DRN-5143414

The complaint

Miss R's complaint concerns a buy-to-let mortgage she has with Pepper (UK) Limited trading as Engage Credit. She is concerned that Engage didn't properly check the affordability of the arrears being capitalised, especially when the mortgage would move to a variable rate of interest.

What happened

Miss R took out her buy-to-let (BTL)mortgage with Pepper Money, at that time another lender in the same group as Engage Credit, in 2018 following advice from an independent mortgage broker. It was for slightly under £239,000 over a term of 29 years on an interest-only basis. The interest rate was fixed for five years at 3.49% and would then revert to a variable interest rate of 4.95% above the London Interbank Offered Rate (LIBOR). The mortgage was transferred to Engage Credit in 2022.

Miss R experienced financial difficulties during the Covid-19 pandemic, when her tenants were unable to pay the rent. In light of this, she took a six-month payment deferral, but when that period ended, Miss R was still unable to make the mortgage payments. Subsequently she was able to start making payments again and also paid, by arrangement, an additional amount each month to reduce the arrears.

Miss R asked to capitalise the arrears on the account in April 2021. Engage Credit declined the request. Miss R complained and in its response to the complaint, Engage Credit confirmed that it would consider capitalising the arrears if she paid a higher amount to the mortgage for six months, which would demonstrate she could afford the higher monthly payment that capitalising would require.

Miss R asked Engage Credit to capitalise the arrears again in April 2022 with the aim of improving her credit file so she could re-mortgage the property. Engage Credit reminded Miss R of what it had said in 2021 about demonstrating affordability. She increased her monthly payments from June 2022. She then asked for the arrears to be capitalised again in October 2022.

Miss R was asked to provide information relating to her income and outgoings. It was highlighted at this point that the interest rate would be increasing significantly when her fixed rate ended. The information requested was provided at the beginning of November 2022.

In the subsequent conversation between Miss R and Engage Credit it was again highlighted that the fixed interest rate would be ending soon and that the monthly payment would increase when it did. Engage Credit confirmed what her current interest rate was and what the variable rate she would revert to was at that time. It highlighted that the variable rate was almost double what she was paying at the time and the mortgage payment would be too. Miss R reassured Engage Credit that she was aware of this and always had been, but she expected to be in a better financial position by that time. This was due to an increase in her salary the following month due to a promotion, the rental income increasing at the end of the current tenancy and her cost of living reducing. Miss R also told Engage Credit that an adult relative living with her contributed to the household costs. Miss R said that the best thing for her would be to re-mortgage to obtain a lower interest rate than her mortgage with Engage Credit would revert to, but this wouldn't be possible if the mortgage was in arrears.

The income and expenditure exercise initially completed showed that Miss R had a disposable income of only just around £90 each month if the arrears were capitalised. However, when the contribution from the other adult living in the property was factored in, it increased the disposable income to around £450 each month.

Miss R's request was considered by Engage Credit. Its notes show that it did think about the fact that the monthly payment would increase when the fixed rate ended. However, it identified that the rental income from the property was sufficient to cover the increased mortgage payment. In addition, Engage Credit noted Miss R's disposable income gave her the ability to pay more to the mortgage and that this would be increasing the following month. It concluded that capitalisation was affordable and that it was to Miss R's benefit, given it would improve her credit file. As such, Engage Credit agreed to capitalise the arrears and this was done on 18 November 2023. This increased the balance of the mortgage by just under £12,000 and resulted in a monthly payment of just over £740.

Miss R's fixed interest rate ended at the beginning of March 2023. The new interest rate resulted in the monthly payment increasing to just under £1,700. Miss R contacted Engage Credit immediately and informed it that she could not afford the monthly mortgage payments. It applied a temporary interest rate reduction to the account and recommended Miss R seek independent financial advice.

