

## SPICe Briefing

# Personal debt, bankruptcy and homes

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Since 2007, in common with many parts of the world, Scotland has been in the grip of a 'credit crunch', ie a sudden, severe and prolonged reduction in the availability of loans. Scottish economic growth has been affected by this financial crisis and the country has been in recession since mid 2008. This briefing examines the following policy topics in the context of the credit crunch and the subsequent economic downturn:

- personal debt
- bankruptcy
- buying and selling a home
- mortgage arrears and repossessions
- rented housing

For each policy topic the briefing considers: 1) the current legal and policy framework; 2) the impact of the economic downturn; 3) any government response to the issues raised by the downturn; and 4) any public debate associated with that response.

For an examination of the impact of the credit crunch on the Scottish economy and on the Scottish housing market see the earlier SPICe briefing entitled [Impact of the Credit Crunch on the Scottish Economy and the Scottish Housing Market](#) (Berry and Dewar 2008), updated in respect of the housing market by [The Scottish Housing Market](#) (Berry 2009). SPICe also produces quarterly briefings on the Scottish economy. The current briefing is [Economic Indicators](#) (Nicol et al 2009).



# CONTENTS

<b>EXECUTIVE SUMMARY</b> .....	<b>4</b>
<b>PERSONAL DEBT</b> .....	<b>6</b>
WHAT ACTION CAN A CREDITOR TAKE IN RELATION TO A DEBT? .....	6
WHAT CAN A DEBTOR DO WHEN FACED WITH REPAYMENT DIFFICULTIES? .....	7
<i>Seek debt advice</i> .....	7
<i>Negotiate with creditors</i> .....	7
<i>Debt Arrangement Scheme</i> .....	7
<i>Protected trust deeds and bankruptcy</i> .....	7
<i>Time to pay and time orders</i> .....	8
IMPACT OF THE DOWNTURN .....	8
POLICY INITIATIVES .....	8
<b>BANKRUPTCY</b> .....	<b>9</b>
THE LEGAL FRAMEWORK .....	9
<i>Sequestration</i> .....	9
<i>Protected trust deed</i> .....	10
<i>Low Income, Low Asset Debtors</i> .....	10
IMPACT OF THE DOWNTURN .....	11
<b>BUYING AND SELLING A HOME</b> .....	<b>12</b>
THE LEGAL FRAMEWORK .....	12
<i>Home Reports</i> .....	12
<i>The conveyancing process</i> .....	13
<i>Contractual obligations</i> .....	13
<i>Duty of solicitors</i> .....	13
IMPACT OF THE DOWNTURN .....	14
<i>Volume of house sales</i> .....	14
<i>The impact of the Home Report</i> .....	14
<i>Withdrawing from transactions</i> .....	15
<i>Negligence claims against solicitors</i> .....	15
<i>New build contracts</i> .....	16
<b>MORTGAGE ARREARS AND REPOSSESSIONS</b> .....	<b>16</b>
THE LEGAL FRAMEWORK .....	16
<i>Routes to repossession under the 1970 Act</i> .....	16
<i>The effect of the Mortgage Rights (Scotland) Act 2001</i> .....	17
IMPACT OF THE DOWNTURN .....	17
<i>Trends in mortgage arrears and repossessions</i> .....	17
<i>Lenders' practices</i> .....	18
POLICY DEVELOPMENTS AND DEBATE .....	18
<i>Scottish Government Initiatives</i> .....	18
<i>UK wide initiatives</i> .....	19
<i>Debate over other measures required</i> .....	20
<b>RENTED HOUSING</b> .....	<b>20</b>
SOCIAL HOUSING .....	20
PRIVATE SECTOR HOUSING .....	21
<i>Assured tenancies</i> .....	21
<i>Short assured tenancies</i> .....	22
IMPACT OF THE DOWNTURN .....	22
POLICY DEBATE .....	22
<b>SOURCES</b> .....	<b>24</b>





(SB 09/25)

## EXECUTIVE SUMMARY

### Personal Debt, Bankruptcy and Homes

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#### Personal debt

- Scottish statistics on personal debt are difficult to obtain. At a UK level, levels of personal debt were high in 2008 and there had been an increase compared to previous years in the number of households reporting that they were experiencing difficulty in keeping up with payments on their debts and other commitments, although this remained well below the peak levels recorded in the early 1990s
- In 2008-09 the Scottish Government introduced a variety of measures intended to address the needs of individuals experiencing debt problems during the economic downturn. These build on the existing legislative and policy framework which includes the Debt Arrangement and Attachment (Scotland) Act 2002 (asp 17) and the Bankruptcy and Diligence (Scotland) Act 2007 (asp 3)

#### Bankruptcy

- In the third quarter of 2008/09, there was an extremely steep rise in personal bankruptcies in Scotland compared to the corresponding quarter of 2007/08. However, this increase is attributed by the Accountant in Bankruptcy to the introduction of a new route into bankruptcy rather than to the economic downturn

#### Homes

- The housing market in Scotland has slowed significantly in 2008 compared to 2007 in terms of volumes of sales. Debate is still ongoing about what impact the introduction of Home Reports on 1 December 2008 has had on the already struggling property market
- A variety of risks normally associated with residential property transactions (eg one party wishing to withdraw from a transaction) may be exacerbated during the economic downturn
- The Conveyancing and Feudal Reform (Scotland) Act 1970 (c 35) provides mortgage lenders with three separate legal routes they can take when dealing with borrowers who have defaulted on mortgage payments. The Mortgage Rights (Scotland) Act 2001 (asp 11) amended the 1970 Act by enhancing borrowers' rights in relation to those routes
- Rates of mortgage arrears and court actions for repossession increased in 2008 at a UK level (with the rise in court actions for repossession being particularly steep)

- The Scottish Government and the UK Government have responded to concerns about increasing levels of mortgage repossessions with a wide range of policy measures. There has been debate in Scotland about further measures that might be required
- Official statistics on evictions due to rent arrears are either not available (the private sector) or not up to date enough to reflect the impact of the current economic climate (the social rented sector). This makes it difficult to establish whether the economic downturn has caused, or will cause, an increase in the number of evictions from rented property
- There is ongoing debate about whether the current levels of evictions from social rented housing in Scotland are at a reasonable level
- At a UK level the Council of Mortgage Lenders recently reported that landlords with buy-to-let mortgages are now falling behind with their mortgage repayments more quickly than owner occupiers. This will have an impact on private sector tenants but the issue has so far not attracted much attention in Scotland

## PERSONAL DEBT

This section of the briefing considers the topic of 'personal debt', ie debt owed by individuals. Debt owed by companies is outwith the scope of the briefing.

