



# Legal charges on family home - repossession

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For the majority of people, their main asset is the family home. When they seek to borrow a large sum of money for whatever reason, high street lenders (banks, building societies etc) will usually secure that loan against the value of the property.

A legal charge (a type of mortgage) is the means by which lenders enforce their rights to a property; it is registered at HM Land Registry. It is not unusual for a property to have more than one legal charge registered against it.

The purpose of this note is to provide general information about the registration and priority of charges. It also provides information on what would happen if there were insufficient funds from the repossession and sale of a property to repay more than one lender.

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## 1 Types of charges secured on property

A legal charge is the means by which lenders enforce their rights to a property. There are different types of legal charge and the type used will vary from lender to lender. For example, building societies tend to use a charge for the specific amount that they have lent. Banks tend to use an 'all monies charge', allowing them to recover overdrafts and other loans if they have granted more than just a mortgage.

A primary mortgage will normally be secured by a registered first charge against the property. The obvious example of a primary mortgage is when people borrow to purchase their own home. The holder of a 'first charge mortgage' (normally a bank or building society) has the legal right to make a first call on the property in the event that the borrower defaults on repayments.

Second or subsequent charges may be made on a property if additional money has been borrowed against the same property. The holder of a second charge has a legal call on the property in the event of the borrower defaulting on repayments, but only after all liabilities to the holder of the first charge have been settled.

There are a number of reasons why borrowers are attracted to second charges, including:

- accessibility and flexibility;
- the speed in which the finance can be arranged; and
- the minimal charges applied on early redemption.

In recent years, a marked development has been the increased use of second charges secured on land under consolidated loan agreements.

A charge secured on land (whether a first or second charge) can only be created by deed expressed to be by way of legal mortgage.<sup>1</sup> The borrower and the lender are generally free to agree the specific conditions of the loan secured by the charge and the circumstances in which the lender can enforce the charge in order to recover the outstanding monies.

## 2 Regulation of charges

On the 31 October 2004 the Financial Services Authority (FSA) became responsible for regulating most first charge mortgages under the *Financial Services and Markets Act 2000*.

A second charge secured on land, regardless of value, is regulated by the Office of Fair Trading (OFT) under the *Consumer Credit Act 1974* (CCA) as amended by the *Consumer Credit Act 2006*.<sup>2</sup>

A point worth mentioning is that when FSA mortgage regulation was introduced, changes were made to the CCA 1974 to avoid dual regulation. However, there remain circumstances where some lenders could find themselves having to comply with both regimes simultaneously. This was the subject of a recent informal discussion paper produced by HM Treasury and the DTI (now the Department for Business Enterprise & Regulatory Reform), following discussions with the FSA and OFT. This paper can be viewed in full at:

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<sup>1</sup> Section 85 of the *Law of Property Act 1925* – a mortgage deed is the legal document establishing a loan on property

<sup>2</sup> On 6 April 2008, the £25,000 financial limit on all consumer credit agreements was removed by the CCA 2006. As a consequence, all new consumer credit agreements, regardless of value, made by 'individuals' (as defined) will be regulated by the CCA 2006. First charge mortgages continue to be regulated by the FSA under the *Financial Services and Markets Act 2000*.

<http://www.cml.org.uk/cml/search?keywords=%27informal+discussion+paper+dual+regulation+consumer+credit+act+and+fsma%27&x=15&y=13>

### 3 How are charges registered?

The relevant legislation is the *Land Registration Act 2002* and the *Land Registration Rules 2003* which came into force on 13 October 2003. The Act applies only to England and Wales.

Very briefly, for each property (known as 'title') registered at the Land Registry there is an individual register. This individual register is usually in three parts. The first part is the Property Register and contains a description of the land in the title and will refer to a title plan. The second part is the Proprietorship Register, which gives the name and address of the legal owner (the proprietor) and shows whether there are any restrictions on their power to sell, mortgage or otherwise dispose of the land. The third part of the register is the Charges Register. This contains details of registered charges and notice of other financial burdens secured on the property.

To be effective as security, charges of land must be registered at the Land Registry. This applies whether or not the property itself is registered at the Land Registry at the time the charge is created.<sup>3</sup> There are three possible options:

- If the charge is created at the same time as the transfer of the property to the borrower (i.e. on the buyer's purchase of the property), then the transfer and charge will be registered at the Land Registry at the same time. The borrower's name and details will be inserted in the Proprietorship Register of the registered title, and the lender's name and details in the Charges Register.
- If the charge is created because the borrower is re-mortgaging the property (i.e. paying off the original loan and taking out a new loan from another lender), then the borrower's name and details will remain in the Proprietorship Register of the registered title and the new lender's name and details will replace those of the previous lender in the Charges Register.
- If the charge is created because the borrower is taking out a second or further loan to be secured on the property (i.e. the borrower is not repaying the original loan, and is taking out a further loan, usually from another lender), then the borrower's name and details will remain in the Proprietorship Register of the registered title and the new lender's name and details will be placed below those of the existing lender(s) in the Charges Register. In some cases, the existing lender(s) must give consent to any later secured loan(s) (see paragraph 5 below). Unless otherwise stated in the Charges Register, the lenders will have priority as between themselves in the order in which the charges in their favour appear in the Charges Register. This means, for example, that the lender under a first charge will have to be repaid in full, before the lender under a second charge receives any money at all, and the same principle of priority applies as between the lenders under a second and any third charge, and so on.

