DRN-5334793

## The complaint

P (a limited company) complains about the actions of Saffron Building Society ("Saffron") in relation to its commercial mortgage application, and the administration of its mortgage.

P is represented by one of its directors, Mr R.

## What happened

P wanted to borrow money from Saffron to develop a property. P entered into discussions with Saffron and a Heads of Terms document ("HOT") was issued in March 2021. That document referred to P borrowing from Saffron using a commercial mortgage. The interest rate set out in the HOT was 8.5%.

P says that it wasn't until the mortgage offer was issued in September 2021 that it realised that the 8.5% interest rate on the mortgage was a variable interest rate. Mr R says he felt misled by the wording in the HOT. He told us that by that time significant expenses had been incurred in relation to the project, so he felt there was no other option but to agree to the mortgage offer. He told us by that time the bridging loan P had used to purchase the property was due and was in the process of being refinanced by Saffron.

In late 2022 it became clear that the original contractor P had used for the development was unable to complete the project. Mr R complains about the amount of time Saffron took to agree to a replacement contractor. He says that during that time Saffron prevented P from using the money from the mortgage to pay for the ongoing work. So the directors had to use their own money (at considerable personal financial and emotional cost) to fund the project. The directors also entered into personal guarantees to ensure the project went ahead – something they feel they were forced into.

Mr R says that as a result of Saffron's actions the project moved slower than it should – costing more money. He complains that in the end Saffron agreed to a contractor it had initially rejected – the contractor the directors had used at their own expense. He says that Saffron's delays meant that P had to agree to another loan – increasing its costs once again.

Saffron said it didn't do anything wrong. In its June 2024 final response it said the applicable interest rate for P's mortgage was variable. It was made up of Saffron's standard variable rate ("SVR") plus a 3.11% margin. Saffron's SVR was 5.39% at the time the HOT was issued. It said the HOT didn't say that the rate would be fixed or variable - it just gave an indication of what the interest rate would be at that time the HOT was issued.

Saffron also said that it acted reasonably during the period P was replacing the original contractor. It said it was reasonable to raise its concerns regarding releasing further money to P given the level of outstanding borrowing compared to the estimated value of the mortgaged property at that time, and that it made every effort to act as quickly and professionally as it could.

<u>Our investigation so far</u>

Our investigator looked into what happened. He said he didn't think it was fair to say that P was misled about the interest rate on the mortgage. Nor did he think Saffron acted unreasonably in the way that it handled matters after P lost its original contractor. So he didn't recommend that P's complaint was upheld.

Mr R didn't agree with our investigator. He asked for this complaint to be reviewed by an ombudsman. So this complaint was passed to me to decide. He has made a number of points that I will consider below.

**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.

Having done so I've reached the same conclusion as our investigator. I'll explain why.

Did Saffron make a mistake in the way the interest rate was described in the HOT?

The HOT was issued in March 2021. It included the following statement on the first page:

*"Please note these terms are of an outline nature only at this stage, and have not been approved by the Society's underwriters or by a credit committee and as such, should not be relied upon to constitute a formal offer of facilities. They are however, terms that I consider to be deliverable.*

*These terms have a shelf life of 14 days, and thus will expire at the Close of Business on 6th April 2021"*

So I'm satisfied that Saffron was upfront about the fact that the terms hadn't been finalised and were indicative only.

The HOT went on (amongst other things) to describe the interest rate:

*"Interest rate 8.5%. This rate of interest assumes that interest will be rolled up during the loan term."*

I appreciate that Mr R was clear in his own mind that the 8.5% interest rate quoted in the HOT was fixed. He says they'd had other development loans at a fixed rate and there was nothing in the HOT to say the rate was variable. So he thinks it was reasonable to assume the interest rate was fixed – something he says is fairly normal with short contracts.

I'm in no doubt that Mr R was shocked when he realised the 8.5% interest rate set out in the HOT wasn't fixed. He has told us that by the time that became clear P was effectively locked into working with Saffron as finding another loan provider would take time, adding to the project costs. I appreciate his point of view. However, I don't think it would be fair and reasonable for me to say that Saffron misled him by not saying more about the interest rate in the HOT.

