DRN-5130526

## The complaint

Mr W has complained about the second charge mortgage he took with Optimum Credit Limited in 2021. Optimum Credit Limited is now UK Mortgage Lending Ltd trading as Pepper Money and I will refer to Pepper hereafter. Mr W doesn't consider the mortgage was affordable and resulted in his financial situation deteriorating to the point he had to sell his home. Mr W is also unhappy about how Pepper administered the mortgage during his financial difficulties and that it would not allow part of his garden to be sold to provide him with funds to help with his finances.

## What happened

Mr W contacted an independent mortgage broker in July 2021, as since his divorce in 2019 he had run up a significant amount of debt– around £80,000 in loans, credit cards and overdrafts. Some of this borrowing was taken to pay the divorce settlement and costs, but not all. The amount of debt meant that while he was generally managing to make the monthly payments, he was then struggling to find money for day-to-day living expenses. As such, Mr W wanted to consolidate his debts into one monthly amount. He told the broker that he wanted £75,000 to clear all of his debts and wanted to repay the borrowing over around seven years.

At that time, based on the information Mr W gave about his cost of living (based on the figures the broker gave to Pepper), the existing mortgage, secured loan and unsecured debts, his outgoings were around £450 per month more than the net income he received from his employment. Mr W's net income took account of deductions for his occupational pension scheme contributions and £125 to a sharesave scheme. The broker told Pepper that Mr W expected to retire at 70.

The broker recommended a second charge mortgage with Pepper for £53,695 over a term of 30 years and with a five-year fixed interest rate of 11.855%. Of that advance, £5,000 would be used to pay the broker fee and £595 for Pepper's lender fee.

When the application was sent to Pepper the broker provided it with information about Mr W's income and expenditure. When completing its affordability assessment Pepper used the higher of the amounts the broker had provided for various outgoings, or Office of National Statistics (ONS) figures for a single man. The figure used for Mr W's general outgoings, not including debts, mortgage, or child maintenance was £925. The £283 Mr W paid in child maintenance payments each month were added to the cost of the debts that were not being consolidated into the new mortgage loan. – totalling slightly over £807 per month. Mr W's first charge mortgage amounted to £785 each month.

In relation to the income Pepper used, it decided that it would not factor into its calculations two payments Mr W made from his salary before it was paid to him. These being his pension contributions of around £270 each month and the sharesave scheme of £125 per month. Pepper has confirmed that these amounts were not taken into account as Mr W could choose to stop paying them. The fact that the pension was not taken into account in the calculation was confirmed when Pepper spoke to Mr W before Pepper agreed to lend to him.

Pepper's affordability assessment included a stress test, as the fixed interest rate Mr W had on his first charge mortgage was due to end in four years' time. This identified that, if Mr W stopped paying into his pension scheme and cancelled his sharesave scheme, he would have a disposable income of almost £69 per month. Pepper has subsequently highlighted that Mr W would, until the end of the main mortgage fixed rate, also have the amount of the stress test available to him – just under £200.

Within six months of the mortgage advance Mr W was missing payments. He told Pepper this was due to the payment coming out midway between paydays. However, he also told it in September 2022 that within three days of being paid all of his money was gone. He also mentioned during conversations that he was prioritising paying his mortgages. Moving the payment date was discussed several times, but Mr W said that he couldn't afford the additional interest payment to do it – around £200. In February 2023 Pepper offered to capitalise the additional interest so that the payment date was aligned with when Mr W was paid. However, that didn't stop Mr W missing payments.

In October 2022 Mr W asked Pepper if it would agree to release part of the land from his property title, so that he could sell it and used the £20,000 proceeds to reduce his unsecured debts, as he was still struggling financially. Pepper declined the request, as a valuation identified that the property value would decrease by £5,000 from what it was when Pepper had granted the loan. Given the loan-to-value when the mortgage was advanced was over 93%, Pepper decided increasing the risk associated with the mortgage was not something it was willing to agree to.

Mr W complained about the existence of the mortgage and how Pepper's administration and decisions while it was in place.

Pepper responded to the complaint in letter of 17 May 2024. It didn't uphold Mr W's complaint. It highlighted that the broker was responsible for the advice he received, but also commented that it had spoken to Mr W before it had granted the mortgage to check that it had received suitable advice, that the figures given were correct and that there were no health concerns that might make paying the mortgage difficult. It was satisfied the mortgage was affordable for Mr W in 2021 and that he was given information that meant he would have understood how it worked. In relation to the sale of part of the garden, Pepper was satisfied it was right to have rejected the request. Pepper also set out what had happened after Mr W had told it he was struggling to pay the mortgage and it didn't agree that it had failed to support him.

