Housing costs – payment of "capitalised interest".

Samuel Guedes

Commissioner's File: CIS/146/93

SOCIAL SECURITY ACTS 1975 TO 1990

CLAIM FOR

DECISION OF THE SOCIAL SECURITY COMMISSIONER

Name: [redacted]

Appeal Tribunal: Oxford

Case No.: 2:13:6753

1 My decision is that the decision of the social security appeal tribunal was erroneous in point of law. All the findings of fact necessary for me to make a decision have been found, and I shall, pursuant to the powers in that behalf contained in section 23(7)(i)(a) of the Administration Act 1992, give the decision which I think the tribunal should have given. It is agreed that the calculation of "eligible interest" to which I hold the claimant to be entitled, is a question I should leave to the adjudication officer with the right, if the parties cannot agree, to refer the matter back to me.

2. My decision is that the claimant is entitled to the monthly instalments of what I call in this decision "capitalised interest" payable by reference to the interest which would have been payable during the previous year if it had become payable, if as and when, the interest rates changed. On the other hand, I disallow the interest on such "capitalised interest itself".

3. This is an appeal with the leave of the chairman against the decision dated 14.5.92 of an appeal tribunal that the claimant is entitled to housing costs of £101.23 per week for the period 1.1.91 to 29.4.91 and £88.53 from 30.4.91.

4. The claimant and her husband took out a mortgage for £33,000 to enable them to purchase their house. The provisions for payment of interest are complicated but are designed to enable the borrower to know in advance exactly what his monthly instalments will be for the next 12 months from 1 May in each year, without any fluctuation during that period. The rate of interest is set on 1 April in each year and monthly instalments of interest at the appropriate rate are paid as from 1 May. There is obviously a sting in the tail and while the monthly instalments payable during the year may be unaffected by the change in interest rates from time to time charged by the bank, the bank calculates how much interest would have been charged immediately, according to the rate changes when they occurred, that figure is "capitalised", divided into 12 and added to the

instalments payable each month in the subsequent year. There are three components in these instalments:-

(i) interest on the original loan at the rate as set on 1 April every year;

(ii) repayment of the "capitalised income" for the previous year; and

(iii) interest on "the capitalised interest", though reducing as the monthly payments are made.

5. I refer to the appropriate provisions in the terms of the offer (T27):-

" 6. Interest.

Interest will be charged on a day to day basis on the outstanding balance and other outstanding sums at the Lender's Home Loan rate ruling at the time or such other rate or rates as may be agreed in writing between the Lender and the Borrower and capitalised on the last day of each month. Variations of the Lender's mortgage rate may occur at any time and notice of such variation will be published at least once in two National newspapers ...

7. Repayment.

All payments will be due on the first of each month and will be payable by variable direct debit and the Lender's usual form authorising this must be signed prior to the completion of the the advance. The first repayment will fall due on the first of the month following the making of the advance ...

The interest payments from the anticipated date of completion of the advance to 1 April next will be calculated at the rate prevailing on the anticipated date of completion of the advance.

If the rate of interest increases during this period the consequent interest arrears will be capitalised in accordance with the previous condition and repaid (with interest) during the following year. The monthly payments in the following year to 1 April reflect that these payments (starting on 1 May) will be calculated at the rate prevailing on 1 April in that year.

This procedure will be repeated in each succeeding year ..."

6. I shall take for example the year 1 May 1990 to 30 April 1991. On 1 April 1990, the rate was fixed at 15.75%. The balance then outstanding on the mortgage was £35,974.78.

However, of this £1,184.04 represented unpaid monthly instalments which immediately became due. They are excluded from being eligible since they are truly "arrears". The balance was therefore £34,610.74. The original loan was £33,000, and the balance of £1,610.74 was "capitalised interest" for the previous year 89/90. That is the interest which would have been paid in the previous year had interest been chargeable immediately on a change of rates, as happens in a more conventional mortgage. If that had happened, I do not think that it can be argued that the increased interest would qualify as "eligible interest".