I say that because the interest rate term in the HOT was silent about whether the interest rate was fixed or variable. I think that Saffron could reasonably expect P's directors to ask whether the interest rate was fixed or variable if they felt the wording of the HOT wasn't clear or if they had questions and negotiate/shop around for a better interest rate if they thought 8.5% was too high (Mr P told us he thought it was a high interest rate). This was a commercial mortgage. Commercial mortgages aren't typically regulated by the Financial Conduct Authority, meaning that they don't have to be set out in a particular way. Lenders would expect commercial borrowers to negotiate the HOT and the mortgage terms in the period before a formal mortgage offer was made.

On 29 September 2021 Saffron sent P its mortgage offer. That offer made it clear the interest rate on the loan was variable. It said the following about the applicable interest:

*"A variable rate which is the Saffron Building Society Standard Variable Rate, currently 5.39%, plus 3.11%, to give a current rate payable of 8.50%.*

*PLEASE NOTE: the rate of interest charged will not fall below 3% (the minimum interest rate) at any point during the term of the mortgage.*

*Once the loan is completed this variable interest rate may change from time to time when the Saffron Building Society Standard Variable Rate changes and we will give you at least 10 working days' notice of the implementation of any increase in the applicable interest rate after the loan has started. The new applicable interest rate will be charged on the outstanding balance from the 1st day of the month following the rate change."*

P accepted the mortgage offer on 11 October 2021. The interest rate at that time was 8.5% - in line with the 8.5% interest rate set out in the HOT. However, it rose steadily after that. Saffron's final response says it notified P of the increase of the interest rate of the mortgage to 11.9% on 13 July 2023. Saffron said that was due to market conditions common to all lenders in the marketplace.

I don't underestimate the impact the interest rate increases had on the profitability of the development project. Mr R said the interest rate increases were so significant that no borrower could plan for them. However I'm conscious the cost of borrowing in the UK rose significantly in the 2021 to 2023 period. Saffron has said its SVR was tied to market conditions. Between October 2021 (P's acceptance of the mortgage offer) and July 2023 (the point when Saffron agreed to the new contractor and said P could draw down more money from the mortgage) the Bank of England Base Rate increased from 0.1% to 5.25% in response to rising inflation that peaked at 11.1% in October 2022.

The mortgage offer said that once the loan had been agreed this variable interest rate could "change from time to time when the Saffron Building Society Standard Variable Rate changes". Saffron's website shows that its SVR increased in stages from 5.39% on 19 March 2020 to a 8.79% on 7 August 2023 – an increase of 3.4%. That's less than the increases to the Bank of England Base Rate.

Overall I think that the interest rate increases to P's mortgage were in line with the mortgage offer P agreed to in 2021.

It follows that I don't uphold this part of the complaint.

<u>Did Saffron act unreasonably after the original project contractor went out of business?</u>

Mr R is very unhappy about the way Saffron acted after P lost its original development contractor in late 2022. He says its delay agreeing to a new contractor increased the costs of the project considerably. That was compounded by the fact that Saffron wouldn't allow P to draw down more money under the mortgage until July 2023. So P's directors had to step in personally (at huge personal cost and effort) to keep the project going. Mr R has told us that they borrowed money from friends, family and loan sharks to keep the project running, and felt forced to sign personal guarantees worth £300,000.

I think it's worth me saying here that I'm very sorry to hear about the consequences of P losing the original development contractor in late 2022. I appreciate the impact of what happened on the directors personally. However, I'm afraid I can't consider that in this complaint. That's because Saffron lent P money to fund the development, not P's directors personally. P, not its directors, is Saffron's customer and is the eligible complainant in this case. So my role in this complaint it to consider whether Saffron made mistakes, and the impact of those mistakes (if any were made) on P.

Looking at the information I've been provided with, I can see that the original property valuation Saffron based its lending on set out three key stages of the project. The value of the mortgaged property was linked to those stages:

1. MV1 stage – before the property was wind and waterproof. Saffron considered the market value of the property assuming vacant possession of all parts in accordance with the planning consent for redevelopment to be £475,000

2. MV2 stage - wind and waterproof stage. Saffron considered the property assuming vacant possession of all parts to be £985,000.

3. GDV stage – completed project. Saffron considered the Gross Development Value of the property on the successful completion of the development to a good overall standard, with vacant possession and subject to the sale of the residential premises on separate leasehold titles to be £1,850,000.