### WHAT ACTION CAN A CREDITOR TAKE IN RELATION TO A DEBT?

A creditor will typically use informal methods of debt collection in the first instance, such as sending warning letters or negotiating with the debtor. The creditor also has the option of raising a formal court action for repayment and this avenue is usually pursued in a minority of cases where other methods of recovery have failed and where it is considered financially worthwhile to do so. Such actions are normally raised in the sheriff court with the type of court procedure used depending on the value of the debt (eg the small claims procedure is used for debts up to £3,000).

Once a court decree for payment of the debt has been granted in favour of the creditor, the creditor can use 'diligence' to recover the debt. 'Diligence' in Scots law refers to the range of legal procedures that provide the means to recover a debt. Key pieces of recent legislation on this topic are the Debt Arrangement and Attachment (Scotland) Act 2002 (asp 17) ('the 2002 Act') and the Bankruptcy and Diligence (Scotland) Act 2007 (asp 3) ('the 2007 Act').

Popular types of diligence, or debt enforcement procedures, are outlined below:

#### The main debt enforcement procedures

##### Earnings arrestment

Requires employer, whilst the arrestment is in effect, to deduct a sum from the employee's net earnings on every pay-day, the sum being calculated in accordance with a statutory table.

##### Bank arrestment<sup>1</sup>

Allows the creditor to freeze the money in the debtor's bank or building society account so that it cannot be removed. The bank or the building society does not have to release to the creditor the sum owed unless the debtor consents or the court orders it. Consent by the debtor enables him or her to access the account again and avoids the cost of further court action. Once the debt is paid any surplus funds are released for the debtor's use.

##### Attachment

Introduced by the 2002 Act. Prevents sale by the debtor of items of property which he or she owns and allows their subsequent removal from the debtor's premises and ultimate sale at auction by the creditor to recover the sum due. Unless an exceptional attachment order has been granted (see below) only items belonging to the debtor kept outside his or her home can be attached, eg business assets or property kept in the debtor's driveway.

##### Exceptional attachment order

Also introduced by the 2002 Act. Where this court order is granted, items in a debtor's home can be attached, removed and ultimately sold at auction to recover the sum due by the creditor. Only 'non-essential assets' can be targeted and, as the name of the order suggests, the creditor has to persuade the court that exceptional circumstances apply before the order will be granted.

<sup>1</sup> Other than arrestments affecting earnings, arrestments are almost always of bank or building society accounts. However, in principle an arrestment can be of any property belonging to the debtor which is held by a third party.

Where the creditor is a local authority (eg where there are council tax arrears) or HM Revenue and Customs these bodies can use 'summary warrant procedure', followed by diligence, to recover the debt. Summary warrant procedure involves an application to the court but, unlike the procedure with other debts, there is no court hearing and there is no opportunity for the debtor to apply to the court for more time to pay the debt before the warrant is granted (for more on the rules relating to time to pay see further below). This procedure simplifies the process of enforcing debts for government bodies which deal with a very large number of debtors.

Depending on the nature of the debt, a creditor may also have options other than the standard debt recovery procedures described above. These include repossession (in respect of mortgage arrears), eviction (in respect of rent arrears)<sup>2</sup> and applying to have the debtor made bankrupt or entering into a protected trust deed with the debtor (which is similar to bankruptcy). These other options are considered in more detail in later sections of this briefing.

## **WHAT CAN A DEBTOR DO WHEN FACED WITH REPAYMENT DIFFICULTIES?**

When faced with repayment difficulties, there are a number of things a debtor can do to prevent matters escalating to the stage where formal debt recovery methods are used or to halt the progress of such enforcement action. These are considered below.

### **Seek debt advice**

Free, confidential and impartial debt advice can be obtained from the following sources:

- Money Advice Scotland: [www.moneyadvicescotland.org.uk](http://www.moneyadvicescotland.org.uk)
- Citizens Advice Scotland: [www.cas.org.uk](http://www.cas.org.uk)
- Scottish Debtline: [www.scottishdebtline.co.uk](http://www.scottishdebtline.co.uk)
- National Debtline: [www.nationaldebtline.co.uk](http://www.nationaldebtline.co.uk)

### **Negotiate with creditors**

Either independently or with the assistance of money advisers or debt counsellors, a debtor can enter into a 'debt management plan' which is an informal arrangement with creditors to pay off debts over an extended period of time. These types of arrangement are very common. However, such an arrangement is not legally binding on creditors so the option of formal court action remains open to them.

### **Debt Arrangement Scheme**

A debtor with multiple debts and sufficient surplus income from which to pay some of his or her debts has the option of entering into a 'debt payment programme' under the 'Debt Arrangement Scheme'. This is a formal arrangement which gives a debtor more time to pay several creditors, without the threat of court action. More information on the scheme, including a list of approved money advisers for the scheme, can be found on the Government's Money Scotland website: [www.moneyscotland.gov.uk](http://www.moneyscotland.gov.uk) (not to be confused with the website of [Money Advice Scotland](http://www.moneyadvicescotland.org.uk)).

### **Protected trust deeds and bankruptcy**

A debtor can also pre-empt any action that a creditor might take and apply to be made bankrupt or can seek to enter into a 'protected trust deed' with his creditor. These topics are discussed further under 'Bankruptcy' below.

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<sup>2</sup> Although this only prevents future arrears – it is not a method of addressing existing arrears.

## Time to pay and time orders

'Time to pay directions' and 'time to pay orders' provide a debtor with the opportunity to apply to the court for more time to pay once formal enforcement action has commenced.<sup>3</sup> Once time to pay has been granted, diligence and bankruptcy actions cannot proceed. Most types of debt under £25,000 qualify for time to pay, although not hire purchase or mortgages. The 2007 Act brought debt relating to local government taxes within its scope for the first time.

As an alternative to a time to pay, a 'time order' can be applied for if a debtor has fallen behind on payments relating to a loan agreement regulated by the Consumer Credit Act 1974 (c 39) (but not in relation to other types of debt). A time order can give the debtor more time to pay *and* alter the terms of the loan, eg vary the interest rate charged. Although a potentially useful tool for debtors, applications for time orders are not common in Scotland.

## IMPACT OF THE DOWNTURN

A likely consequence of the economic downturn is that people will experience greater difficulty in repaying their debts. Unfortunately Scottish statistics on this topic are difficult to obtain. The Scottish Government collects (but has not published since 2002) a range of statistics relating to the different types of court orders associated with debt recovery. However, figures for all of 2008 are not yet available and, in addition, the Scottish Government has expressed doubt about the accuracy and reliability of the data which was collected prior to April 2008.

