DRN-4730031

The complaint

Miss R has complained about two secured loans she took out with Evolution Lending Limited. She said the lending was irresponsible and unaffordable.

What happened

Miss R owned two rental properties and lived with her mother. Miss R had first charge mortgages on both properties.

In February 2018 she applied for a second charge loan with Evolution to be secured on one of the rental properties. The money was said to be for debt consolidation and home improvements. The mortgage offer dated 14 February 2018 indicated the loan was £20,000 (plus £2,699 fees) over a 15-year term on a repayment basis. The interest rate was 19.56% variable, which gave an initial payment of around £365 a month.

In the period since that loan was taken out Miss R approached Evolution as she wanted further borrowing, but an application couldn't be progressed as her income wasn't sufficient.

Miss R received a pay rise and so she approached Evolution again as she wanted a further few thousand pounds for home improvements. A mortgage offer was issued on 14 June 2019 which showed a loan amount of £25,000 (plus £3,199 fees) over a 15-year term on a repayment basis. The interest rate was 16.08% variable, which gave an initial payment of around £395 a month. The 2018 loan was repaid from this advance.

The direct debit payment was returned as unpaid in July and September 2019, with Miss R making the payments up by card the same months they were due. The direct debit was then returned as unpaid again in November 2019, with Miss R not making that payment up until January 2020.

Miss R took covid-19 payment deferrals from April to September 2020 (inclusive) so she didn't need to make the payments due in those months, and then she missed the payment due in October 2020.

In December 2020 Miss R entered into a payment arrangement to clear the arrears, but that arrangement was immediately broken due to the fact the December direct debit was returned as unpaid.

Miss R cleared the arrears in February 2021 but then went back into arrears in May 2021. The full monthly payment was made in June 2021, and then nothing further was paid until January 2022 when Miss R paid £100. Miss R made her payments in February and April 2022, missed March, May, June and July 2022's payments, and paid £200 in August 2022 and £200 in September 2022.

In the meantime, Miss R had raised a complaint with Evolution. As she only quoted the 2019 loan account number Evolution just responded about that loan in June 2022. It said it had fully assessed her application, there was no evidence of a payday loan cycle, and that it had thoroughly discussed any discrepancies it had identified between what Miss R had said and what the evidence showed. It said, having reviewed everything, it was satisfied the loan was affordable.

Unhappy with Evolution's response Miss R referred the complaint to our service. Whilst it was with us we identified that Miss R was also concerned about the 2018 loan, and Miss R raised that with Evolution. It responded about that complaint in similar terms to it had about the 2019 sale, not upholding her complaint.

Our Investigator explained that we needed to consider both sales together as they were intrinsically linked, and after some communication back and forth with both sides, he issued his final assessment of the complaint. His final assessment was that the lending was irresponsible and he set out what he thought Evolution should do to put things right.

Evolution said it could appreciate how our Investigator had come to his conclusion to uphold the complaint as it was an unusual situation. However, they asked that it be reviewed as they didn't think the outcome was fair or proportionate. Evolution explained why it felt the loans were affordable, and said it specialises in ad hoc assessments which these applications needed.

As an agreement couldn't be reached the case was passed to me to decide.

What I've decided – and why

I issued a provisional decision in March 2024, the findings of which said:

"<u>The 2018 loan</u>

The first loan was taken out by Miss R in February 2018 and was for £20,000 over a term of 15 years. Added to this was a product fee of £2,000 and a lending fee of £699. The loan was on a variable rate of 19.56% (APRC 23.11%). The monthly payment was £365.55 with the total amount repayable being 65,799.80.

The income and expenditure form completed by Evolution shows Miss R would have £98.22 left each month after the loan was taken out (and once her mortgages and secured loans were stress tested). But having compared the income and expenditure form to Miss R's bank statements I can see the information on the form wasn't an accurate reflection of her income and expenditure.