Mr W wasn't satisfied with Pepper's response to his complaint and asked this Service to look into it. One of our Investigators did and recommended that it be upheld. She concluded that there had been failings in Pepper's assessment of affordability and the mortgage had been unaffordable. As such, she recommended that Pepper work out what the redemption figure would have been in March 2024 if no interest had been charged during the term and no fees had been applied due to arrears or exiting the mortgage. She said the difference between that figure and the actual redemption figure should be refunded to Mr W, along with interest until the date of settlement. In addition, the mortgage application fee should be refunded. The Investigator also considered that Pepper should amend Mr W's credit file to remove mention of missed payments or payment arrangements. She also recommended that Pepper pay Mr W £500 for the upset and inconvenience its mistakes had caused him.

Mr W accepted the Investigator's conclusions, but Pepper did not. It set out why it disagreed with the Investigator.

**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.

When an application is made to borrow money, the lender must assess whether the borrower can afford the repayments. This second charge mortgage is a regulated mortgage contract which means the provisions in the Mortgages and Home Finance: Conduct of Business Sourcebook ("MCOB") apply.

Chapter 11 of MCOB is entitled 'Responsible lending and financing'. It says a lender must treat customers fairly by assessing whether the customer will be able to repay the sums borrowed and interest. To do that the lender must take account of the income of the customer, and the customer's committed and basic essential expenditure. This means that before agreeing to lend, a lender must carry out reasonable and proportionate checks to assess whether a borrower can afford the loan repayments alongside the borrower's other expenditure.

I have kept all these things in mind, and I have thought carefully about the information Pepper relied on when it decided to lend to Mr W.

Pepper has provided us with its affordability assessment for the mortgage Mr W took out. When establishing Mr W's normal expenditure, Pepper used the higher of two figures – those that Mr W provided and those produced for a single man by the ONS. I don't think this was an unreasonable approach, although I think it should reasonably have checked whether figures for a single man were the appropriate ONS figures to use, given that it was aware Mr W was making a payment for maintenance and/or child support.

Pepper calculated what Mr W's disposable income would be, based on basic expenditure for living, the cost of his main mortgage, the new second charge mortgage and the unsecured debts that would remain outstanding. It added to that an amount for a stress test on Mr W's main mortgage. Stress tests are completed in order to ensure that mortgages are not just affordable at the time of the application, but also in the longer term. As Mr W's fixed interest rate on his main mortgage was due to end in around four years from the application, Pepper was right to complete this stress test. It added just under £200 to the costs taken into account for the mortgage. This assessment resulted in Pepper concluding Mr W would have just under £69 disposable income after his debts, mortgages and basic living costs.

I note that Pepper has said that the stress test on the main mortgage would not kick in for around four years, and so Mr W's income would be around £200 a month higher for that period. That may be the case, but the FCA introduced stress tests for a reason – to ensure that mortgages were affordable for the foreseeable future when they were granted. Given Mr W's circumstances, and taking account of the fact that he had two dependent children, I am not persuaded that the mortgage was in reality affordable.

Added to that, when Pepper completed its assessment, it decided not to take into account two sums that were deducted from Mr W's income before he was paid each month. The first of these was a sharesave scheme costing £125 each month. I don't think it was inappropriate for this sum to be ignored for the purposes of affordability, as Mr W's priority was to repay his debts and get his finances back to a functional state. However, I note that Pepper didn't tell Mr W that when it had assessed whether the mortgage was affordable, it had effectively assumed he would stop paying into the scheme.

Pepper also didn't take into account Mr W's pension contributions when it assessed affordability. When Pepper spoke to Mr W briefly before it approved his application it said:

"*When reviewing your income on the application we will not take into account any pension contributions. This is because we believe these contributions to be a discretionary expenditure and if needed you would have the ability to lower these contributions to ensure you could meet your financial commitments. Can you confirm you're happy to proceed on this basis?*" Mr W confirmed that he was and that he didn't have any concerns about maintaining payments to the mortgage.

While Pepper made Mr W aware that it had not taken his pension contributions into account when completing its affordability assessment, it didn't expand on that statement. It didn't tell Mr W that the mortgage only passed its affordability test if Mr W stopped making payments to his pension. As such, I don't think Mr W was in a position to make an informed decision about whether to accept the mortgage offer.

Pepper has said that it didn't take into account Mr W's pension contributions as the FCA had said in 2014 that under the mortgage rules, pension contributions were not considered to be committed expenditure because the borrower has the ability to flex pension payments and could, for example, reduce the amount they pay into their pension for a period, prioritising instead their mortgage payments. As such, lenders were expected to exercise judgement as to the extent to which pension contributions were factored into an affordability assessment.

What Pepper has said is correct, the Regulator does allow a lender to exclude pension payments from affordability assessments. However, as the FCA said, this would be a judgement call and I would expect that assessment to be made on an individual case by case basis. Pepper has not provided any details of an individual assessment it completed in relation to Mr W's pension payments, and I am not persuaded that it had enough information about the situation for such an assessment to be completed. Rather it appears that Pepper simply discounted the payments automatically.