At a UK level, current personal debt levels are historically high. In the third quarter of 2008 the total amount of consumer credit debt outstanding in UK households (excluding mortgage debt totalling £1.2 trillion) was around £237 billion. This represents an increase of around 9% on the third quarter of 2007 and is also around 33% higher than the equivalent figure for the third quarter of 2003 (Office for National Statistics 2009).<sup>4</sup>

A survey of British households for the Bank of England reported that in 2008 there had been an increase in the number of households reporting that they were experiencing difficulty in keeping up with payments on their debts and other commitments, although this remains well below the peak levels recorded in the early 1990s. Difficulties in servicing debts were attributed to higher than expected household bills and the rising cost of essential items such as food. However, whilst around a third of households said they struggled from time to time, the number of households actually admitting to falling behind with bills or credit commitments was relatively small at around 3%. The survey also found little evidence to indicate that households were increasing their borrowing to cope with these pressures (Hellebrandt *et al* 2008).

## POLICY INITIATIVES

In 2008-09 the Scottish Government introduced various measures which are intended to address the needs of individuals experiencing financial difficulties in the current economic climate. These include:

- £382,000 to support a television and online campaign to raise awareness of the telephone helpline, [National Debtline](#) (Scottish Government 2008b)

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<sup>3</sup> A 'time to pay direction' will be applied for where a court action for payment has commenced but before a decree for payment has been granted. On the other hand a 'time to pay order' will be applied for after a court decree for payment has been granted and can be used even where a diligence process has started. Note that time to pay is only appropriate in respect of single debts. Where there are multiple debts entering into a Debt Arrangement Scheme is appropriate.

<sup>4</sup> The figures used are seasonally adjusted.

- an additional £3 million to enhance the capacity of legal advice services, including the In-Court Advice Service operating in sheriff courts, with the intention of supporting those who are facing a court hearing as a result of debt problems (Scottish Government 2008d)
- an extra £1 million for Citizens Advice Bureaux to increase the capacity of face to face debt advice services (Scottish Government 2009a)
- the creation of a Debt Advice Forum to examine information on debt relief and debt advice and recommend a package of legislative and non-legislative measures to tackle the issue. Analytical reports on debt, insolvency and repossessions are to be produced to support its work (Scottish Parliament 2009; Scottish Government 2009b)

## **BANKRUPTCY**

### **THE LEGAL FRAMEWORK**

The winding up, liquidation and receivership of limited companies and limited liability partnerships are matters largely reserved to the UK Parliament and are not, therefore, considered as part of this briefing. Insolvency of individuals, ordinary partnerships and some public bodies (such as universities) are matters devolved to the Scottish Parliament.

The Bankruptcy (Scotland) Act 1985 (c 66) ('the 1985 Act') sets out the overarching legal framework for bankruptcy. It was reformed by the Bankruptcy (Scotland) Act 1993 (c 6) and, more recently, by the Bankruptcy and Diligence etc. (Scotland) Act 2007 (asp 3) ('the 2007 Act'). In particular, the 2007 Act modernised the laws of personal bankruptcy (and diligence), aimed to strike a better balance between the rights of creditors and debtors and support business risk. The bankruptcy provisions within the 2007 Act came into effect on 1 April 2008.

Insolvency occurs where a person or company cannot pay their debts. There are two procedures for taking possession of and distributing a debtor's estate in order to meet the demands of creditors. These are:

- I. sequestration (usually called 'bankruptcy') and
- II. protected trust deed.

### **Sequestration**

'Sequestration' describes the legal process where the court takes control of property for the benefit of creditors. To say someone is 'bankrupt' is nearly always meant to mean that they have been sequestrated under the 1985 Act.

A creditor who is owed at least £3000 can petition a court seeking sequestration (it is also possible for two or more creditors to apply together). The creditor can apply either at a local Sheriff Court or at the Court of Session in Edinburgh. Self-sequestration is also an option in certain circumstances.

When sequestrated, a debtor is subject to various restrictions. In particular the debtor is barred from asking for more credit without disclosing their bankruptcy to the lender. These restrictions are lifted when the debtor is discharged. The 2007 Act changed the standard discharge period from three years to one year.

In most cases the court appoints the Accountant in Bankruptcy to be trustee. A trustee is appointed to safeguard a debtor's estate and generally administer the sequestration process. The Office of the [Accountant in Bankruptcy](#) is an Executive agency that oversees the insolvency process in Scotland. Since 1 April 2008, the Accountant in Bankruptcy has been appointed trustee in 9850 cases representing 91% of all bankruptcies awarded that year. The Accountant in Bankruptcy is deemed to be trustee in all bankruptcies awarded through the 'Low Income, Low Assets' procedure (LILA) (see further below).

If the debtor is a homeowner, they will have to hand over their interest in the house to the trustee. The trustee may sell the property. However, the 2007 Act provides for the ownership or other right in a debtor's family home, which is part of the sequestrated estate, to be returned to the debtor if the trustee has not taken any action in relation to that property within 3 years of the date of sequestration.

### **Protected trust deed**

The protected trust deed is considered to be a less formal, less costly and less time consuming alternative to sequestration. Under this procedure, the debtor signs a contract (trust deed) to pay the creditors as much as the debtor can afford. The trustee then gathers in assets and pays a dividend in much the same way as a sequestration. The trustee would typically be an insolvency practitioner.

There are fewer restrictions placed on a debtor who grants a trust deed and it is considered, therefore, a gentler alternative to sequestration. Other benefits of a protected trust deed include:

- the trustee handles all correspondence from creditors, relieving the pressure on debtors
- more flexible and less costly to administer than sequestration
- creditors cannot add further interest, charges, or take any further action against debtors
- debtors can, in most cases, continue to hold certain public offices
- debtors can remain self-employed and continue to serve as a director of a company
- information about the protected trust deed is not published (unlike sequestration)

Creditors have the right to receive any equity on a debtor's home, however, there are ways that a debtor can protect his or her property. Debt is paid off over a specified period of time (normally 3 years) and monthly payments based on what the debtor can afford are normally arranged. After the period of the protected trust deed, any remaining debt is written off.

### **Low Income, Low Asset Debtors**

The Low Income Low Assets (LILA) procedure was introduced in April 2008 and provides an alternative route into bankruptcy. It removes the need for debtors who meet the LILA requirements to demonstrate 'apparent insolvency' – which uses certain court documents to show that they have failed to pay their debts. This process is intended to provide relief for debtors who were in a debt trap where they could not pay their debts but, because they lacked sufficient income or assets, no creditor had taken court action and they were therefore prevented from demonstrating their apparent insolvency.

