

complaint

Ms S and Mr M complain about their mortgage with Santander UK Plc. They say that interest rates it offered them in 2019 weren't competitive. And they say it should have offered them rates sooner – as they've been paying the standard variable rate (SVR) since 2011.

background

Ms S and Mr M have an interest only mortgage with Santander. They had a fixed rate which expired in 2011, and from then on the mortgage was on the standard variable rate (SVR).

In April 2019, Ms S and Mr M contacted Santander to discuss new interest rates. It offered a two-year fixed rate at 2.79% with a £999 fee, or a 2.99% rate with no fee. It also offered a three-year fixed rate at 3.29% with no fee. As there were only four years left on the mortgage, no longer term fixed rates were available, though they could also have taken a tracker rate at 2.79% with a £999 fee.

Ms S and Mr M complained that they didn't think these rates were competitive. And they complained that Santander hadn't contacted them before to invite them to apply for new rates.

They also complained that if they took one of the rates with fees, the fee couldn't be added to the mortgage balance because Santander said the loan to value was above 90%. Ms S and Mr M said they had recently had their property valued at £280,000 which would make the loan to value below 75%, so this couldn't be right. But Santander said its valuation was £208,000. Ms S and Mr M said they believed Santander was manipulating the valuation to offer them less competitive rates.

Ms S and Mr M also complained that they had previously asked for a rate, in 2014, but again the rates weren't competitive – at that time they were offered 4.29% with a fee or 4.59% without a fee, when the SVR was 4.74%.

Ms S and Mr M say that as customers with a large interest only mortgage they are trapped with Santander, and being taken advantage of.

In April 2020, Ms S and Mr M switched to Santander's follow on rate. They said they had also decided to put the property on the market.

Santander offered to arrange a free valuation for Ms S and Mr M's property. Our investigator thought that was fair – and said that if the valuation showed that there was a change to the loan to value (LTV) which would affect the rates available, Santander should backdate that to April 2019.

The valuation showed that the property was worth £290,000 in December 2020. At the same date, the automated valuation model Santander uses estimated it was worth £228,000.

Santander accepted that there was a substantial difference between the valuation estimate produced by the model and the valuation by a surveyor visiting the property.

Santander said that the valuation model showed an increase from £208,000 to £228,000 between April 2019 and December 2020 – suggesting house price inflation in the area of around 10%.

Based on that 10% figure, that would suggest, Santander said, that the property was probably worth around £265,000 in April 2019. This would reduce the LTV at the time – not by enough to change the rates Ms S and Mr M were eligible for, but by enough to add a product fee to the mortgage balance, as Ms S had wanted.

Santander therefore offered to backdate the 2.79% tracker rate (because Ms S had said at the time she wanted a product with no tie in) to April 2019, adding the £999 fee to the mortgage balance.

Ms S and Mr M didn't accept this offer. They said it was the same as they were offered in April 2019. Ms S said that she believed they would have been eligible for rates of around 1.5%, based on Santander's published announcements of rates. And they wanted compensation for the worry and upset of not being given access to a fair rate of interest, and of being led to believe their property was worth much less than it was – when they were relying on it to repay their interest only mortgage.

my provisional decision

I didn't think Santander had done enough to put things right. I issued a provisional decision setting out my thoughts on the case. I said:

Our investigator said that we couldn't consider whether Santander should fairly have offered Ms S and Mr M a rate between 2011 – when they reverted to the SVR – and 2013, six years before they complained. He said that period was out of time under our rules. Ms S and Mr M agreed with that, and so do I. I therefore won't say any more about what happened in this period.

Once Ms S and Mr M were on the SVR, from 2013 onwards, there was no general obligation for Santander to pro-actively contact them to offer new interest rates. It included information about how to apply on their annual statements.

From 2018, however, while there was still no regulatory obligation to pro-actively offer new rates, Santander – in common with many other lenders – undertook to write to customers on SVR who could benefit from new interest rates. While this is a voluntary agreement not a regulatory requirement, it was something Santander committed to do and in my view now represents good industry practice.

Ms S and Mr M did in fact contact Santander to ask for new rates in April 2019, not long after the agreement came into force. So in this decision I'll focus on whether they were treated fairly in their two applications for rates – in 2014 and 2019.

In April 2019, Ms S contacted Santander and was told that rates were available, but she couldn't add any product fee to the loan balance. And she was told that the rates discussed were the only ones available based on her loan to value.

Ms S didn't think the property valuation – based on its index – that Santander relied on to produce the loan to value was accurate. She asked what could be done about it, and was told nothing could be done.

I don't think this was fair. Santander should have given Ms S the opportunity of asking for her property to be valued at that point.

It is generally reasonable for a lender to rely on estimated valuations produced by an index for rate switches – it's not practical or cost-effective to revalue properties regularly during a mortgage. But the indexes available are only estimates based on local market movements. And so where, in an individual case, a customer reasonably disputes the index valuation, it's fair for the lender to agree to a physical valuation, at the borrower's expense.

