Build-Out Indemnity Insurance

A Borrower's Guide

Key information at a glance

• Build-out indemnity insurance may be taken out by your lender as additional security for itself.

• Build-out indemnity insurance does not cover you.

• You must repay all money owed under your mortgage whether the lender makes a build-out indemnity insurance claim or not.

What is Build-Out Indemnity Insurance?

Build-out indemnity is an insurance which your lender may take out for its protection. If the lender has to repossess your property during the construction/ renovation/conversion phase they will make a decision on whether to complete the project using the remaining drawdown funds available on your mortgage or sell the property in its current state. Market conditions together with professional advice at the time will determine which option the lender takes.

If the property is sold for less than the amount outstanding on your mortgage, your lender can claim on the build-out indemnity insurance to recover some (or all) of its loss. The basic security for the mortgage is your property and the build-out indemnity insurance, therefore, acts as a form of additional security for your lender. It is not, however, additional security for you.

What happens when a lender makes a Build-Out Insurance claim?

A lender can make a claim after it exercises its power of sale (i.e when the lender has actually sold the repossessed property) and the price obtained for your property is less than your outstanding mortgage. The difference between the amount the property was sold for and the amount of your outstanding mortgage is called a shortfall. When you take out a mortgage you make a legal obligation to repay all the money you owe under the mortgage.

The build-out indemnity insurance will cover your lender and in the event of a loss the insurer gains the right of "subrogation."

What is subrogation?

Subrogation means that the insurer can reclaim from you any money it has paid to your lender under build-out indemnity insurance which has been caused by a “third party”. In the case of build-out indemnity insurance, you, as the borrower, are the “third party” whose default led to your lender making the claim.

Either your lender or its insurer can take legal action against you to recover the shortfall if you do not repay it voluntarily, although any action would be taken in the name of the lender. In most cases, therefore, it is your lender who will contact you to recover the shortfall on behalf of itself and its insurer. This does not mean that the lender is claiming the debt twice; any money paid by the insurer which is collected from you will be passed back to the insurer. In some cases, however, the insurer may contact you direct.

The fact that your lender has build-out indemnity insurance does not mean that you are less likely to be pursued for the shortfall than if no build-out indemnity insurance arrangements are in place. In both cases, your promise to repay all of the money you owe applies and lenders (and insurers) have 12 years (6 in Scotland) in which to seek recovery from you and all of the money that you owe.

Some people say that Build-Out Indemnity Insurance covers me and enables me to escape from negative equity. How can I be sure that this advice is wrong?

Some advisors have misunderstood the nature of the build-out indemnity insurance and the wordings of build-out indemnity insurance policies, taking them to mean that build-out indemnity insurance covers borrowers. However, it is very clear, and has been confirmed by various cases in the courts, that this is not the case and that build-out indemnity insurance covers only your lender and does not affect your personal promise and responsibility to repay the loan. Consequently, you should be very wary of taking advice offered by any person or company that by simply handing your property back to your lender (known as “voluntary surrender”) you will be covered by your lender’s build-out indemnity insurance and so avoid the payment of any shortfall. As you can see, such advice is wrong. You would remain responsible for repaying any shortfall and your chances of obtaining another mortgage, or any form of credit, in the future may be severely reduced (for example, your name may be placed on the Council of Mortgage Lenders’ Possessions Register which most lenders check before granting a mortgage).

This information sheet is intended as a general guide and you should contact your lender for a fuller explanation, if necessary.

YOUR HOME MAY BE REPOSSESSED IF YOU DO NOT KEEP UP REPAYMENTS ON YOUR MORTGAGE