To be regarded as having low income, a debtor must meet be in receipt of less than the current national minimum wage based on a forty hour working week (currently £229.20) or in receipt of certain benefits. To meet the low assets criterion a debtor must not have:

- any property

- any single asset worth more than £1,000
- total assets worth more than £10,000

All debtors who wish to make themselves bankrupt using this process are required to apply to the Accountant in Bankruptcy. The LILA application is made in exactly the same way as any other debtor application, and a £100 fee must be paid for all applications.

On 19 February 2008, the Justice Committee debated the draft Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc) Regulations 2008 (which commenced this scheme). During the debate the following concerns were raised by MSPs:

- people may see the system as an easy way to rid themselves of debt, and may accrue debts that they have no intention of paying and then make themselves bankrupt; and
- the credit industry will cease lending because a large section of society may declare bankruptcy

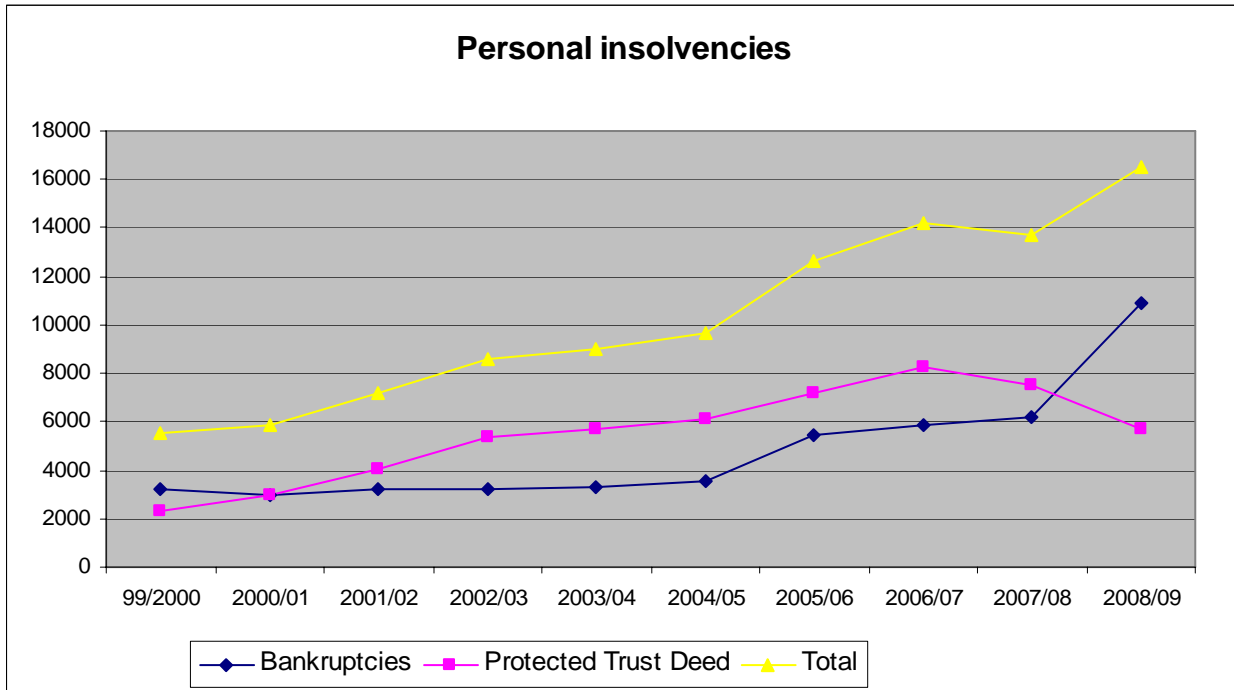
In response to these concerns, the Cabinet Secretary for Justice assured the Committee that a review would be carried out after the scheme had been in operation for four months and again after one year. The [review](#) found that there had been no identified instances of deliberate abuse and did not, therefore, recommend any significant changes to the LILA procedures (Accountant in Bankruptcy 2008).

## **IMPACT OF THE DOWNTURN**

Section 19 of the 2007 Act limits to three years from the date of sequestration the time during which the trustee can insist on their claim to the family home. Previously, creditors were entitled to wait as long as they wanted in the hope, perhaps, of some speculative gain being realised in a later sale. In the current economic climate, creditors may prefer to wait for market conditions to improve before making any claim on a family home but are limited, by the 2007 Act to waiting for a maximum period of three years.

There has been an increase in the number of individuals and partnerships that go bankrupt in most years since 1999 (see Figure 1 below). In the third quarter of 2008/09, there were 5807 individual insolvencies in Scotland. This represented a decrease of 3% on the previous quarter but an increase of 75% on the same period in 2007/08 (Accountant in Bankruptcy 2009). In the total there were 3970 bankruptcies, a decrease of 2% on the previous quarter but a 154% rise on the corresponding quarter of 2007/08. This increase in bankruptcies is attributed by the Accountant in Bankruptcy to the introduction (on 1 April 2008) of the new route into bankruptcy for people who have low income and low assets (see above) rather than being a consequence of the economic downturn.

**Figure 1: Personal Insolvencies in Scotland**



Source: [Accountant in Bankruptcy Annual Reports](#) (figures for 2008/09 to end Q3, [Accountant in Bankruptcy 2009](#))

## BUYING AND SELLING A HOME

This section of the briefing explains the legal process for buying and selling a residential property in Scotland and considers some of the issues that may be of particular relevance within the context of the current economic downturn.

## THE LEGAL FRAMEWORK

### Home Reports

The Housing (Scotland) Act 2006 (asp 1) provides that certain documents have to be made available when a house is marketed for sale in Scotland and gives Ministers power to set regulations about what those documents are.<sup>5</sup> The Housing (Scotland) Act 2006 (Prescribed Documents) Regulations 2008 stipulates that those documents must contain:

- **single survey** which gives the condition and value of the property and which must be carried out by a qualified chartered surveyor
- **energy report** which contains a house's energy efficiency rating and carbon dioxide emissions
- **property questionnaire** which includes general information such as a property's council tax band, factoring arrangements, the existence of any local authority notices and information about alterations that have been made.

Since 1 December 2008, the majority of property sellers who put their homes on the market for sale must provide a Home Report for potential buyers.

<sup>5</sup> SPICe briefing [The Home Report](#) (Berry 2008) provides full background to the scheme.

The cost to the seller of a Home Report at any given time is determined by the market. The Law Society of Scotland estimated that the cost was likely to be between £400 and £800 and the Royal Institution of Chartered Surveyors ('RICS') suggested a figure of between £500 and £700 (Law Society of Scotland 2008b; RICS 2008). These estimates make the cost of a Home Report broadly equivalent to a Scheme 2 survey under the system that existed prior to 1 December 2008.