Thus the three components in the instalments were made up as follows:-

(i)	interest on the original loan (£33,000 at 15.75%) -	£433.13
(ii)	1/12th of the "capitalised interest"	£134.23
(iii)	Interest on the unpaid "capitalised interest"	£ 11.72
		£579.08 (per month)

7. The claimant says that (i) is the correct sum payable. The adjudication officer submits that "capitalised interest" and interest on the unpaid "capitalised interest" are arrears. He says that for the period 90/91 the weekly eligible interest is calculated according to the formula set out in para 7(4), Schedule 3 to the Income Support General Regulations:-

$$\text{"}\frac{£33,000 \times 15.75\%}{52}$$

This he says produces £101.23. Capitalised interest is "arrears" and does not qualify as eligible interest - sub-paragraph (6) of para 7. If that interest is indeed accumulated arrears that conclusion would be correct. The adjudication officer states in s submissions to the Commissioner:-

" 18. The claimant's representative has argued that the capitalised shortfall that has been described above should not be regarded as arrears in the context of sub-paragraph 7(6) because the word "arrears" has a special meaning for the mortgage lender. ...

19. I submit that the interest charged by the lender is identical to that calculated under the formula; it is simply the method by which the lender collects that interest that is unusual and which leads to arrears in the claimant's account. It is not therefore necessary to consider the provisions of sub-para (4C) I further submit that the word "arrears" in sub-para 7(6) carries its ordinary meaning for income support purposes, that it encompasses the deficit in [the claimant's] mortgage payments, and that there is no provision for help

towards her arrears from this sub-paragraph."

8. So far as I can see, there is, in fact, no difficulty in applying the formula set out in sub-paragraph (4) of para 7 but if need be I see no reason why sub-paragraph (4C) should not be prayed in aid. The formula whereby the weekly amount of eligible interest is calculated is (simplified) as follows:-

$$\frac{C \times D}{52}$$

C is the amount of the loan: D is the rate of interest on "that loan or any part thereof expressed as a percentage". There is not, I think, any difficulty in calculating the true interest rate payable in 90/91 or any other year for that matter. The "capitalised interest" is added to the interest payable under the rate set on 1 April 1990 and the percentage can be easily determined. If my arithmetic is correct the sum works out as follows:-

Interest on the original loan viz £33,000 x 15.75%	£5,197.50
(b) Capitalised interest	<u>£1,610.74</u>
Total interest	£6,808.24

Expressed as a percentage that is 20.63%. The formula therefore is $\frac{\text{£}33{,}000 \times 20.63\%}{52}$

i.e. £130.92 pw.

Sub-paragraph (4) therefore presents no difficulties but if and in so far as it is necessary it would be right to rely on sub-paragraph (4C).

9. Where, however, the adjudication officer and I part company is in describing "capitalised interest" as arrears. A satisfactory definition of "arrears" is to be found in the Australian case of <u>Paice v. Ayton</u> 1941 VLR63 at p68 (per Mann C.J.):-

> ""Arrears" pre-supposes a time fixed for payment of a sum of money and a lapse of time thereafter without payment."

The instalments of "capitalised interest" are not arrears: they are part and parcel of the interest payable although they might be paid in arrear, and are not due until the year subsequent to the year in which the interest was "earned". The contract date for payment is no more than postponed; "that date" is the first of every month in the subsequent year and there is no lapse of time <u>after that date</u> without payment.

10. Accordingly I hold that the "capitalised" interest for the years 90/91 and 91/92 is "eligible interest". On the other hand, I do not think that the interest on the capitalised interest i.e component (iii), qualifies since that is interest upon interest

and for that strictly limited purpose, I think it would be right to treat that as arrears for the purposes of sub-paragraph (6).

11. As I have said, I leave the calculations to the adjudication officer with liberty to refer back to me. If any point requires clarification I give both sides liberty to refer back to me in any event.

Finally for the sake of completeness I should say that the insurance premium which is charged by the bank is neither eligible interest nor an eligible housing cost under paragraph 1 of Schedule 3 - R(IS) 19/93.

12. My decision is therefore as set out above.

(Signed) J.M. Henty
Commissioner

(Date) 21 July 1994