For example, Evolution recorded that Miss R received £400 a month maintenance from her child's father (Mr S), but in December 2017 he only paid her £180 and there were no payments made from Mr S to Miss R in January 2018. In fact there were actually payments *out* from Miss R to Mr S of £1,475 in December 2017 and £520 in January 2018. Those payments out weren't included in the income and expenditure form despite showing on Miss R's bank statements, and the maintenance that is recorded on the form isn't supported by the bank statements for those months.

Miss R's service charge is recorded as £100 a month, but the following transactions show on her bank statements, which from the name of the company I assume relate to ground rent and/or service charges:

- 5 December 2017 £350
- 10 January 2018 £250
- 5 February 2018 £250
- 12 February 2018 £400

In the call Miss R said it was £112 a month and she had just paid it all off, so assuming these four payments were the full amount for the year then that should have been recorded as £104.17 a month, or the £112 a month Miss R said in the call.

Miss R's payment to Sky was recorded as £64.99, but the following show on her bank statements:

- 8 December 2017 £65.29
- 20 December 2017 £109.20
- 6 January 2018 £64.99
- 18 January 2018 £95.31
- 11 February 2018 £64.99

Miss R said in the first call that there would be double payments to Sky as she paid out for both her and her mother. But as the money in from her mother had been included in Miss R's income, the outgoings for her mother should also have been included as a counter payment.

Miss R also made payments of £11.99 a month towards Sky protect that I can't see have been included on the income and expenditure assessment.

And Miss R's payments to a mobile phone provider are recorded as £42.50 on the income and expenditure assessment, but I can see the following payments leaving her accounts:

- 28 December 2017 £70.38
- 28 December 2017 £40.01
- 29 January 2018 £40.01
- 29 January 2018 £50.27
- 6 February 2018 £42.50
- 12 February 2018 £38.84

It may be the extra payments are Miss R's mother's, but that wasn't discussed in any of the calls that have been provided by Evolution for this loan application, and they weren't included in the income and expenditure assessment.

The following payments are also showing leaving Miss R's bank accounts, but I can't see they have been reflected in the income and expenditure form:

- Netflix £7.99
- AA £21.98
- Credit expert £14.99 (twice, so £29.98 a month)
- GGS/RPP £9.49
- Premium credit £26.21
- Unison £17.25

There also appears to be an additional car insurance payment showing on Miss R's bank statements (Esure) that isn't on the income and expenditure form, with only £133 and £109 appearing on the income and expenditure assessment:

- Esure
  - 20 December 2017 £183.04
  - 28 December 2017 £171.50
  - 7 February 2018 £136.09
- Quote me happy

    - 28 November 2017 £109.40
    - 28 December 2017 £109.40
- Mercedes Insure
    - 12 December 2017 £133.12
    - 12 January 2018 £133.12

It may be one insurance replaces another, but again that wasn't discussed in any of the calls that have been provided by Evolution for this loan application and there is clearly some cross over.

Evolution also hasn't provided full copies of Miss R's bank statements with bank N, so it may be there is other expenditure that we don't have a record of.

In the second call on 13 February Evolution asked Miss R about the cash advances she'd taken from her credit card which is what I would expect it to do. However when the answer Miss R gave – in that she said she paid for her holidays on her credit card for the consumer protection – didn't answer the question, the adviser didn't push the matter and instead accepted that answer. Paying for a holiday on a credit card for the consumer protection wouldn't show as a cash advance on a credit card, so Evolution had no explanation for those cash withdrawals.

In addition, Miss R took out a £1,000 payday loan on 2 January 2018 (the credit for which shows on Miss R's bank statement) but this wasn't questioned in any of the calls that have been provided by Evolution for this loan application.