## The conveyancing process

Once a decision has been taken to purchase a property in Scotland, the mechanism for acquiring it is essentially a three stage process. It is only on completion of the third stage that ownership of the property legally changes hands. The three stages are as follows:

- **Stage 1 - contract:** the parties enter into a contract, commonly known as 'the missives'
- **Stage 2 - conveyance:** the formal deed transferring the land, along with the keys to the property, is delivered by the seller to the purchaser in exchange for the purchase price
- **Stage 3 - registration:** the conveyance or disposition is registered in the Land Register

## Contractual obligations

The missives relating to a house sale are generally governed by the ordinary common law rules of contract. Missives typically include specific penalty clauses in the event of breach of contract which may ultimately be enforced through the courts. The purchaser's contractual obligations to the seller under the missives include paying the purchase price on the due date. Failure by the purchaser to pay the purchase price on the due date does not necessarily entitle the seller to immediately rescind (terminate) the contract and some degree of latitude may be extended to a defaulting party. However, it is now standard practice for the seller's solicitor to insist on making 'time of the essence' in relation to payment of the purchase price on, or exceptionally within a short period of, the date of entry. Damages may be due for any consequential loss incurred by an innocent party due to the late performance of the purchaser.

Where the purchaser ultimately fails or refuses to pay the price, the seller may either sue to have the terms of the contract implemented or terminate the contract altogether. As trying to compel an unwilling purchaser to go through with a contract may cause more difficulties than it resolves, terminating the contract may be the favoured option, leaving the seller free to resell the property at the best price obtainable and, thereafter, to sue the original purchaser for damages. Damages may include the difference between the original and the resale price, plus expenses associated with the delay and resale. The seller should, however, make every endeavour to minimise any loss by reselling the property at the best possible price obtainable. Nevertheless, the costs associated with litigation may make such a course of action unattractive and the seller may ultimately be compelled to simply write off any such losses.

## Duty of solicitors

In residential property transactions, solicitors acting on behalf of both purchasers and sellers have a professional duty to conclude missives without undue delay. While solicitors require to have regard to the interests of their clients and to take their clients' instructions, they must also have regard to the principles of good professional conduct and may not accept an improper instruction (such as to delay the conclusion of missives to suit their clients' circumstances). They should not knowingly mislead professional colleagues and must act with fellow solicitors in a spirit of trust and co-operation (Law Society of Scotland 2002).

## IMPACT OF THE DOWNTURN

### Volume of house sales

[Statistics](#) from the Registers of Scotland indicate that the housing market in Scotland has slowed down significantly. The number of house sales registered in Scotland in the last quarter of 2008 (19,240) is 53.6% lower than in the last quarter of 2007 (when there were 41,458 sales). The number of sales for the last quarter of 2008 also represents a decrease of 23.2% on the third quarter of 2008 (when there were 25,042 sales).

### The impact of the Home Report

Even in benign economic conditions, there are risks associated with property transactions and these risks may be exacerbated during an economic downturn. The introduction of the Home Report scheme during the current downturn has been a source of particular controversy.

On one hand, the Scottish Government and bodies such as Consumer Focus Scotland argue that the introduction of Home Reports provide a range of clear benefits for consumers including (Scottish Parliament Local Government and Communities Committee 2008; BBC News 2008):

- buyers are generally spared the expense of multiple surveys (this was one of the main criticisms of the old system)
- first-time buyers no longer have to spend anything on surveys
- the Home Report provides better information for sellers and buyers about the condition and value of properties than was available previously

On the other hand, some commentators, including the Scottish Law Agents Society ('SLAS'), have argued that asking sellers to pay for a single survey up front has dissuaded some prospective sellers from bringing their property to the market and that this has caused a further loss of confidence in an already struggling housing market. The Royal Institute of Chartered Surveyors ('RICS') does not accept this, arguing that Home Reports have actually boosted buyer interest (BBC news 2009). Furthermore, a spokesman for Consumer Focus Scotland (which campaigned for Home Reports) recently observed:

"It is quite extraordinary, faced with the worst credit squeeze in a generation, fears of negative equity and some of the most worrying weeks for anyone in a job, to decide that blame for the fall in house sales should be pinned on home reports." (The Journal 2009)

In its response to a recent parliamentary question on home reports, the Scottish Government acknowledged their mixed reception amongst the legal profession but referred to evidence from RICS suggesting the current state of the property market was attributable to other factors (Scottish Parliament 2009b).

Another issue that has arisen in relation to Home Reports is whether, in the climate of falling house prices, the valuation part of the Home Report remains accurate for very long. Under the legislation the Home Report has no set 'shelf-life' as such but an individual seller can decide, with advice from their solicitor or surveyor, if parts of the Home Report need to be updated. The Law Society of Scotland has recommended to solicitors that they advise all clients against relying on a Home Report more than 12 weeks old (and some solicitors even indicated they would apply an eight or four week shelf life to the Home Report) (Law Society of Scotland

2008a; The Journal 2008).<sup>6</sup> This has particular consequences for buyers and sellers at present as a property may take many months to sell in the current climate. In response to questions about shelf-life, the former Minister for Communities and Sport recently argued that the valuation is only a small part of the detailed and useful information contained within a Home Report, most of which, he argued, will not go out of date quickly (Scottish Parliament Local Government and Communities Committee 2008).

The Government has stated that it will commission a review of the operation of home reports in December 2009 (Scottish Parliament 2009c).

### **Withdrawing from transactions**

One particular consequence of the current economic climate may be the increased incidence of parties pulling out of a house purchase due to a change in their financial circumstances. There may also be increasing incidence of delay in the conclusion of missives where, for example, a purchaser is still trying to sell his or her property. Indeed, the Professional Practice Committee of the Law Society has recently issued a [statement](#) to assist members in the interpretation and application of the [Avoidance of Delay in Concluding Missives](#) guidelines. However, even where a solicitor refuses to act where a purchaser wants to withdraw this will not necessarily help the seller. No one can force a purchaser to conclude the missives.

It is difficult to quantify the extent to which the current economic conditions are causing parties to pull out of house purchases. In a recent parliamentary answer on the number of cases of failure to complete legally binding house sales in the last year, the Minister for Communities and Sport indicated that such information is not held centrally (Scottish Parliament 2008a).

In the current economic climate, where a purchaser fails or refuses to pay the price agreed, the seller may not be able to resell the property at all, let alone achieve a satisfactory price. This raises the question as to the extent of the original purchaser's liability for damages.<sup>7</sup>

### **Negligence claims against solicitors**

In a recent Scots Law Times article, Robert Rennie (2008), Professor of Conveyancing at Glasgow University and partner of law firm Harper Macleod, suggested that negligence claims against solicitors are likely to increase during periods of economic downturn. He suggested, for example, that claims may arise over legal mistakes or over failure by the solicitor to disclose to the lender important information about the borrower. Professor Rennie also considered the binding nature of missives and the fact that the client does not generally have to sign them. In the current economic climate, purchasers may find themselves legally bound in missives of purchase but unable to sell their own house. In such circumstances the client may argue that their solicitor concluded missives without specific authority. Professor Rennie recommended, therefore, that solicitors should take particular care in recording their client's instructions and ensure they clearly understand the binding nature of missives in order to avoid future negligence claims.

