This is a draft of the Voluntary Code produced by the Council of Mortgage Lenders. The CPA is consulting its Members and other key stakeholders on the proposal whilst the CML consult within the mortgage industry. Views are sought by the end of July 2017.

The target audience for this document are lenders and not claimants or acquiring authorities. A separate guidance note will be produced for these audiences.

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Voluntary Code - Compulsory Purchase Orders and Mortgage Customers in Negative Equity

Introduction

This voluntary code sets out some general principles and considerations for mortgage lenders, in relation to owner-occupier borrowers in negative equity, whose properties become subject to compulsory purchase or qualify for the service of a Blight Notice. The purpose of the code is to help facilitate affected customers to port their existing mortgage product to an alternative property where that is appropriate for the customer and meets regulatory requirements and lending policies in place at the time.

Background

Compulsory purchase powers are provided to enable acquiring authorities to compulsorily purchase land to carry out a function which Government has decided is in the public interest. The Compulsory Purchase (CP) compensation regime is based on the principle of equivalence. This means those affected should be no worse off in financial terms than they were before. Nor should they be any better off.

For owner-occupiers, compensation can be claimed under a number of heads of claim. Broadly, owner-occupiers can expect to be compensated for the market value of the property at the time that the acquiring authority vests the property or takes actual possession Rule 2, Section 5, Land Compensation Act 1961 requires that a claimant receives the open market value of its interest in the land being acquired. The Acquiring Authority will first deduct the outstanding mortgage amount (and repay that amount to the lender) before paying the balance of monies to the owner occupier. In addition, owner-occupiers will also qualify for other heads of compensation such as disturbance and home-loss payments.

In a small number of cases, those homeowners who face compulsory acquisition are placed in a negative equity position (as the secured debt exceeds the property's value), following a valuation process triggered under the CP legislation. The CP regime requires the market value compensation to be paid directly to the lender to address the mortgage debt. This causes the theoretical negative equity to 'crystallise', and leaves the claimant liable to pay the debts over and above the market value compensation settlement, to the lender. The lender will normally then need to work with the customer to address the shortfall has their usual remedies for default.

This issue is specific to the impending exercise of compulsory purchase powers or the service of a blight notice. Most households in a negative equity position have the choice to wait for their property value to appreciate until it exceeds the loan amount, or take steps to manage the shortfall in other ways. However, the time needed for a gradual uplift in asset values is often not feasible within CP timescales.

More information about the CP regime and the compensation available can be found here.

Status

This is a voluntary code for members of the Council of Mortgage Lenders – it is not a statement of the law and should not be regarded as such. This code has no regulatory status.

The Compulsory Purchase Association has shared this code with its members, who are acquiring authorities[1] and advised them to make enquiries as to the extent of outstanding mortgage liabilities at the earliest opportunity, so that mortgage lenders are advised as early in the process as possible.

[Member signatories to the code are listed at Annex x].

Scope

This code only applies to residential owner-occupier borrowers who, by virtue of the fact that their property is subject to a CPO, face the crystallisation of negative equity.

This code will only apply where lenders are dealing with their existing customers. It will be a decision for individual lenders as to whether they offer a product to a customer who wishes to switch lending providers; and lending decisions will be made on a case by case basis. Where the customer's lender is no longer actively lending, that lender will also work with the customer on a case by case basis.

Signatories will apply the code where they become aware that the mortgaged property is subject to a CPO and that negative equity has, or will, crystallise as a result. Normally the lender will be advised by the acquiring authority, as there is a statutory duty to do so, as part of agreeing the compensation which is paid directly to the lender.

General principles

Signatory lenders may consider whether an existing mortgage product held by a customer facing negative equity as a result of a CPO can be ported to a new property, subject to:

- The proposed transaction meeting regulatory requirements and the lender's lending policies in place at the time of the request.
- Being able to evidence that the new mortgage loan is affordable for the customer, in circumstances where affordability assessments are required and using flexibility in the Financial Conduct Authority's Handbook: Mortgage Conduct of Business (MCOB), which permits lenders to not apply affordability requirements where appropriate.
- The new property being considered acceptable security based on the lender's policies at the time of the request. The customer should seek advice from the lender or mortgage broker to establish this.
- The customer seeking independent advice (from, for example, an independent financial adviser) and concluding that porting is the most appropriate option available to them.
- The customer applying any additional equity released (if, for example, the customer moves to a property which is valued less than their existing property) and any home-loss payment element of their compensation to reduce the amount of negative equity.

Where the mortgage product is ported, signatory lenders will review the fees and charges which may be triggered on porting, to establish whether it is possible to waive or refund some or all of them. In some cases this may depend on the customer entering into a new mortgage agreement within a certain timeframe, typically within three to six months.

[1] Acquiring authorities are bodies, who are authorised via legislation to acquire land compulsorily where the landowner or occupier is not willing to sell by agreement**.**

In all instances, the lender will consider what is in the best interests of the customer.

Particular circumstances

This section sets out some specific circumstances which raise additional considerations for lenders.

Customer is in arrears
The lender will need to consider whether appropriate to port mortgage product and / or allow the customer to borrow additional funds, based on customer's particular circumstances. It will depend on how deep the arrears are, and whether the lender and customer have arranged an arrears repayment strategy, for example, and the impact on whether the customer is able to port the mortgage product as a result (e.g. if the loan has been converted to interest only for a time, or arrears have been re-capitalised). Lenders must ensure that they are compliant with their regulatory obligations (for example, MCOB 13.3.1).