Having reviewed Miss R's bank statements it is clear that she was regularly overspending, and that her expenditure was vastly in excess of that declared on the income and expenditure form. For instance, in the period from 15 January until 14 February 2018, Miss R's expenditure (even taking out the extra ground rent payments, and the payments to the debts that she was repaying with this loan) exceeded her income by a few thousand pounds, and that is without a stress test, the Evolution loan being taken into account, or one of the first charge mortgages requiring a payment (as Miss R had just remortgaged so it appears she didn't need to make a payment in that period).

There are a few instances of direct debits being returned unpaid, and as I say Miss R took out a £1,000 payday loan at the start of January and she also took cash advances from her credit card in December and January. It appears from what Miss R told Evolution and her bank statements that the recent remortgage had consolidated other debts and she received £5,830 into her bank account. And in September 2017 she'd remortgaged her other property, receiving £31,585 into her bank account.

In terms of Miss R's income she said she completed tax returns for her rental properties, but it doesn't seem that Evolution requested copies of those so it could fairly assess that part of her income. Instead the adviser said on the call that it would just take 20% tax off the income. But it is possible that it wouldn't have been 20% tax because Miss R's declared rental income was £26,400 and her employed income was £24,467, which combined would have taken Miss R into the higher rate tax bracket. It is possible she was able to offset some costs against her rental income, but from April 2017 buy to let tax relief was being tapered off under Section 24, so this was a much more complicated scenario than simply deducting 20% tax. In a case like this where the buffer was so small Evolution should have ensured it had the precise figures for Miss R's rental profit to ensure it wasn't overcommitting her.

I also note Evolution didn't build any allowance in for the unexpected costs that Miss R would undoubtably encounter with two buy to let properties. When a person is an owner occupier of a residential property they can opt to not make repairs or buy replacements, if they can't afford it. For instance, if the boiler breaks down, the washing machine needs replacing, or the roof needs a repair, whilst uncomfortable an owner occupier potentially has the option to delay replacing/repairing those until they can afford it. But as a landlord Miss R would need to carry out those repairs / replacements promptly for her tenants.

In its response to our Investigator Evolution said that Miss R stated on multiple occasions that it was her intention to sell one of the properties, and that when she did so she would clear the loan. Having listened to the calls provided by Evolution for the 2018 loan application I didn't hear Miss R saying that, in fact when asked she said she didn't have any plans to sell the property the loan was being secured against. This was mentioned in May 2019, but I can't take that into account when assessing the 2018 loan application lending decision.

Evolution has also said that Miss R's higher expenditure was due to the fact it had recently been her son's birthday and that she was due to go on holiday. Again there is no reference to this in any of the calls I've listened to for the 2018 loan application. This was mentioned in May 2019, but I can't take that into account when assessing the 2018 loan application lending decision.

At the time this loan was taken out the Financial Policy Committee recommendation on appropriate interest-rate stress tests was to use an interest rate 3 percentage points higher than the reversion rate.

It isn't clear what rate Evolution used for the stress test but based on the figures provided I think it was lower than the 3 percentage points that was the standard recommendation at the time. MCOB 11.6.18 doesn't give the option of market expectations 'or' any prevailing Financial Policy Committee recommendation, it says 'and.' I can't see any reasonable basis here for Evolution to decide to use a lower percentage stress test than the recommended 3 percentage points. Whilst Evolution isn't bound by that recommendation, it would be viewed as good industry practice and for a lender to deviate from it I'd expect to see a detailed and robust reason for that decision.

Had the stress test been carried out using the recommended 3 percentage point increase then I believe the result would have been significantly higher, in effect removing the entire disposable income it had been stated Miss R would have.

In light of all the above, I don't think the income and expenditure information accurately reflects Miss R's true income and outgoings at the time. It significantly underestimates her expenditure as shown on her bank statements, and her income for the rental properties doesn't appear to have been calculated using the correct tax status. But even on the income and outgoings which were included in the form, the loan appears to be potentially unaffordable when stress tested at a 3 percentage point increase as set out above.