In April and May 2024 Miss R raised concerns about the capitalisation of the arrears. She said that Engage Credit had known the interest rate would increase two months after the capitalisation and that the mortgage would be unaffordable for her with the new higher balance. Miss R said that she believed the decision to capitalise the arrears was irresponsible and unaffordable, and that she had not been in the right state of mind to make financial decisions at the time.

Engage Credit responded to Miss R's complaint in a letter of 28 May 2024. It set out the circumstances surrounding Miss R's request to capitalise the arrears on the mortgage. It was satisfied that it had followed the correct process and its decision to grant Miss R's request was appropriate. It did not uphold the complaint. Miss R referred the complaint to this Service as she was not satisfied with the response she had received.

One of our Investigators considered the complaint, but she didn't recommend that it be upheld. Miss R didn't agree and questioned that Engage Credit had determined that there was a disposable income of the level it did, based on the figures she gave it at the beginning of November 2022. She also said that Engage Credit had not factored into the affordability calculation the cost of maintaining her two rental properties.

The Investigator provided Miss R with further information about the affordability assessment that had been completed. She responded to Miss R's further comments and also said that she didn't consider the arrears being capitalised had caused Miss R any detriment. This was because it stopped adverse information being recorded on her credit file from December 2023 for a period and placed the account in the best possible position, in light of Miss R's improved financial situation. The Investigator didn't change her conclusion that the complaint should not be upheld and Miss R asked that it be referred to an Ombudsman.

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.

Miss R doesn't think that Engage Credit should have agreed to capitalise the arrears as it should have known the new payment after the end of the fixed rate would be unaffordable. Having listened to the conversations Miss R had with Engage Credit it is clear that it was concerned about whether the mortgage would be affordable when the fixed interest rate ended. It raised the concern with Miss R, including highlighting that the then current variable interest rate would mean the monthly payment would approximately double. She reassured Engage Credit that she was aware the rate would be going up and was confident that it would not be a problem. I suspect this is because Miss R was anticipating re-mortgaging at the end of the fixed rate, but she highlighted to Engage Credit the ways in which her income would be increasing and her anticipation of her outgoings reducing, indicating she thought the higher payments would be affordable.

That said, it was for Engage Credit to make its own assessment of the situation. I am satisfied that it did that, albeit relying on information about Miss R's future income that could not be evidenced at that time. It concluded that Miss R had shown that the increased cost of the mortgage at the then current rate was manageable for her. She had disposable income that could provide for the further increase at the end of that rate and it accepted Miss R's explanation that her income would be increasing in the near future which could also provide resource for that change. Engage Credit also made the decision that the consolidation would also benefit Miss R as it would improve her credit file, as she was hoping to do.

So I am satisfied that Engage Credit took into account the fact that the mortgage payments would be increasing significantly at the end of the fixed rate period when it made the decision to grant Miss R's request to capitalise the arrears. The decision was made against the background of Miss R having been asking to capitalise for around two years and her having maintained the mortgage satisfactorily during that time. I am also satisfied that Engage Credit had made the implications of the capitalisation, including what would happen when the fixed rate ended, very clear and Miss R was still keen to capitalise. I think that the decision was very finely balanced, but I am not persuaded that the decision to capitalise the arrears was wrong in the circumstances.

I would also comment that even if I had found the decision by Engage Credit to capitalise the arrears was wrong, I don't think that Miss R suffered any detriment due to the decision. This is because by making the decision it did, it meant that Miss R's credit reporting improved for a period. In addition, given the discussions Miss R had with Engage Credit following the end of the fixed interest rate period, and her comments to this Service, I am not persuaded that the mortgage would have been affordable at that point whether the arrears had been capitalised or not. I think the only difference that the capitalisation made to the situation that she is currently in, is that she had a period of no arrears being reported on her credit file, and that the £12,000 that was capitalised was on the mortgage balance, rather than the arrears balance.

My final decision

My final decision is that I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I am required to ask Miss R to accept or reject my decision before 3 January 2025.

Derry Baxter
Ombudsman