In my view, that's what fairly should have happened in this case. Ms S wasn't given this option, but I think that if she had been she would have taken it.

Once the complaint came to us, Santander offered to carry out a free valuation, and I think that's a fair way to resolve this part of the complaint.

The valuation showed that the index was inaccurate. And while the valuation showed the value as at December 2020 – not April 2019 – it's likely the index was inaccurate then too. It's not easy to retrospectively value a property, and I think Santander's approach to arriving at an estimate for the earlier date based on the December 2020 value minus local house price inflation is a fair one.

Santander said that while this reduced the loan to value, it didn't reduce it enough to make a difference in the rates available.

I wasn't convinced by its explanation about this, so I asked Santander for some more information about its criteria for setting rates, as well as the rates it had available.

Santander told me that the index loan to value in April 2019 was around 96%. But the loan to value using the figure derived from the survey reduced the loan to value to around 80%.

In common with all lenders, Santander offers different products to different customers. In very general terms, the riskier a mortgage the higher the interest rate.

Santander said that it places mortgages into bands, based on various criteria. And the valuation made no difference to the band the mortgage was in – and therefore the rates Ms S and Mr M were eligible for. This is because the loan to value was over 75% and more than 50% of the mortgage was on interest only terms. That was true whether the mortgage was at 80% or 96%.

Ms S and Mr M made clear that they wanted a rate with no tie in – no early repayment charge (ERC). Santander's fixed rates all carry ERCs, so this means they would have taken a tracker rate.

The tracker rate, based on the band I've set out above, was 2.79% (base rate plus 2.04%) - which was the rate Santander offered to backdate. This was the rate whether the loan to value was 80% or 96%.

However, if Ms S and Mr M's mortgage had been on repayment terms the valuation would have made a difference.

With a loan to value of 80% on repayment terms, they would have been eligible for a lower tracker rate of 1.74% (base rate plus 0.99%).

I don't think it's fair for Santander to offer Ms S and Mr M a higher rate because they're on interest only terms, compared to the rate it would offer them if they had a mortgage that was similar in all other respects but on repayment terms.

I accept that lending standards have changed over the years. And as a result, interest only mortgages are far less common, and lenders more reluctant to offer them. But Ms S and Mr M's mortgage was taken out in earlier times, and Santander was comfortable with lending to them when the mortgage was taken out.

One consequence of the changes to lending standards is that it would be much harder now for Ms S and Mr M to move their mortgage elsewhere, especially as they don't have a repayment strategy that would be likely to be acceptable to a new lender.

Where a borrower can't move, there's a particular obligation on a lender to treat them fairly – and not to put them in a worse position compared to other borrowers with similar characteristics.

I'm not persuaded that having an interest only mortgage means that Ms S and Mr M have different characteristics to other existing customers with similar loan to value and similar track record of paying their mortgage.

And so I'm not persuaded that it's fair for Ms S and Mr M to be placed in a higher band than they would have been had they had a repayment mortgage.

I'm satisfied that working back from the 2020 valuation and backdating a rate from April 2019 is a fair way to resolve this complaint. But I'm not satisfied it's fair to do so by offering a higher rate because Ms S and Mr M have an interest only mortgage. I think a fair resolution is to put them back in the position they would have been in had Santander offered them the 1.74% tracker rate, not the 2.79% tracker rate.

This will mean that Ms S and Mr M have made overpayments on the SVR and then the follow on rate compared to the rate they should have been on. They should have the choice of either having those overpayments refunded to them, or used to reduce their mortgage balance.

And a two-year tracker rate from April 2019 would expire around now. So from April 2021 Ms S and Mr M will revert to the follow on rate.

When Santander responds to this provisional decision, it should also tell me what rates Ms S and Mr M are eligible for now – using a loan to value based on the December 2020 valuation plus index inflation – and without distinguishing between interest only and repayment terms. It may be that options are limited as Ms S and Mr M are close to the end of the mortgage term. But if there are rates other than the follow on rate available, it seems sensible to me to include a rate going forward as part of the resolution of this complaint rather than asking Ms S and Mr M to immediately go through another application process.

I've also looked at what they were offered in 2014. I'm satisfied that, at that time, the rates would have been the same with either the index or valuation value, and the same on either interest only or repayment terms. The rates Santander offered at that time, which Ms S and Mr M chose not to take, were the only ones fairly available. So I don't think it's fair to ask Santander to backdate a rate offer to 2014, when Ms S and Mr M were offered a fair

rate but chose not to take it because they didn't think it represented good value in their circumstances at the time.

