

## The complaint

Mr and Mrs H complain that Evolution Lending Limited gave them a third charge mortgage without properly considering if it was affordable for them.

## What happened

In 2017, Mr and Mrs H took out a third charge mortgage with Evolution. They borrowed £11,800 (including fees) over four years with a variable interest rate of 11.8%, with monthly repayments of £404.53. The purpose of the loan included to consolidate unsecured debt and to repay arrears on Mrs H's mortgage. Mr and Mrs H repaid the loan in March 2020.

Mr and Mrs H complain that Evolution did not properly assess whether the loan was affordable. They said they struggled to make the repayments from the start and had to take additional loans, including from family, to make the repayments.

An investigator thought the complaint should be upheld. He said if Evolution had considered Mr and Mrs H's application responsibly, it wouldn't have lent to them. The investigator said Evolution should refund any interest and charges applied to the loan plus 8% simple interest from the date the loan was repaid until date of settlement and remove any negative information about the loan from their credit files.

Mr and Mrs H accepted what the investigator said. Evolution did not. It made a number of points, including:

- Mr and Mrs H had a large disposable income that would absorb some of the disputed expenses.
- Mr and Mrs H did not miss any repayments – and that is evidence the loan was affordable and sustainable until their circumstances changed. The investigator found there was no suggestion the customer was unemployed or was about to become unemployed and they have since said that was not until a later date. Evolution could not have foreseen any issues with affordability.
- We could not assume that the hotel expenses were for food and drink. They could be for non-essential expenditure that Mr and Mrs H could have cut back on. In any case, there were no hotel expenses in August, with the majority in October.
- We could not assume all spending in a supermarket was for food and drink. Some of that would be included in the figure it accepted for housekeeping.
- While the phone agreement was in Mr H's name, he had no involvement in the maintenance of that agreement.
- The investigator had mentioned a loan for £97.83 a month – but it believed this was consolidated. All the other loans were correctly factored into its income and expenditure calculations.

- It had allocated £142.98 to “other” expenditure. This covered other expenses such as other insurance, gym and socialising.
- It agreed it had not taken into account spending on fuel – but it believed a figure of around £100 a month was reasonable – not over £150 as calculated by the investigator.
- Evolution’s lending policy was to allocate 3% of the balance of any CCJs to expenditure. Mrs H told Evolution that she intended to repay three CCJs in the near future – but it had to include payments to the CCJs in its expenditure calculations. The customers said they weren’t paying anything towards the CCJs and weren’t aware of one of them – but the loan still showed significant disposable income remaining even after 3% of the CCJ and default balances was included. There was no regulatory obligation to consider the CCJs further.
- It had applied a stress test of 2.13% to all secured borrowing. The 3% requirement only applied to first charge mortgages.
- Even if the investigator’s calculation for food expenditure was accurate, the stress test was tripled and the additional loan of £97.83 was taken into account, it could still evidence a disposable income for Mr and Mrs H. There were no issues maintaining affordability for the majority of the loan and the loan was repaid in full.

### **What I’ve decided – and why**

I’ve considered all the available evidence and arguments to decide what’s fair and reasonable in the circumstances of this complaint.

### Rules

The relevant rules in this case are the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB). I must take those rules, amongst other things, into account in deciding what I consider to be fair and reasonable in the individual circumstances of this complaint.

MCOB 11.6 covers responsible lending. Its requirements for lenders include:

- Before agreeing a mortgage, a lender must assess whether a customer will be able to pay the sums due under the mortgage and be able to demonstrate the mortgage is affordable.
- A lender must take full account of the net income of a customer, their committed expenditure, and the basic essential expenditure and basic quality-of-living costs of the customer’s household.
- A lender may generally rely on any evidence of income or information on expenditure provided by a customer unless, taking a common sense view, it has reason to doubt the evidence or information. A lender must have evidence of income and take reasonable steps to obtain details of a customer’s committed expenditure. A lender can either obtain details of a customer’s expenditure or use statistical data.
- If a lender is, or should reasonably be aware from information obtained during the application process that there will, or are likely to, be future changes to the income and expenditure of the customer during the term of the mortgage, the lender must take them into account when assessing affordability.
- A lender must take account of the impact of likely future interest rate increases on

affordability by applying a stress test. The lender must have regard to the prevailing Financial Policy Committee recommendation on interest rate stress-tests, which at the time was 3%. This applies to all regulated mortgage contracts, not just first charge mortgages. A second or subsequent charge lender must also apply any stress test to the first and any subsequent charge loans as well as its own lending.