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<sup>6</sup> It should also be noted that the statutory regulations relating to Home Reports provide that the survey must be prepared within 12 weeks before the property is put on the market in order to prevent the use of out-of date information in the first place.

<sup>7</sup> SPICe has not been able to identify any reported case of a seller seeking damages in such circumstances.

## **New build contracts**

Missives in relation to new build properties differ from normal missives. In particular, rather than the intended date of entry being stated in the missives, the date of entry is generally tied to the issue of a completion certificate or a satisfactory inspection by the local authority. In practice this means that the date of entry is flexible and missives are often concluded well in advance of the date of entry to the property. This raises particular issues during the economic downturn. Long delays may occur as developers struggle financially and the value of a property may fall between the conclusion of missives and the eventual date of entry.

Professor Rennie describes a case in which a purchaser concluded missives with a builder 18 months before the actual date of entry at a price of £450,000. The estimated date of entry was originally only nine months after completion of missives. In the intervening period, the purchaser found himself unable to sell and the builder was now offering the same type of house for only £375,000. The lenders threatened to withdraw and the purchaser was effectively tied to a property worth only £375,000 and had no funds from the sale of his own property. The purchaser blamed the builder for not completing the house in accordance within the original completion estimate (before the market fell). The question as to whether there can be implied into a builder's missive a material condition that the house will be completed within a reasonable time, Professor Rennie observed, will depend on the particular wording of the missives (Scots Law Times 2008).

## **MORTGAGE ARREARS AND REPOSSESSIONS<sup>8</sup>**

### **THE LEGAL FRAMEWORK**

#### **Routes to repossession under the 1970 Act**

The Conveyancing and Feudal Reform (Scotland) Act 1970 (c 35) ('the 1970 Act') provides lenders with three separate legal routes they can take when dealing with borrowers who have defaulted on mortgage payments. These are outlined below.

##### Calling-up notice

The calling-up notice is a letter from the lender to the borrower which has legal effect. It requires repayment of the whole debt within two months. If the borrower fails to comply, the power of sale emerges automatically. However, if the borrower fails to give up possession a court action is required to evict him or her.

##### Notice of default

Where a borrower has failed to comply with any of his or her obligations and the default is remediable, a Notice of Default may be served on the debtor by the lender requiring the default to be remedied within one month. The debtor may object but if no objection is made or the notice is upheld by the court there is a duty to comply with the Notice. If the borrower does not

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<sup>8</sup> This section of the briefing refers to 'repossession' and 'repossession actions' in relation to the process by which a lender enters into possession of a borrower's property with the intention of selling it, thus mirroring the terminology commonly used by those out with the mortgage industry. However, strictly speaking, it is more accurate to refer to 'possession' and 'possession actions', as the lender has not previously been in possession of the property. Those connected with the mortgage industry prefer the latter terminology.

comply the lender has a power of sale, although again a court action for eviction is required if the borrower refuses to leave.

The Notice of Default differs from the Calling-up Notice in that it does not require repayment of the whole debt and the borrower has an opportunity to object to the Notice. The Notice of Default also requires compliance within one month not two.

#### Warrant for sale

This is an application by the lenders to the court stating that the borrowers are in default and asking for permission to sell the property and evict the borrowers (if the latter are still in possession). Whilst this procedure can be used on its own, it is also often used in conjunction with the service of a Calling-up Notice or a Notice of Default.

### **The effect of the Mortgage Rights (Scotland) Act 2001**

The 1970 Act was amended by the Mortgage Rights (Scotland) Act 2001 (asp 11). This did not alter the legal routes available to lenders but did significantly enhance borrowers' rights in relation to those routes. In respect of properties used as the borrower's sole or main residence, the 2001 Act makes provision for the borrower (and other specified parties with an interest) to be able to apply to the court for enforcement action to be suspended. The court will grant a suspension when it considers it reasonable in all the circumstances, taking into account factors including the nature of and reasons for the default and the availability of the applicant (and other residents of the property in question) to secure reasonable alternative accommodation. A successful application for suspension provides an opportunity for the borrower to repay mortgage arrears and retain possession of the house. At the very least it can give a borrower and his or her family an opportunity to arrange alternative accommodation.

## **IMPACT OF THE DOWNTURN**

### **Trends in mortgage arrears and repossessions**

A critical issue is what impact the economic downturn is having on levels of mortgage arrears and repossessions. Unfortunately published statistics applicable only to Scotland are not available.

At a UK wide level, the latest set of statistics published by the Financial Services Authority ('FSA') indicates that in the third quarter of 2008 there was a sudden increase of 10% in the number of new mortgage arrears cases.<sup>9</sup> It had remained constant at around 54,000 cases per quarter since early 2007 but in the third quarter of 2008 there were around 60,000 cases. Consumers are increasingly struggling to clear their arrears and consequently the total number of mortgage accounts in arrears is increasing. At the end of third quarter of 2008 the FSA report that there were around 340,000 loan accounts in arrears, an increase of 10% on the second quarter of 2008 and 24% up on the position a year earlier.

The FSA statistics also show that the number of new repossession cases (ie cases where the mortgage lender has obtained a court order authorising it to take possession of the borrower's property) has increased significantly since the third quarter of 2007 with the 13,161 new cases in the third quarter of 2008 being 92% higher than the year earlier.

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<sup>9</sup> The FSA defines a 'reportable arrears case' as one where the amount of the actual arrears is 1.5% or more of the borrower's current loan balance. Assuming a mortgage interest rate of around 6%, this threshold is roughly equivalent to being three months in arrears.

The Council of Mortgage Lenders ('CML') publishes [forecasts](#) for the UK mortgage sector and is predicting that there will be 75,000 repossession cases in 2009, up from the 40,000 it [recorded](#) in 2008 (CML 2009a). (Note that the CML's and FSA's figures are not directly comparable due to differences in the way the data is collected).

## **Lenders' practices**

Another important issue is the extent to which lenders' practices have been affected by the economic downturn and in particular whether lenders are still complying with the regulatory requirements designed to ensure that borrowers are treated fairly.

In August 2008, the FSA published its [findings](#) from a review of mortgage arrears and repossessions handling (FSA 2008). It found that mainstream lenders were largely complying with FSA requirements and treating customers fairly. However, it had particular concerns about some of the practices of some 'specialist lenders', a category of lenders which includes those who lend to individuals with impaired credit and who provide buy-to-let mortgages. The CML's [response](#) (2008) expressed surprise at the FSA's observations and encouraged the FSA to engage in further dialogue with those lenders.