Finally, Ms S and Mr M have set out some of the impact this complaint has had on them. And I do think that Santander's insistence in April 2019 that the index valuation was correct and there was nothing Ms S and Mr M could do about it did cause them upset and worry. It led them to believe their loan to value was much higher than it actually was – and that they were in a more precarious position as they approach the end of their interest only term. I'm satisfied this did cause them unnecessary worry, and I think £350 compensation is fair in the circumstances.

the responses to my provisional decision

Ms S and Mr M agreed with my provisional decision. But they said they had each suffered considerable distress and anxiety, and they thought the £350 compensation should be paid to each of them, not to both of them jointly. And they said they wanted 8% interest added to the redress whether or not it was refunded to them or used to reduce the mortgage balance.

Santander also agreed with my provisional decision. It re-calculated Ms S and Mr M's loan to value as of now, based on the December 2020 valuation plus index inflation since. It said the loan to value was around 70% as of March 2021, taking into account inflation since the last survey. Adding the overpaid interest to the mortgage balance rather than refunding it to Ms S and Mr M would reduce that figure – but not by enough to change the interest rate they would be eligible for from now on, because the current band is for loan to value of 60% and above.

Santander said that in that band, Ms S and Mr M were eligible for a tracker rate of 1.44% above base rate – currently 1.54%. There were fixed rates too – the best fixed rate was 1.34% with a £1,499 fee, 1.44% with a £999 fee or 1.79% with no fee. However, all the tracker rates ran until July 2023 and Ms S and Mr M's mortgage was due to expire on 1 June 2023. Therefore if Ms S and Mr M wanted to take a fixed rate rather than a tracker rate, the term of their mortgage would need to be extended by a couple of months – which would reduce their monthly payments but increase the time over which interest would be charged.

my findings

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

I'm pleased that, in broad terms, there is now agreement about the fair outcome of this case. But there remain points to be resolved about what Santander needs to do to put matters right.

Dealing first with the overcharged interest, I don't think it would be appropriate to add 8% interest if Ms S and Mr M choose to have the overpayments used to reduce their mortgage balance.

The overpayments are money that Ms S and Mr M shouldn't have had to pay out, because their mortgage payments were too high.

If Santander hadn't set the interest rate so high, Ms S and Mr M's monthly mortgage payments would have been lower. They would then have had a choice of either keeping that

money back and using it for other purposes – or of voluntarily using it to overpay their mortgage.

My redress aims to put them back in the position they should have been in, by giving them that choice now. If they choose to have the money refunded to them, I put them back in the position they would have been in by returning the money, and also compensate them for being deprived of it and the possible gains they might have been able to make elsewhere with it. That's what the 8% simple interest is for; it's a notional figure to compensate Ms S and Mr M for being deprived of funds they otherwise would have had and been able to use as they saw fit.

If, however, they decide to use the overpayments to reduce the mortgage balance, I put them back in the position they would have been in had that been the choice they had made at the time. That involves re-working the mortgage as if they had made overpayments each month – and as if, therefore, their balance was lower and they were charged less interest in future months.

In other words, if Ms S and Mr M decide they want to be treated as if they had never made those payments, they are entitled to the money back plus compensation for being deprived of it. But if they decide they want to be treated as if they had made overpayments to their mortgage, they are entitled to have their mortgage balance reduced not just by the overpayments, but by mortgage interest on the overpayments.

It therefore wouldn't be fair to use the overpayments to reduce the mortgage balance, reduce the interest charged on the mortgage *and* pay 8% interest. That would be to give Ms S and Mr M compensation as if they'd made both choices simultaneously, which was never possible. It would result in them being compensated twice over.

I've thought again about my award for their trouble and upset. I recognise they have both been troubled by what happened. And my award takes that into account, and compensates them both for the trouble they have both experienced. I'm satisfied that £350 in total represents fair compensation.

Finally, the interest rates Santander provided for their mortgage as of now, which I've quoted above, are illustrative of the position as at March 2021. They will need to be revisited based on Santander's current product range, which may change from time to time – as well as the current loan to value as of now. Though we are in a period of house price inflation, it seems unlikely that the loan to value has fallen from 70% to below 60% between March and June 2021, and so Santander should provide the current rates for the 60% and above band.

my final decision

For the reasons I've given, my final decision is that I uphold this complaint and direct Santander UK Plc to:

- Re-work Ms S and Mr M's mortgage so that it is as if the mortgage had been on a tracker rate of base rate plus 0.99% for two years from April 2019 to date;
- Give Ms S and Mr M the option of either:
 - Having the resulting overpayments refunded to them, adding simple annual interest of 8% running from the date of each overpayment to date of refund; or
 - Using the resulting overpayments to reduce their mortgage balance month by month, including the interest charged as a result;
- Give Ms S and Mr M the option of selecting either a further two year tracker rate or two year fixed rate from 1 July 2021, if necessary extending the mortgage term to match the duration of the fixed rate; and
- Pay Ms S and Mr M £350 compensation.

Under the rules of the Financial Ombudsman Service, I'm required to ask Ms S and Mr M to accept or reject my decision before 22 July 2021.

Simon Pugh
ombudsman