Placing a consumer in the position whereby they need to stop contributing to their retirement provision is a significant thing. That is especially so when the mortgage in question runs to almost age 70 and as a manual worker, it is not clear whether continued employment to the end of the term will be possible. Pepper does not appear to have asked any questions about the pension scheme, for example, if Mr W was able to reduce his contributions or, if he needs to stop paying for a period, whether he would be able to re-join the scheme. A borrower being ineligible for a pension scheme where the employer makes a significant payment into it, in this case 10% per year, would have a very detrimental effect on their long-term financial planning and could jeopardise their retirement.

Overall, I am not persuaded that Pepper fulfilled its duty of care to Mr W. I don't consider that it gave him the information he needed to make an informed choice about whether to accept the mortgage offered. Nor do I consider that it did enough to ensure the mortgage was affordable, given his circumstances and this was demonstrated by the fact he had difficulty paying the mortgage almost immediately after it was advanced.

<u>Support when in financial difficulties</u>

Pepper has said that it is satisfied that it provided appropriate support while Mr W was in arrears. I am not persuaded that is the case. A lender should listen to what its customer says and while Mr W told Pepper the problem was with the payment date, that clearly wasn't the only problem. I think Pepper missed flags that Mr W's financial difficulties went beyond that – he told it that within a matter of days all of his pay was gone and that he was prioritising paying his secured mortgages. He also said that he would have to do overtime in order to try to find the money to pay a missed payment. Mr W also asked to be able to sell part of his garden to raise money to pay unsecured debts.

While Pepper did offer to capitalise the additional interest needed to be paid in order for Mr W's payment date to be moved to align with his pay day, this was over a year after Mr W first started having problems making his payments and many months after, reasonably, Pepper was given information that indicated Mr W's problems went beyond the date his payment was due. I am satisfied that Pepper should have picked up on Mr W being in financial difficulties and asked more questions in order to see if it could help Mr W and if it would be appropriate to offer some form of forbearance.

Sale of land

Mr W is unhappy that Pepper would not allow this to happen. As was pointed out to Mr W by his broker at the time of the sale of the mortgage, the loan-to-value for secured borrowing was high – over 93%. It was explained to him that this was higher than many lenders would agree to. This is because if a property has to be sold to repay the mortgages on it, the second charge lender will only receive funds after the main mortgage is repaid and so there is a risk there might not be enough money to clear the second charge mortgage. As such, the higher the loan-to-value, the higher the risk the second charge represents to the lender.

As part of the process of asking for permission to sell part of the garden, Mr W's solicitors had the property valued on the basis of the land being removed from the title. This valuation came back with a figure of £5,000 less than the valuation of the property at the time the Pepper mortgage was agreed. That lower value would increase the loan-to-value percentage if Pepper had agreed to the sale and, thereby, increased the risk to Pepper.

There was no requirement on Pepper to allow the sale of the land and it had the right to protect its position when it came to the amount of risk it was willing to accept in relation to Mr W's mortgage. Given that the proposed sale of land would have increased the risk to Pepper I am satisfied that it was reasonable for it to decline the request.

Compensation

It is clear that Mr W has struggled since being granted the mortgage by Pepper and that he should not have been in that position. I am also satisfied that when he was speaking to Pepper about his payment problems, it didn't pick up on what was being said and so Mr W wasn't offered assistance and support when he reasonably should have been. In light of this, I consider that Pepper should pay Mr W £500 compensation for the upset he was caused by Pepper's actions or lack thereof.

**Putting things right**

Pepper should:

- Calculate how much Mr W would have needed to pay to redeem the mortgage on the date it was repaid, if:
    - no interest had been charged on the mortgage.
    - no charges or fees were applied due to arrears.
    - no early repayment charge was applied.
    - no mortgage exit fee was applied.

Pepper should pay Mr W the difference between this sum and the amount he paid to redeem the mortgage. Interest at 8% simple* should be added to this sum from the mortgage redemption date until the date of settlement.

- Refund the mortgage application fee. Interest at 8% simple* should be added to this sum from the mortgage redemption date until the date of settlement.

- Amend Mr W's credit file to remove any adverse information it told credit reference agencies about the mortgage.

- Pay Mr W £500 compensation for the upset Pepper contributed to by inappropriately lending to him and then not providing appropriate support once it should have become aware he was in financial difficulties.

*If Pepper considers that it's required by HM Revenue & Customs to deduct income tax from any interest due to Mr W, it should tell him how much it's taken off. It should also give Mr W documentation confirming the deduction for use with HM Revenue & Customs if appropriate.

## My final decision

My final decision is that I uphold this complaint. I order UK Mortgage Lending Ltd trading as Pepper Money to settle the complaint as detailed above in "Putting things right" above.

Under the rules of the Financial Ombudsman Service, I am required to ask Mr W to accept or reject my decision before 31 December 2024.

Derry Baxter
**Ombudsman**