Further information is available from the Land Registry website at:

<http://www.landregistry.gov.uk/>

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<sup>3</sup> If the property is unregistered land (this is now increasingly rare in urban areas), the creation of the charge will trigger a requirement to register the property for the first time at the Land Registry

## **4 What does registration mean?**

For charges secured by land, registration at the Land Registry has two important consequences:

- First, priority between charges (except for certain special cases) is determined by the order of the entries as they appear in the Charges Register on the Land Registry.
- Second, the charge will not take legal effect until registered.

## **5 How are second charge loans approved by the first charge lender?**

This is quite complex. Some lenders will put a 'restriction' on the title (i.e. property) at the Land Registry preventing the registration of subsequent charges without the lender's consent. However because of administration difficulties many no longer do this. Instead, a 'unilateral notice' may be used to protect a second charge on the register even if there is a restriction.

Where a lender does not use a restriction there is no need for the second charge lender to obtain consent.

## **6 What happens to the charges in the event of repossession?**

### **6.1 Costs involved**

On default of mortgage repayments and by court order, the lender can repossess the property. After the lender takes the property into possession they have a legal duty to sell the property for the best price that can reasonably be obtained. All costs (for example, estate agents' costs and legal fees) will be charged to the debtor's mortgage account.

From the proceeds of sale, the lender and any other secured lender will be repaid together with costs. If the sale of the property results in a surplus of funds, then the surplus is paid to the debtor. If the sale proceeds are not enough to pay off the money owed to the lender, then there is a 'shortfall debt' which the debtor will still owe his lender. Interest will usually continue to be charged on the mortgage loan until the property is sold and any shortfall is repaid.

### **6.2 Shortfall debt**

As soon as possible after the sale of the repossessed property, the lender is required to notify the debtor of any shortfall debt. If interest is being charged on the shortfall debt, the lender is required to send the debtor regular written financial statements on how much is owed.

The action the lender takes on the shortfall debt will depend on the circumstances. There are a number of options, including:

- seeking repayment of the shortfall debt by coming to terms with the debtor;
- writing-off the shortfall debt; or
- assigning the shortfall debt to another company

In England, Wales and Northern Ireland, a lender legally has 12 years in which to contact the debtor to begin the process of seeking repayment of a shortfall debt; this period is usually 5

years in Scotland.<sup>4</sup> However, in 2000 the industry voluntarily agreed that where the borrower has a shortfall debt following possession lenders will only begin recovery action within 6 years of the sale of the property. The Council of Mortgage Lenders (CML) has stated the industry's commitment to treat debtors sympathetically:

[...] lenders are committed to fair and sympathetic treatment of people who have suffered repossession, and accept that individuals should not face long delays before being contacted to discuss repaying the shortfall. Most lenders will contact you [the debtor] fairly soon after repossession to try to agree to a manageable arrangement for repaying all or some of the debt.

Lenders who are members of the Council of Mortgage Lenders voluntarily agreed from 11 February 2000 to begin all recovery action for a shortfall within six years of the sale of a repossessed property. If your [i.e. the debtor's] property was taken into possession and sold more than six years ago, and you have not been contacted by your lender to recover any outstanding debt, you will not now be asked to pay the shortfall. In Scotland, lenders will begin recovery action within five years.<sup>5</sup>

However, the 6 year limit only refers to beginning recovery action and does not affect a lender's ability to recover the shortfall debt over a longer period. It should also be noted that the 6 years time limit will not apply to a case where the debtor is already abiding by alternative payment arrangements for the shortfall debt or if there is evidence of mortgage fraud.

### **6.3 If the debtor disappears**

According to the CML, after a repossessed property is sold, lenders can often find it difficult to contact former borrowers to inform them of a shortfall debt.<sup>6</sup> Certainly in the early 1990s, when there were a number of repossessions, it was not unusual for debtors to simply post the keys to a property through the letter box of their mortgagor (usually a bank or building society) and disappear, wrongly believing the debt attached to the property and not to them.

In practice, a lender may use a variety of measures to locate a debtor, including using tracing agents.

## **7 If the debtor can pay the first mortgage but not the second charge?**

Many people are under the mistaken impression that as long as the repayments on a first mortgage are kept up to date, their property is not at risk from being repossessed following missed payments on a second charge loan. This is not the case. A second charge lender will pursue court action, ultimately possession of the property subject to the court order being granted. In the event that the property is repossessed and subsequently sold, the proceeds from the sale will first be used to pay off the outstanding first mortgage and then the balance of any further charges, in order of registration at the land registry. Any surplus funds will pass to the borrower.

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<sup>4</sup> The limitation period is 12 years because the charge was created by mortgage deed

<sup>5</sup> Council of Mortgage Lenders, <http://www.cml.org.uk/cml/consumers/guides/debt>

<sup>6</sup> Ibid