Second charge mortgages

Hayley Colenutt, managing director of specialist mortgage administrator firm Fi-Nest, asks whether the MCD could have included a house builder exemption

Whilst the government's 'Help-to-Buy equity loan' scheme will be exempt from the impending EU Mortgage Credit Directive (MCD), house builders will not be afforded the same exemptions.

The MCD is broadening the definition of a regulated mortgage contract to include all mortgages secured on a residential property. Second charge lending will therefore move from the Financial Conduct Authority's consumer credit regime to join the more rigorously regulated first charge lending, under the mortgage regime, on the 21 March 2016.

Whilst the consumer credit Regime is a robust system, I welcome this move, however, I believe further exemptions could have been included for a house builder to rely on.

House builders shared equity loans

A small, privately funded house builder first stepped into the world of 'second charge lending' in the early 1990s. The loan product was initially used as an incentive tool for the house builder's marketing team to generate increased sales over their competitors, albeit deferring an element of sales revenue to a later date. But they soon realised the greater benefit to the home buyer in that those with a smaller pot of savings were now able to get a first foot on the housing ladder.

The loan scheme worked and within 15 years the house builder achieved not only an increase in sales volume but also a portfolio of over 2,000 loans. Skip forward to 2005 and most of the large national house builders were starting to provide their own-brand second charge loan products, to date collectively amassing a back-book portfolio of tens of thousands of loans. These loans, most of which are 'fixed-share equity' loans act as the deposit for the home buyer, who can then source the balance from savings and a first mortgage provider. With a better interest rate and smaller monthly repayments due to the lower loan to value ratio, the home buyer is able to purchase far sooner than they would otherwise have been able to.

Since this loan repayment is based on a fixed percentage of the current market value, and is not due to be paid back until a set date in the future, or when the property is sold, the loan repayment strategy is low risk to the homeowner.

Government second charge shared equity

In 2009, in order to boost homeownership and to provide additional encouragement to house builders, the government partnered with the latter on their own 'second charge loan' scheme.

The first scheme, 'Home Buy Direct', was followed by a second, 'First-Buy', introduced in 2011. In both these schemes, now since concluded, the house builder loan element was regulated under the consumer credit regime.

Meanwhile, the current government offering, 'Help to Buy Equity Loan' which commenced in 2013, is classed as a "restricted public loan" and as such is exempt from the MCD. This scheme does not involve any lending on the part of the house builder and hence redemption of the loan is repayable to the government in its entirety.

Both house builder loans and the government scheme loans were, and are, provided to assist a buyer in affording their new home. The key characteristics that separate their products from other forms of second charge lending are that:

- They are acquired to assist the purchase of the new home, secured on the new property on the same date as the first mortgage and on the date of entry to the Land Registry.
- They do not carry monthly repayments.
- Charge 0 or below market interest rate after a set period of time.

Hayley Colenutt

Definition of seconds

These equity loans are clearly distinct from the majority of second charge lending, which is entered into by a homeowner after purchasing their property. They leverage the equity accrued and use it for such purposes as payday loans and consolidating debt, hence involving greater risk and higher interest rates for the homeowner.

The blanket inclusion of second charge lending into a stringent regulatory framework is clearly a good development in the main, designed to provide a single market for mortgages and also to protect consumers. However, to the house builder, categorising their lower-risk shared equity second charges in with the higher-risk products described above, seems rather like trying to crack a nut with a sledgehammer. Some of those higher-risk second charges are connected with the worst of consumer credit practises, such as extortionate interest rates and aggressive debt chasing.

Nonetheless, these changes are imminent. House builders cannot drag their feet and now have very little time left to implement the new regulatory requirements. The MCD changes affect the back-book of regulated loan products (those that currently sit under the consumer credit regime) and any new lending, post 21 March.

The transition from consumer credit regime to the mortgage regime will not be an easy adjustment, should the house builder decide to go down the route of obtaining direct authorisation. The FCA has a rigorous application process of due diligence, policy writing, compliance and staff training - the same application process a first mortgage lender would be subject to. House builder's expertise and objectives lie in building homes, not in finance and administration.

The simplest and most efficient option for them is to appoint a regulated mortgage administrator firm to provide the post-sale regulated activity requirements. This is where we come in… ■