Whilst the loan reduced Miss R's monthly expenditure by consolidating her debts, it increased her overall indebtedness by over £14,600. This was due to the additional amount of £11,927.34 paid to Miss R on top of the consolidation, along with the product fee of £2,000 and a lending fee of £699. It also meant that the debt was secured against Miss R's property over 15 years which would add a significant amount of interest to the amount she borrowed and meant that her property could be repossessed if she was unable to maintain the repayments. So while the loan might have reduced her outgoings, if that still didn't make her situation sustainable it wouldn't in my view be responsible to exchange unsecured for secured debt.

For all those reasons, I'm satisfied that this loan was irresponsible and unaffordable, and should never have been lent.

<u>The 2019 loan</u>

The second loan was taken out by Miss R in June 2019 and was for £25,000 over a term of 15 years. Added to this was a product fee of £2,500 and a lending fee of £699. The loan was on a variable rate of 16.08% (APRC 19.04%). The monthly payment was £394.67 with the total amount repayable being £71,041.

I don't propose to set out all the reasons why I think this loan was also lent irresponsibly, as many of them are the same as I've set out above for the 2018 sale.

This time we know that Evolution didn't stress test the application at the recommended 3 percentage point increase, with Evolution telling us it used a 2.25 percentage point increase for it.

As I found in relation to the 2018 loan, I can't see any reasonable basis for Evolution to decide to use a lower percentage stress test than the recommended 3%. Whilst Evolution isn't bound by that recommendation, it would be viewed as good industry practice and for a lender to deviate from it I'd expect to see a detailed and robust reason for that decision.

There was another anomaly with the 2019 application in that Evolution took the rental income for both properties into account, but just two weeks earlier Miss R had given Evolution the address of one of the BTL properties as her address:

> *"I just realised you probably have my old address, so I need to give you my new address."*

The new address she gave was that of one of the BTL properties that she was using the rental income from as part of the income and expenditure assessment. It may be there was an explanation for this anomaly, but I can't see that Evolution picked up on it (which it should as the call handler said she had updated Miss R's address in the earlier call) and asked Miss R about it.

For this sale Miss R said her recent expenditure was higher because it had been her son's birthday, and she had a holiday coming up. But annual expenses still need to be considered, albeit they should get averaged out over the year. Having reviewed the 2019 income and expenditure form I can't see this happened.

Miss R also said she was planning to sell one property, but neither property was on the market at the time and so the potential sale of a property isn't a factor in the lending decision.

A letter was provided signed by Miss R and Mr S which said Mr S would pay Miss R £1,100 a month child maintenance from 28 April 2019, but the only complete month's bank statement that was provided after that date was May 2019 and that showed only £520 was paid, so again that amount couldn't be considered regular or sustainable such that it should form part of Miss R's income.

Miss R had consolidated her debts in February 2018, but by the time of this sale in June 2019 not only had the credit card and store card balances been built back up, Miss R had also taken on other debts such as pay day loans.

I think it should have been clear, having considered the spending that was showing on Miss R's bank statements, and from her credit commitments, that Miss R wasn't managing her finances and that this loan wouldn't be affordable or sustainable long term.

This loan further increased Miss R's overall indebtedness by over £5,800. This was due to the additional amount of £2,647 paid to Miss R on top of the consolidation, along with the product fee of £2,500 and a lending fee of £699. It also meant that the debt was secured against Miss R's property over 15 years which would add a significant amount of interest to the amount she borrowed and meant that her property could be repossessed if she was unable to maintain the repayments. So while the loan might have reduced her outgoings, if that still didn't make her situation sustainable it wouldn't in my view be responsible to exchange unsecured for secured debt.

Miss R, for this loan, paid £3,199 in fees to consolidate £1,528 of debts (and receive £2,647 to her bank account). I must also keep in mind that I've already decided that the 2018 loan shouldn't have been lent, and had the 2018 loan not been lent, then the 2019 loan wouldn't have been used to mainly consolidate it.