In the latter half of 2008 Northern Rock, the first UK bank to be taken into temporary public ownership, was attracting criticism from several sources for its allegedly high rates of repossessions compared to other mainstream lenders. In December 2008, Northern Rock announced that it would increase the threshold at which it initiates repossession proceedings from three months' mortgage arrears to six months. Royal Bank of Scotland (including its subsidiary NatWest) and Bradford and Bingley also made announcements to the same effect. Around the same time, the UK Government also secured from the major mortgage lenders a separate, but more modest, repossession pledge (see further below under 'UK Government initiatives').

## **POLICY DEVELOPMENTS AND DEBATE**

### **Scottish Government Initiatives**

The 2001 Act (discussed above) represents the main legislative response to Scottish homeowners facing difficulties with their mortgage repayments. The other main policy initiative, pre-dating the economic downturn, is the Mortgage to Rent Scheme. Under this scheme, a social landlord can buy the home of a household facing repossession and rent it back to them. An evaluation of the Mortgage to Rent Scheme was recently published (Scottish Government 2009d; Scottish Government 2009e). It concluded that in many respects the Scheme had been relatively successful, but identified a number of causes for concern. In January 2009 the Scottish Government announced a number of changes designed to improve the Scheme (Scottish Parliament 2009).

In June 2008, in response to worsening economic conditions, the Cabinet Secretary for Health and Well-being announced the launch of a Home Owners' Support Fund, with a budget which was subsequently increased in January 2009 to £35 million over two years to cope with increasing demand. Part of this fund supports the improved Mortgage to Rent Scheme and part of this fund supports a Mortgage to Shared Equity Scheme which helps homeowners facing financial difficulties, and who have built up a level of equity in their property, to retain their ownership by reducing the level of debt secured against their home to a more manageable

level.<sup>10</sup> The improved Mortgage to Rent Scheme and the Mortgage to Shared Equity Scheme have been open for applications since 16 March 2009 (Scottish Government 2008b; Scottish Government 2009c; Scottish Parliament 2009).

The Debt Advice Forum recently created by the Scottish Government has a sub-group looking specifically at the issue of repossessions and in particular whether further reform is required (Scottish Government 2009b; Scottish Parliament 2009).

On 1 April 2009, section 11 of the Homelessness etc (Scotland) Act 2003 (asp 10) was brought into force. This provides that lenders will be required to inform the relevant local authority when they bring a court action relating to repossession of a property. This will give local authorities early notice of households who might be at risk of homelessness and allow them to provide appropriate advice and assistance.

## **UK wide initiatives**

The UK Government has launched several initiatives with a UK wide application designed to assist those who may have difficulties paying their mortgage.

In September 2008, the UK Government announced temporary changes to strengthen the Support for Mortgage Interest Scheme which helps people on Income Support, income-based Jobseeker's Allowance, income-related Employment and Support Allowance and Pension Credit if they are experiencing problems with interest payments on their mortgage. The changes took effect from January 2009 (Department of Work and Pensions 2009).

In December 2008, the UK Government also announced its proposed Homeowner Mortgage Support Scheme (not to be confused with the separate Scottish Government initiative of a similar name). Under the scheme households who fall into arrears as a result of sickness, redundancy or loss of income will be able to defer part of their interest payments for up to two years. In turn the deferred payments would be rolled up into the mortgage to be repaid once the borrower is back on his or her feet. The scheme commenced on 21 April 2009. Further information about the scheme is provided on the Department of Communities and Local Government's [webpage](#).

In the latter half of 2008 the UK Government was involved in negotiations with major mortgage providers and secured agreement, announced in November 2008 in the pre-budget report, that these providers would wait three months after an account fell into arrears before initiating repossession proceedings (HM Treasury 2008).

The economic downturn has also thrown the spotlight in policy terms on the 'sale and rent back' sector. 'Sale and rent back' (also known as 'sale and lease back') is a relatively new type of property arrangement which involves individual homeowners selling their property at a discount to a private company in return for the option to remain in the home as a tenant of that company. These arrangements are likely to be taken up by individuals in financial difficulties facing possible repossession of their homes (but should not be confused with government led schemes described above). Following a recent Office of Fair Trading (2008) [report](#) which was critical of current practices, the FSA (2009) published a [consultation paper](#) in February 2009 setting out proposals for regulation of the sector. In this the FSA states it intends to have an interim regime in place by summer 2009 and full regulation by the second quarter of 2010.

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<sup>10</sup> The Mortgage to Shared Equity Scheme is not to be confused with existing shared equity schemes offered by the Scottish Government to help first time buyers own a home on a more affordable basis by only paying for part of it.

## Debate over other measures required

### Pre-action Protocol in England and Wales

In October 2008 in relation to England and Wales a Pre-action Protocol relating to disputes over mortgage payments and arrears was introduced. It is designed to ensure that a repossession claim is only used by the lender as a last resort. The absence of an equivalent Protocol in Scotland has been criticised for leaving Scottish homeowners more vulnerable than their southern counterparts and the campaign for reform has united opposition parties at Holyrood. In response, the Scottish Government has pointed to other Scottish policy initiatives. It also endorsed the view of the CML that Scottish homeowners are sufficiently protected because of the requirement on all UK lenders to comply with the FSA's regulations and the existence of the CML's own industry guidance, both of which encourage repossession actions only as a last resort. The Scottish Government has, however, also promised to keep the situation under review (Scottish Parliament 2008a).

### Legal aid

The availability of legal aid in Scotland for defending repossession actions and, in particular, the Scottish Legal Aid Board's application of the 'preservation of property' rule is another issue which has been the subject of recent parliamentary debate. This is the rule that, if as a result of a court action funded by legal aid, an individual keeps property that someone is trying to take from him or her, he or she may subsequently become liable for some or all of his or her solicitor's fees (with no contribution from the Board or a lesser contribution than would otherwise have been the case).<sup>11</sup> The policy justification for this rule is that the successful litigant has retained an asset which could be sold in order to pay his or her legal fees. However, it has been argued by some campaigners that individuals who defend mortgage repossession actions are unlikely to be in a position to pay the sum due (or obtain a loan to do so) and this acts as an effective deterrent to bringing such actions in the first place (Govan Law Centre 2008).