### Income

Evolution obtained evidence of Mr and Mrs H's income. It said their average monthly net income was £3,542.50 and £1,109.75 respectively. I consider that was a reasonable assessment of the evidence it had been given about Mr H's income.

Evolution also took into account child benefit Mrs H received. I don't consider it was reasonable to take this amount into account. Due to the age of Mrs H's child, she would not receive this amount over the term of the mortgage. And there were other factors that meant she may have become ineligible for child benefit in the short term. Evolution ought to have done more to explore that. I don't consider the child benefit amount should have been included in the income calculation. Evolution ought reasonably to have known that would not be available over the term of the mortgage.

So the income Evolution could reasonably take into account was £4,652.25 a month.

Based on the information available to it, I can't see that Evolution had any reason to think that Mrs H was unemployed or would become unemployed.

### Expenditure

Evolution recorded Mr and Mrs H's average monthly expenditure as £3,275.70. That was made up of £1,681.83 household (including a stress test amount), £1,306.04 debt and £287.82 vehicle. That would leave Mr and Mrs H with £1,376.55, which was enough to cover the loan payment of £404.53, with a surplus left over.

The investigator initially said that, based on the information Evolution had, he considered a more realistic figure for expenditure was £4,459.89 – so when the loan payment of £404.53 was added, the total amount was over £4,800 and that exceeded Mr and Mrs H's income.

The key point here is that it is for Evolution to demonstrate that the loan is affordable, taking a reasonable and common sense view of the information it had. It would have been relatively straightforward for it to challenge Mr and Mrs H where the evidence of their expenditure was unclear and to document the steps it took to do that. If it had done that, and it had information that supported the conclusions it reached, then it would be straightforward for me to decide that it had acted fairly and reasonably in determining the loan was affordable and sustainable for Mr and Mrs H.

Of course, just because a lender did not carry out reasonable checks or hasn't been able to demonstrate in a clear and persuasive way that the loan was affordable and sustainable, it doesn't mean that if it had looked into things properly that it would have decided the loan was unaffordable or unsustainable.

But, like the investigator I have some doubts that a responsible lender, taking a reasonable and common sense view of the information it had could reasonably have concluded that the loan was affordable and sustainable for Mr and Mrs H.

I say that for the following reasons:

- I consider that Evolution has under recorded how much Mr and Mrs H spent on food and drink. The information on the bank statements show that spending was on average at least double the amount Evolution recorded on its income and expenditure form. Some of that spending might have been discretionary or non-essential. But there was a clear track record of Mr and Mrs H spending in that way. I consider a figure of around £700 would have been realistic and fair – so around £340 more than recorded.
- The evidence shows that expenditure was under recorded across a number of different categories. For example, the bank statements shows regular or committed expenditure on “media”, travel, and insurance that was not properly taken account of in the recorded expenditure. Again Evolution ought to have done more to clarify and challenge Mr and Mrs H where the expenditure was unclear. I make the total amount on those things to be around £260. Even if Evolution had taken those things into account under “other” expenditure, it is still under recorded by over £100.
- It was not reasonable for Evolution not to include committed expenditure in Mr and Mrs H’s name because they said they’d taken the debts out for someone else. Ultimately Mr and Mrs H were liable for those amounts. That increases the commitments by £47.09.
- It is not clear why Evolution applied a stress test of 2.13% - or how in doing so it paid due regard to the Financial Policy Committee’s recommendation on interest rate stress tests of 3%. Evolution stress test figure was £102.20. But if 3% had been applied to all secured borrowing, that would be £390 – a difference of £287.80.
- Evolution has accepted that the bank statements support a figure of £100 a month on fuel. That is £50 more than it recorded.
- The rationale for assuming that Mr and Mrs H would pay 3% of the CCJ balances is unclear and not persuasive. There is more that Evolution ought reasonably to have done to understand the position as it applied to Mr and Mrs H rather than making assumptions. It is not clear that using 3% of the balances reflected the true position. There was a risk that Mr and Mrs H could be required by the court to pay more than that – particularly if as Evolution said they were not making any payments to those debts at the time.