<u>In summary</u>

For the reasons above, I don't think Evolution carried out adequate checks in either 2018 or 2019 having regard to the information it held about Miss R's financial circumstances, particularly given the fact the loans would be secured against her home.

Had Evolution considered whether the information in its possession gave common-sense grounds for doubting what was on the income and expenditure form, as I think it fairly should have done, I think it ought reasonably to have questioned whether the loans were affordable and sustainable for Miss R. And given that the loans were secured on her property, the impact of that on Miss R could be significant. I think this ought to have led Evolution, acting fairly, to question whether it was responsible to lend in these circumstances.

I think the information available supports that the loans were not affordable or sustainable for Miss R. It is my view that had Evolution properly reviewed the information available to it, it would not have been able to demonstrate that the loans were affordable or sustainable for Miss R. In all the circumstances I am minded to find that Evolution lent irresponsibly for both loans."

Miss R accepted my provisional decision and Evolution, despite a reminder of the deadline, didn't respond.

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

Having done so I see no reason to depart from the findings I reached in my provisional decision.

Putting things right

To put matters right, Evolution should bring the 2019 loan agreement to an end and remove any adverse entries associated with these loans from Miss R's credit file. It should remove the £699 lending fee and £2,000 product fee it charged in 2018, and the £699 lending fee and £2,500 product fee it charged in 2019, from the balance, as well as all interest charged on the borrowing to date (that is, on both the 2018 and 2019 loans). If any other fees have been added to the balance over the life of the two loans those should also be removed. Evolution should then treat all the payments Miss R has made as payments reducing the capital balance.

If this results in a balance outstanding, Evolution should reach a sustainable arrangement with Miss R for the repayment of the remaining outstanding capital balance, and can retain the charge over the property in the meantime.

If, however, this means that Miss R has already repaid more than the capital she borrowed, the excess should be refunded to her, adding simple annual interest of 8% running from when any payments above the total capital amount were made to the date Evolution refunds them. In this scenario, Evolution may deduct income tax from the 8% interest element of my award, as required by HMRC – but should tell Miss R what it has deducted so she can reclaim the tax if she is entitled to do so. In this case, it should also remove the charge from the property.

I don't think it would be fair to ask Evolution Lending to write off the remaining capital balance, if there is one. Miss R received the capital and used it to pay off other debts, so it's fair and reasonable that she pays back what she borrowed. But it's not fair and reasonable for Evolution Lending to charge fees and interest for a loan it should not have entered into.

I can see that Miss R has experienced difficulty in making repayments to this loan. If Evolution Lending had not lent, Miss R would not have experienced these problems – though she may well have had difficulties with the unsecured debt she would have retained had it not been consolidated into this loan.

However, it's also possible Miss R would have come to some arrangement with her unsecured creditors had this loan not existed. So it's not possible to be sure exactly what capital or interest Miss R would have had to pay if the debts had not been consolidated into this loan.

It's likely that removing all interest from this loan results in a saving to Miss R compared to the amount she would have had to pay towards the consolidated debts had they not been consolidated. But it's also possible she would have entered an arrangement such as an IVA or bankruptcy which would have led to her paying less (though with other consequences). It's likely there is some saving in removing interest from the loan. But nevertheless I think it's a fair outcome to this complaint because I don't think it's fair and reasonable for Evolution Lending to recover fees and interest charged under a loan agreement that ought never to have been entered into.

Although the existence of this loan caused Miss R distress and inconvenience, with the added worry that it was secured over her home, I don't compensate Miss R separately for the distress and inconvenience this lending and the associated financial difficulties caused her. I think the saving made in writing off the interest on this loan, compared to what she would likely have had to pay had the debts not been consolidated, represents fair compensation for that.

My final decision

I uphold this complaint and direct Evolution Lending Limited to put matters right in the way I've set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Miss R to accept or reject my decision before 7 May 2024.

Julia Meadows
Ombudsman