Customer has an interest-only mortgage
Where the customer has an interest-only mortgage, the lender might no longer offer such products. In this instance, the lender's specific policy and any restrictions in relation to interest-only lending will apply. In most cases, a lender will want to check the customer's repayment strategy if the product is ported, and they may operate loan to value limits. The customer may be able to port the original amount, then 'top-up' on a capital and interest product. Lenders can use transitional provisions relating to interest-only mortgages under MCOB 11.7.3R on a case by case basis.

Vulnerable customers:
Lenders will need to consider if the situation created by the CPO which crystallises the customer's negative equity will raise the risk that the customer is vulnerable[2]. If the customer is identified as vulnerable or the customer is already vulnerable before the CPO is issued then the firm will need to consider how best to deal with the customer's situation, bearing in mind MCOB 13.3.1CR; MCOB 4.7A; FCA occasional paper No 8 and FOS guidance.

Credit-impaired customers
If a customer is credit-impaired, i.e.:
- Within the last two years has had overdue payments of an amount equivalent to three months payments on a mortgage or other loan (secured or unsecured)
- Has been subject to an Individual Voluntary Agreement or bankruptcy order at any time within the last three years; or
- Subject to a County Court Judgement greater than £500 within the last three years.

This may limit the ability of the lender to port an existing mortgage product.

The principles in practice

Below are the three main scenarios which may arise under this code and how the principles could apply in practice.

1. Mortgage product ported to property worth more than current property

Where a customer wishes to move to a property which is valued higher than the current property, the compulsory purchase regime provides that if a customer needs to buy a more expensive dwelling, then if the acquiring authority is a local council they may be willing to grant a special mortgage under which the repayment of the capital sum is deferred until a later date.[3] The customer should seek advice from an independent adviser about whether this applies to their circumstances.

Where the above circumstances do not apply, and the customer would like to port their existing mortgage product to a property which is valued at more than their current property:

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[2] For the purposes of this code, a 'vulnerable customer' has the definition provided in the FCA's occasional paper Number 8 on consumer vulnerability as follows: A vulnerable consumer is someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care.
[3] Department of Communities and Local Government, Compulsory purchase and compensation - Booklet 4, p 19, para 2.58

- Under this scenario, the customer is likely to need to contribute additional funds from their own resources, to fund the balance of the purchase price. The availability of additional funds may be unlikely under the circumstances, given the customer is in a negative equity situation.
- The customer is unlikely to be able to borrow more given the negative equity position they are in.
- If the customer does not want to borrow more, then an affordability assessment may not be required, provided the conditions at MCOB 11.6.3R or 11.7 are met. The lender would need to assess if this was in the customer's best interests.
- The lender would expect the customer to apply compensation from the market value and home-loss compensation payments toward the mortgage balance.
- The new property must be considered acceptable security based on the lender's policies at the time of the request. The customer should seek advice from the lender or mortgage broker to establish this.

2. Property worth the same as current property

Where a customer would like to port their existing mortgage product to a property which is valued at or around the same value as the current property, the following may arise:

- If customer wishes to borrow more, they will need to be assessed under current lending regulations. The lender will need to undertake affordability checks on the customer and stress-test the customer against future interest rate rises; and the customer would need to be able to demonstrate that they could afford to repay the new loan balance.
- If the customer does not wish to borrow more, then an affordability assessment may not be required, provided the conditions at MCOB 11.6.3R or 11.7 are met.
- The lender would expect the customer to apply compensation from the market value and home-loss compensation payments toward the mortgage balance.
- The new property must be considered acceptable security based on the lender's policies at the time of the request. The customer should seek advice from the lender or mortgage broker to establish this.

3. Mortgage product ported to property worth less than current property

Where a customer would like to port their existing mortgage product to a property which is valued at less than their current property, the following may arise:

- The negative equity and therefore the Loan to Value (LTV) ratio will increase, if the mortgage balance remains the same. A mortgage agreement with an increased LTV may require the lender to ensure that the new agreement will fit within their lending policy.
- However, the customer could offset some of their compensation payments (the market value and home-loss payment of 10% of market value) against the mortgage balance, to redress the negative equity either partially or entirely.
- The lender would expect the customer to apply compensation from the market value and home-loss compensation payments toward the mortgage balance.
- The new property must be considered acceptable security based on the lender's policies at the time of the request. The customer should seek advice from the lender or mortgage broker to establish this.

Where the customer does not wish to purchase a property

If the customer does not wish to purchase a property (for example, they wish to rent or make alternative accommodation arrangements) then the lender will work with the customer on a case by case basis to address the outstanding loan shortfall. Lenders will work within the framework of MCOB 13.

Dispute Resolution

The lender will have, and operate in accordance with, a written complaints handling policy, approved by a relevant senior management committee. The lender will assess complaints fairly and promptly against its own policies, and in line with regulatory requirements. If a customer is not happy with the final outcome, they may be able to have their complaint considered by the Financial Ombudsmen Service.

Monitoring

This statement of practice will be reviewed regularly through the CML’s Lending Strategy and Practice Panel and any changes will be signed off by the CML’s Executive Committee.

Second-charge lenders

For the avoidance of doubt, this code does not apply to second-charge lenders. However, we have shared this Code with the Finance and Leasing Association.

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