I can't pay my debts but have equity in my home. What should I do?

This leaflet looks at how you can potentially save money and offer a better deal to your creditors by proposing an Individual Voluntary Arrangement using the equity rather than waiting to be made bankrupt.

What is equity?

The equity is the difference between the value of your home and any loans secured against it. This could be a mortgage, a business loan or a 'charge' because you have not paid a debt and the Court has decided to grant the creditor security against your home. If you do not live alone, you may not own all the equity. For example, people in a formal long term relationship are usually expected to own half each unless shown otherwise.

What are creditors?

These are the people, companies or organisations you owe money. The most common ones are banks, credit cards, friends and HM Revenue & Customs.

What are bankruptcy and an IVA (Individual Voluntary Arrangement)?

Bankruptcy is when you or a large enough creditor realise you cannot pay your debts, and after legal process a Trustee is appointed to sell your assets (though some are not included) to pay your debts and the costs of the bankruptcy.

An Individual Voluntary Arrangement is an agreement between you and your creditors. You offer them an amount to clear your debts over a period of time (usually 5 years), and they hopefully they agree to do so. They may, however, decide that you can afford to repay more than you are offering, or introduce other assets into your offer above just monthly repayments. One such asset is the equity in your home (if there is any).

What if my debts are more than my share of equity?

If you owe more to your creditors than your share of the equity you are not likely to be able to keep the equity. If this is your only asset you may think it easier to go bankrupt. You will have to make monthly payments to a Trustee in Bankruptcy (though this will be for 3 years not 5). Your partner may be invited to buy your share of the equity, but the property may be sold if this cannot be agreed. They will then get their share of the proceeds, and your share will go towards paying your creditors. There are also restrictions on what jobs you can have and even though the stigma of bankruptcy has almost gone, some people prefer not to go bankrupt.

You can still offer an IVA, and an Insolvency Practitioner can help you make the decision which is right for you.

How much will my creditors want in an IVA?

In their ideal world, they will want all of your equity, but most of them realise that there has to be something left for you since if you go bankrupt they will probably get far less (though it will cost you more).

Creditors realise that you will not have the funds to offer the equity in your property, and will have to take out a loan. We suggest that you offer the maximum you would get from a loan against the property, up to your share of the equity. For example:

	£	£	£
Value of Home	150,000	200,000	250,000
Mortgage	(120,000)	(120,000)	(120,000)
Equity	30,000	80,000	130,000
Partner's half share	(15,000)	(40,000)	(65,000)
Your share	15,000	40,000	65,000
Maximum likely loan (75% of value)	112,500	150,000	187,500
Current mortgage	(120,000)	(120,000)	(120,000)
Possible loan	0	30,000	67,500
Offer to creditors (lower of your share and loan)	0	30,000	65,000
Your retained share of equity	15,000	10,000	0
Your partner's retained share of equity	15,000	40,000	65,000

As you can see, whilst there is equity in each example, in the first you would need to pay nothing, in the second less than your share of the equity but in the third all your share.

Remember that if creditors do not accept your IVA you may end up bankrupt.

In an IVA, you will only pay in enough to cover the costs of the procedure, and the creditors (with interest if appropriate). Remember, though, that as well as the equity in the property you will probably also be making monthly payments for 5 years (or until you get the loan). You will obviously have to repay the loan to release the equity!

What if my debts are less than my share of equity? What should I try to do first?

You are normally best advised not to enter a Voluntary Arrangement if you can avoid it. With interest rates still at a relatively low level, if you are able to get a secured loan (which you can afford), you are probably better off, but don't forget that interest rates may go up, so include a provision. This is because of the costs involved in a Voluntary

Arrangement and the requirement of many creditors that if you can pay their debt in full you should also pay interest at the statutory rate (currently 8% every year) out of the assets and contributions you make. Don't forget, though, that if you don't make payments on a loan secured on your home it could be repossessed!

What if I get turned down for a loan?

An Individual Voluntary Arrangement may still be the best solution, but the creditors will still want some (or all) of your share of the equity. Sometimes an IVA can get you the time you need to prove you can make the repayments so you can avoid selling or going bankrupt.

Why not just wait for someone else to do something?

As the worst case scenario, that thing will be bankruptcy.

It may help to look at the costs of an IVA or bankruptcy - we have made some reasonable assumptions including that the Trustee will charge on the lowest scale rate (they will usually charge a lot more). We have included a 'normal' 5 year IVA and one where the equity is enough to pay all the debts within a year, but due to pressure it was not possible to arrange a loan in time. Again there are several assumptions.

	Bankruptcy £	IVA 1 year £	IVA 5 years £
Debts due to creditors	45,000	45,000	45,000
Bankruptcy Petition Costs	2,250		
Official Receiver's Fee	2,775		
Insolvency Service General Fee	6,000		
Trustee in Bankruptcy's Fee	11,019		
Nominee's Fees and Disbursements		1,520	1,520
Supervisor's Fees		1,250	6,250
Bordereau	1,200	900	1,200
Other disbursements	559	66	80
VAT	2,503		
Funds Required	71,306	48,736	54,050

As you can see, if you have enough equity in the property to pay your creditors, the costs of bankruptcy can be very high. If you have £45,000 in creditors and a lot of equity you might need to pay more than £71,300 in bankruptcy, though this could be reduced to less than £48,750 through an Individual Voluntary Arrangement in which you raise funds within a year. Of course, if you do not have enough equity in the property, you will not have to pay as much.

What should I do?

Discuss your specific situation with your financial advisor or a Licensed Insolvency Practitioner, to make sure that you safeguard your home and do not pay over the odds.

The best advice may involve a remortgage, sale to save costs, sale and rent back or an Individual Voluntary Arrangement though bankruptcy may be the most appropriate for you.

The information in this leaflet is believed to be correct as at October 2016, but is general. Before acting upon it, you should seek the advice of a Licensed Insolvency Practitioner about your specific circumstances.

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