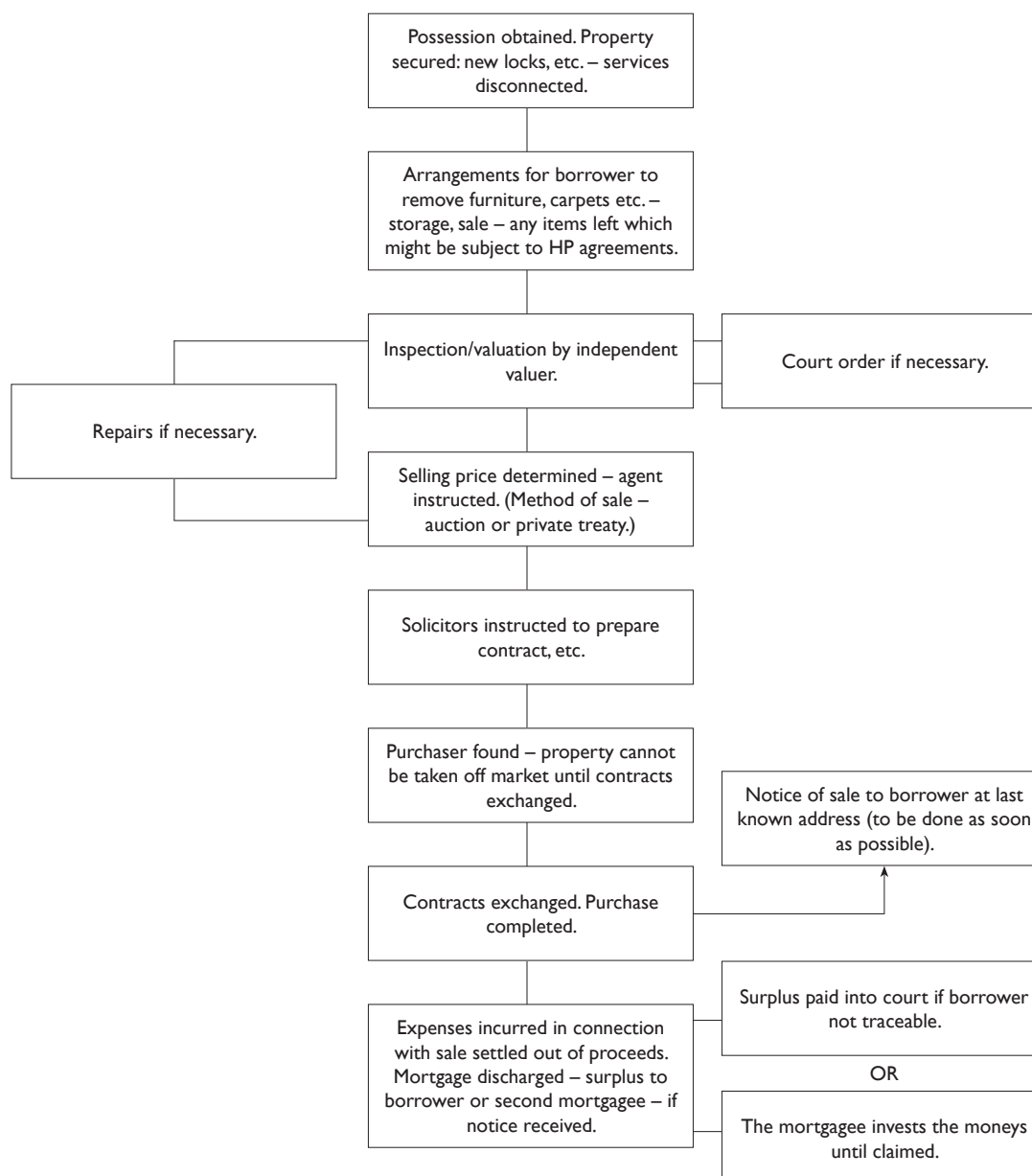
CASE LAW: MORTGAGEE OBLIGATIONS

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

'NURSING' A PROPERTY

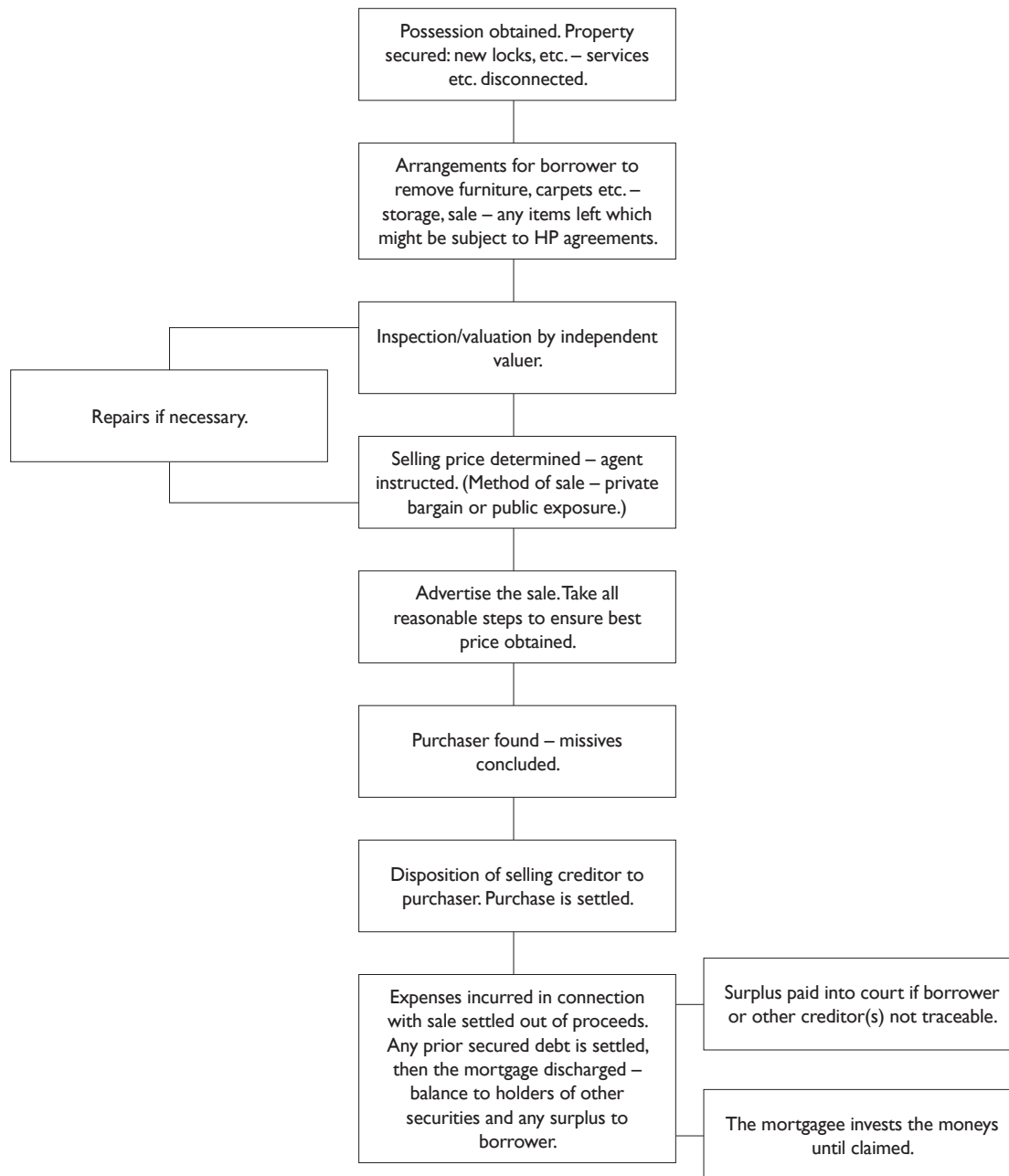
Setting a sale price and then not selling the property until an offer at or very near that price is received, regardless of the time taken to achieve it.

FIGURE 29.4 SALE PROCEDURE – ENGLAND, WALES AND NORTHERN IRELAND



If the sale proceeds are not enough to pay off the mortgage, the lender must inform the borrower of any shortfall in a durable medium. If it intends to pursue the borrower for payment of any shortfall, the lender has six years from the date of sale to notify the borrower of that intention.

FIGURE 29.5 SALE PROCEDURE – SCOTLAND



**CONSIDERATIONS IN SCOTLAND**

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

If the sale proceeds are not enough to pay off the mortgage, the lender must inform the borrower of any shortfall in a durable medium. If it intends to pursue the borrower for payment of any shortfall, the lender has five years from the date of sale to notify the borrower of that intention.

LENDER BEWARE!

Some lenders consider auction as well as private treaty to ensure that the highest price possible is obtained for the property. If a lender sells a property and fails to obtain an appropriate selling price due to error or omission from the sale particulars, it can be sued for damages by the former borrower.

In a 1971 case, one lender had to pay in excess of £10,000 damages to the former borrower because the sale particulars omitted any reference to the existence of planning permission for the property, which would have substantially increased the potential selling price.