The September 2021 mortgage offer said that after the first drawdown of money had been taken (it had already been taken by the end of September 2021), further drawdowns would only be released in certain circumstances after Saffron's surveyor had certified that development work had been completed in line with the stages set out above, and assuming all relevant paperwork and warranties were in place.

As I've said above, in late 2022 it became clear that the original contractors P had been using wouldn't be able to complete the project as they were effectively insolvent. So P started to look for a new contractor.

At that stage the property wasn't wind and waterproof, so Saffron considered the market value of the property to be £475,000. Even so, Saffron agreed to let P draw down a further £55,124 around this time - despite the loss of the original contractor. So by this point P had drawn down more than £440,000 from the mortgage. The loan to value ("LTV") at that time was over 90%.

Mr R feels that Saffron acted unreasonably by not doing more to support P after the original contractor failed. He told us that by October 2022 P had already borrowed a significant amount of money, and didn't have much financial headroom. So it needed a low-cost solution to keep the project moving. Mr R says P knew that getting a new contractor would cost more money, so P negotiated with a number of workers who'd lost their jobs with the previous contractor and brought in a highly experienced structural engineer who'd worked for large players in the construction industry on significant projects and had started his own company.

Mr R says that Saffron wouldn't entertain that structural engineer/P's chosen contractor. Instead it told P to search for established companies to take over the project. Mr R told us it was obvious that such companies would never take on P's project at a price that would work for P. But P had no choice but to spend several months searching for companies to take over the contract and get quotes.

Mr R says the structural engineer they chose completed the project for £866,000 –

significantly less than the £1.5 million the more established companies wanted. Finally, around July 2022 Saffron agreed to the structural engineer P had been working with.

Mr R feels Saffron should have listened to the directors' arguments about why the structural engineer they chose was the right one sooner. He says that their refusal to listen cost P six months when they were paying the mortgage but were unable to draw down on it further.

Saffron disputes Mr R's point of view. It told us it didn't reject P's choice of contractor. It said it was advised of P's proposal to appoint a new contractor at the beginning of November 2022 and instructed its solicitor about that. However, it required due diligence and relevant paperwork (an industry standard Joint Contract Tribunal contract and associated warranties) to put in place before it could allow any further drawdowns. So the delays P experienced were down to the time it took for that to happen. Saffron said it agreed to P's choice of contractor despite it not meeting its normal requirements because it thought it was the best option in the circumstances. It didn't think it was unreasonable to stop P withdrawing further mortgage tranches before the relevant paperwork was in place – in line with the mortgage offer P had agreed to.

Having considered all the information that has been provided I don't think it would be fair and reasonable for me to say that Saffron acted unreasonably after the original contractor was lost in late 2022. I can see from the paperwork it has provided that Saffron was willing to work with P's chosen new contractor from the start, but it did require the due diligence and paperwork set out in the mortgage offer to be in place before it would let P draw down any more money from the mortgage. I don't think that was unreasonable. Mr R accepts that P's chosen contractor was a relatively new business. So I can understand why Saffron needed to take care to ensure that it was in a position to complete the project and act in line with the legal and other requirements of the role. Mr R has said that Saffron forced P to waste time talking to other contractors that were never going to be able to take on the project at a price P could afford. However, the paperwork I've been provided with doesn't support that conclusion.

Mr R feels that Saffron should have been more flexible, allowing further drawdowns sooner given the personal guarantees Saffron had from P's directors. Mr R has said that taking the personal guarantees into account the LTV after the £55,124 drawdown was made was around 56%.

I don't underestimate Mr R's strength of feeling about this point, especially given the personal impact of personal guarantees on the directors. But as our investigator said, personal guarantees aren't usually considered in an LTV calculation. That's because a personal guarantee would only be called upon if the project failed, Saffron acted to recoup the money it was owed from the property it had taken as security for the mortgage, and there was a shortfall.

So I don't think it's fair to say that Saffron was wrong to act in line with the contract regarding drawdowns.

*Conclusion*

I appreciate P is likely to be very disappointed by this decision. But for the reasons set out above, I don't uphold this complaint.

## My final decision

For the reasons set out above, my final decision is that I don't uphold this complaint.

Under the rules of the Financial Ombudsman Service, I’m required to ask P to accept or reject my decision before 5 September 2025.

Laura Forster
**Ombudsman**