The Scottish Government recently increased the financial eligibility limits for civil legal aid, meaning that more people will be potentially eligible for financial help than was the case previously (Scottish Government 2008c). However, in relation to the specific concerns raised in relation to mortgage repossessions, the Scottish Government has said it will keep the situation 'under review' but has defended the status quo by reference to the free and subsidised legal advice currently available through the legal aid scheme, the in-court advice service and the voluntary sector (Scottish Parliament 2008b)

## RENTED HOUSING

### SOCIAL HOUSING

Since the Housing (Scotland) Act 2001 (asp 10) ('the 2001 Act') came into force, the majority of social housing, whether run by local councils or housing associations, is subject to a single type of tenancy agreement, namely the Scottish Secure Tenancy (SST). However, some tenants, usually in certain types of supported accommodation may have a Short Scottish Secure Tenancy or an occupancy agreement.

With a SST the tenant has the right to stay in the property even after the date has passed which is stipulated in the lease as the expiry date. To bring the lease to an end against the wishes of the tenant the landlord must raise court proceedings for recovery of possession, citing one of

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<sup>11</sup> Although payment by instalments is possible and payments can be delayed until the house is sold.

the statutory grounds of termination, and give the tenant a minimum of four weeks written notice of its intention to raise these proceedings.

One ground for the recovery of possession is that rent is due from the tenant but has not been paid. However, the court does have the power to adjourn proceedings (with or without imposing conditions) and one common use of this power is to allow the tenant time to pay the outstanding rent due. Furthermore, the court has discretion to refuse to grant an order even where a ground of termination exists.

## **PRIVATE SECTOR HOUSING**

In the private sector, the two main types of tenancy are 'assured tenancies' and 'short assured tenancies', both regulated by the Housing (Scotland) Act 1988 (c 43) ('the 1988 Act').<sup>12</sup> The majority of tenants have short assured tenancies.

### **Assured tenancies**

As is the case with SSTs, tenants under assured tenancies have a right to remain in the property after the period stated in the lease document has expired and can only be compelled to leave the property if the landlord brings a successful court action based on one of the grounds set out in the 1988 Act.

The grounds of termination for assured tenancies are a mixture of mandatory ones, where the court must grant an order in favour of the landlord if it finds the ground of termination exists, and discretionary grounds, where the court does have a measure of discretion in granting the order, as it must only be granted where the court considers it reasonable to do so.

#### **Mandatory grounds**

There are two mandatory grounds of particular relevance during the economic downturn. In the first place, if the landlord has defaulted on its obligations in respect of any mortgage over the property (eg there are mortgage arrears) and the bank or building society wishes to sell the property with vacant possession, the court must order the tenant to leave.

Secondly, if there is a specified number of months' rent in arrears, both at the date of service of the notice on the tenant relating to the court proceedings and at the court hearing itself, this constitutes a mandatory ground of termination (with the actual amount that must be owed for this ground to be satisfied depending on how often the rent is payable). Significantly, other than where there has been a delay in paying housing benefit to the tenant and this is not the tenant's fault, the court cannot take into account any mitigating circumstances. The only leeway allowed is that the tenant has an opportunity to bring arrears below the level of arrears that triggers the ground being satisfied during the period prior to the date of the hearing.

#### **Discretionary grounds**

There are also two discretionary grounds of termination relating to rent. One ground covers the situation where the rent has been persistently late (whether or not there is rent due at the date of the hearing itself) and the other covers rent arrears which do not qualify under the mandatory ground described above.

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<sup>12</sup> Whilst most private sector tenancies are assured tenancies or short assured tenancies, some 'regulated tenancies' continue from the regime that existed prior to the enactment of the 1988 Act. In addition, a minority of private sector tenants are 'unprotected tenants', ie they are not assured, short assured or regulated tenants.

Where the court action is based on any of the discretionary grounds of termination, the court has the power to delay proceedings, including adjourning the case. However, where it does adjourn the case, the court is required to impose conditions with regard to the payment of any arrears (or any other condition it sees fit) unless this would cause exceptional hardship or would otherwise be unreasonable.

### **Short assured tenancies**

The short assured tenancy is a special type of tenancy where the landlord has an absolute right to recover possession of the property after the period stated in the lease has expired. In order to qualify as a short assured tenancy, the initial period of the lease must be for at least six months and the tenant must have been given written notice in advance that tenancy was to be short assured tenancy.

After the initial period of the lease has expired, the tenants must rely on the landlord being willing to renew the lease, either expressly or by the legal doctrine of 'tacit relocation' operating. (Tacit relocation is where the law presumes, in the absence of evidence to the contrary, that the parties have silently agreed to renew the lease.) However, to evict a tenant the landlord must still follow procedures prescribed by statute which include the requirement to give the tenant at least two months' notice of the landlord's intention to evict.

Furthermore, if the landlord wants to evict a tenant *during* a short assured tenancy he or she must be able to satisfy one of the grounds prescribed by the 1988 Act. These include the mandatory and discretionary grounds described above under 'Assured Tenancies'.

### **IMPACT OF THE DOWNTURN**

An important issue is whether the economic downturn has caused, or will cause, an increase in the number of evictions from rented property due to rent arrears.

Official statistics on evictions due to rent arrears from properties owned by private landlords are not collected for Scotland. However, at a UK level the CML (2009b) has [reported](#) that landlords with buy-to-let mortgages are now falling behind with their payments more quickly than owner occupiers. It could be argued, therefore, that these landlords may be more likely to be repossessed than other borrowers. This will have an impact on tenants who may be required to move out of the property when it is repossessed by the mortgage lender.

For the social housing sector, statistics are collected (but not regularly published) by the Scottish Housing Regulator on evictions for non-payment of rent. Unfortunately the available statistics only go up to 31 March 2008 and so do not reflect the impact of the current economic climate. The historical data reveals that evictions increased rapidly in 2006/07 and 2007/08, with a rise of around 40% in 2006/2007 and a further rise of around 23% in 2007/08, bringing the total number of evictions for non-payment of rent in 2007/08 to 882 (Scottish Housing Regulator 2008).

### **POLICY DEBATE**

In December 2008, Shelter (2008) published [Evictions by Social Landlords in Scotland](#) which covered the period 2007-2008 and argued that current levels of evictions by social landlords demonstrate that eviction is not being used as a 'last resort'. The Scottish Federation of Housing Associations (2008) subsequently [disputed](#) the conclusions drawn from the available figures. However, in January 2009, Shelter launched a new [campaign](#) to reduce what it sees as unacceptably high levels of evictions by social landlords (Shelter 2009).

The recent [Housing and the Credit Crunch](#) report of the House of Common's Communities and Local Government Committee (2009) highlighted the issue of private sector tenants in England and Wales being evicted when their home is repossessed due to the mortgage arrears of the landlord and recommended better protection for this group. This issue has so far not attracted much attention in Scotland and the lack of data in this area makes it difficult to assess the extent to which it is happening.

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