Looking at the information we have, as set out above, I consider a realistic figure for Mr and Mrs H’s expenditure would be over £824.89 a month more than recorded by Evolution. That makes expenditure £4,100.59 – with the loan repayment, that makes it £4,505.12, which would leave Mr and Mrs H with just under £150 a month. But that does not include their liability under the CCJs, which could be called in at any time.

There are also several transfers to friends and family from Mr and Mrs H’s accounts. For example in August Mr H transfers over £500, in September over £1,300 and in October £767.50. Some of the transfers appear to be repaying loans. There are also two standing orders for £75 and £79 that appear on the statements each month along with other payment that appear to be regular. I can’t see they were taken into account in the expenditure. I consider a reasonable lender would have at least questioned Mr and Mrs H about this.

#### Was the lending affordable and sustainable?

I consider Evolution took into account income it should not have reasonably included – and it under recorded Mr and Mrs H’s expenditure. As I set out above, a realistic figure based on the information Evolution had showed that affordability was marginal at best. But that did not take into account other expenditure on the statements to friends and family, including at least two regular standing orders totalling over £150. Taking those payments into account, the loan was unaffordable.

Looking at Mr and Mrs H's credit histories, Mrs H had three defaults from 2014, three CCJs, one from 2012 and two from 2014, and was in arrears on her mortgage – and had been for at least the previous two years, apart from one month. Mr H had one CCJ from 2015. But he had taken out five unsecured loans in the past six months.

In this case I'm satisfied affordability was marginal at best – and probably unaffordable if a reasonable approach had been taken. But we also know Mrs H had been in arrears on her mortgage for around two years and Mr H had taken a significant amount of debt out in the past six months.

I consider a reasonable lender ought to have considered why a borrower with, by its calculations, a disposable income of over £1,300 a month was unable to maintain a mortgage payment of £285 per month. It is also not clear that Evolution properly considered that Mr H had taken out five unsecured loans in the previous six months. That does not support that Mr and Mrs H were managing as they were – it suggests that they could not support their existing expenditure. Evolution accepted an explanation from Mrs H that she'd suffered an injury and her wages fluctuated. But I don't consider reasonably explains mortgage arrears going back two years.

Further, the loan was intended to repay mortgage arrears. Mr and Mrs H's first charge mortgage was with a high street lender. The interest rate was significantly lower than that charged by Evolution. There is no explanation why Evolution thought it appropriate to refinance the arrears by taking this loan, with an interest rate of over 11%, rather than negotiate with the first charge lender.

After careful consideration – and in all of the circumstances – I don't consider that a responsible lender acting reasonably and in line with the relevant rules could have concluded that the lending was affordable or sustainable. At best affordability was marginal. But looking at Mr and Mrs H's recent borrowing and the fact they were in arrears on their mortgage, I don't consider that it was fair or reasonable to approve lending secured against their home. I consider if Evolution had acted fairly and reasonably it would not have approved the loan.

Therefore, I consider that Evolution should refund the interest and charges Mr and Mrs H paid, including the lending fees and pay interest on those amounts at 8% simple per year from the date the loan was repaid. The investigator said that Evolution should remove any negative information from Mr and Mrs H's credit file. But it does not appear that Evolution has recorded any adverse information on their credit file.

I agree with the investigator that it would not be fair for Evolution to pay Mr and Mrs H compensation for any distress and inconvenience. That is because if Mr and Mrs H did not take the loan, they would still have had the unconsolidated debts to deal with. And while the loan contributed to some financial difficulty, it was not the only source of that.

### **My final decision**

My final decision is that Evolution Lending Limited should:

- Calculate what the redemption balance would have been if:
  - No fees or charges had been added to the balance
  - No interest had been charged on the capital Mr and Mrs H borrowed, and all payments had been used to reduce the capital balance

- Calculate the difference between that revised redemption balance and the actual redemption amount Mr and Mrs H paid, and pay the difference to Mr and Mrs H
- Pay interest on the above amount at 8% simple per year from the date the loan was redeemed until date of settlement. If Evolution considers that it's required by HM Revenue & Customs to deduct income tax from that interest, it should tell Mr and Mrs H) how much it's taken off. It should also give Mr and Mrs H a tax deduction certificate if they ask for one, so they can reclaim the tax from HM Revenue & Customs if appropriate.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs H and Mr H to accept or reject my decision before 22 July 2024.

Ken Rose  
**Ombudsman**