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

29.5 What is the procedure on default where a MIG is in place?

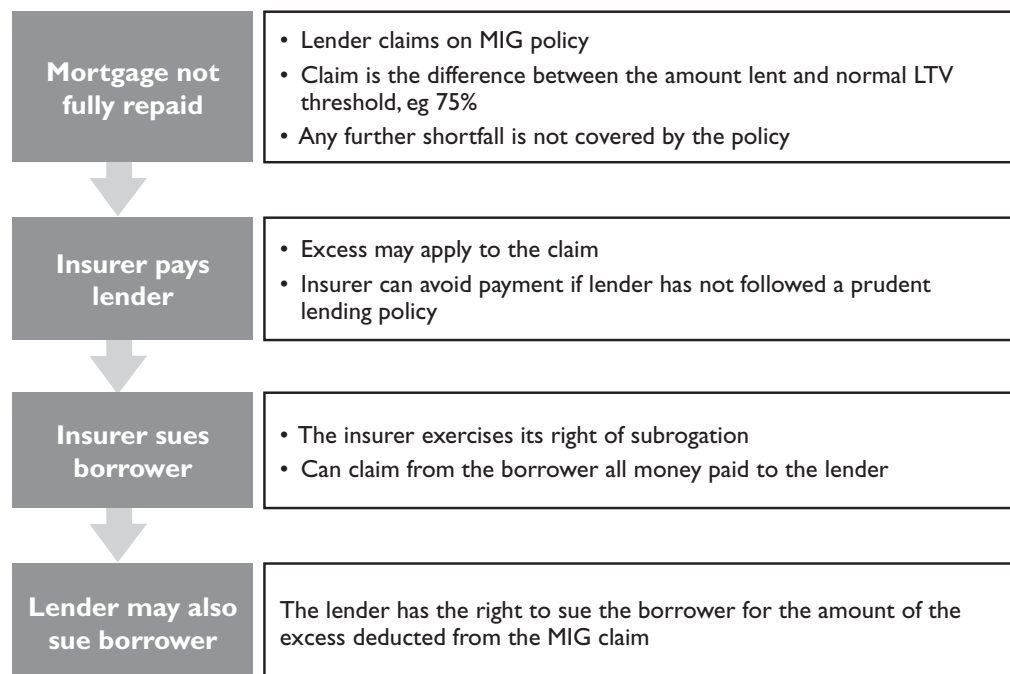


CHECK YOUR UNDERSTANDING

We looked at subrogation earlier, but it would be useful to refresh your memory here. Can you recall:

- what is meant by the term 'subrogation'?
- the type of fee that is often used by a lender to purchase a mortgage indemnity guarantee (MIG)?

FIGURE 29.6 PROCEDURE ON DEFAULT WHERE A MIG IS IN PLACE



MCOB 13 covers the situation where the proceeds of sale are less than the amount due under the mortgage contract or home purchase plan. The borrower must be provided with certain information as soon as possible after the sale in a durable medium. They must be informed of the shortfall and whether another company, such as a mortgage indemnity guarantee insurer, may pursue them for the shortfall.

If the lender, insurer or another party decides to pursue the borrower for the shortfall, it must notify the borrower within six years (five years in Scotland).

**THINK AGAIN ...**

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- describe the legal remedies available on default?
- outline the stages in the possession procedure prior to the court hearing, and the range of different potential outcomes?
- outline the sale process once a property has been taken into possession?
- explain how the borrower might be affected if they default on a loan on which the lender has taken out a mortgage indemnity guarantee?

Go back over any points you don't understand and make notes to help you revise. Then test your knowledge.



Test your knowledge

Use these questions to assess your learning for Topic 29. Review the text if necessary.

Answers can be found at the end of this book.

- 1) Which of the following legal remedies is no longer used in the UK?
 - a) Exercising the power of sale.
 - b) Suing on the borrower's personal covenant.
 - c) Appointing a receiver.
 - d) Foreclosure.
- 2) Appointing an LPA receiver is a legal remedy available where a property is let to tenants. True or false?
- 3) Once a possession order has been granted, the lender can usually take possession within:
 - a) 7 days.
 - b) 14 days.
 - c) 28 days.
 - d) 60 days.
- 4) Once a property has been taken into possession, the borrower has the right to regain possession by:
 - a) paying off the arrears, up to the point at which the lender exchanges contracts with a new buyer.
 - b) paying off the full mortgage debt, up to the point at which the lender markets the property for sale.
 - c) paying off the full mortgage debt, up to the point at which the lender exchanges contracts with a new buyer.
 - d) paying off the full mortgage debt, up to the point of completion of the sale to a new buyer.
- 5) A suspended possession order automatically becomes an outright possession order if the borrower fails to keep up the agreed repayments. True or false?

- 6) Lenders have a legal obligation to sell a property taken into possession for at least the amount of the mortgage. True or false?
- 7) Once a lender has taken possession of a property, it can delay a sale until it feels it will get the highest possible price. True or false?
- 8) The right of subrogation enables insurers to sue borrowers for any amount paid out on a mortgage indemnity guarantee policy. True or false?

