TOPIC 25

Schemes for specific groups of borrower

LEARNING OBJECTIVES

The mortgages we have considered so far have been available to most property buyers and serve a wide range of buyers. This topic looks at schemes designed to help specific types of purchaser to secure a home, or to gain access to the equity built up in an existing property. Some of the schemes discussed are not mortgages as such, but allow individuals who meet particular criteria to buy a property on special terms with a mortgage product from a lender involved in that market.

By the end of this topic, you should have an understanding of the following home finance products and schemes:

- shared ownership;
- equity share;
- government initiatives to help people to buy a home;
- right to buy;
- lifetime mortgages;
- home reversion schemes.

THINK . . .

Before you start work on this topic, take a moment to think about what you already know about the schemes and products we are going to cover. We have looked at some of them in a different context.

For instance, we touched briefly on equity-release products in Topic 3. In Topic 8, we covered the particular requirements relating to advice for customers applying for a mortgage under statutory right to buy or for an equity share arrangement.

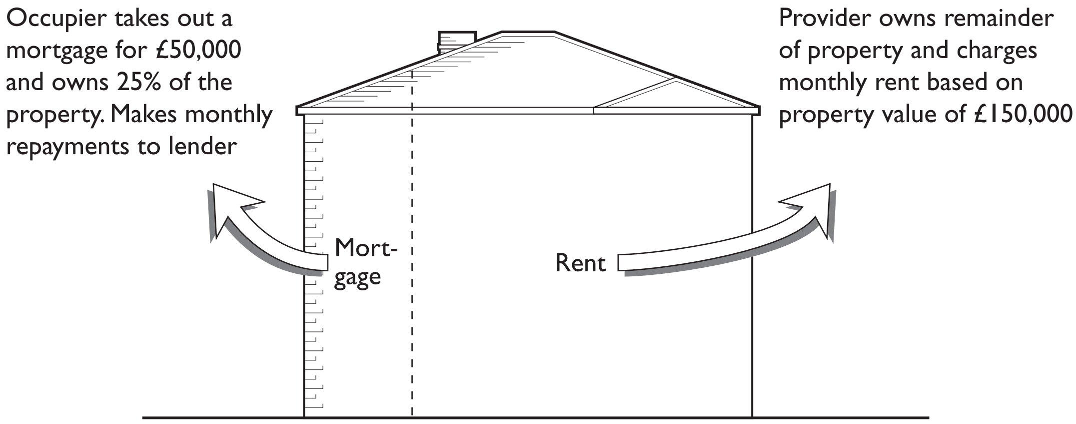
You might also have personal experience of buying a property using one of the schemes explored in this topic.

TOPIC 25

25.1 What is shared ownership?

Shared ownership is not a mortgage scheme as such, although many lenders offer mortgages to shared-ownership buyers. Shared-ownership schemes offer a way for first-time buyers to get on the housing ladder, and were first developed in the late 1970s, as a result of co-operation between housing associations, local authorities and mortgage lenders.

FIGURE 25.1 SHARED OWNERSHIP ON £200,000 PROPERTY



IN BRIEF

HOW DOES SHARED OWNERSHIP WORK?

- The provider (eg a housing association) assesses the applicant to ensure that they fulfil all the relevant criteria to be allocated a property under the shared-ownership scheme. In some instances, a local authority may put forward applicants who have been on the housing waiting list for more than a specified period.
- The buyer purchases a share in a property, with the provider retaining ownership of the rest of the property. The maximum initial share is 75 per cent. The property will be leasehold and is valued at its open market value.
- The buyer arranges a conventional mortgage via the scheme provider's partner lender to buy their share. The lender assesses the application for that share in the usual way.
- The buyer pays rent to the provider; the amount is based on the value of the part retained by the provider (the maximum is 3 per cent).

- Their total outgoings are lower than if they had to take out a mortgage to buy the whole property.
- The buyer can buy further shares in the property through a process called staircasing, with the cost of the additional shares based on the property value at the time. Some schemes will eventually allow the property to be purchased outright through staircasing, while others may impose a limit of 75 per cent on the share that can be owned.
- The borrower is responsible for maintenance of the property, in the same way as an outright owner of the property.

STAIRCASING

Buying further shares in a shared-ownership property based on its market value at the time of the additional purchase.

WHAT HAPPENS WHEN A SHARED-OWNERSHIP PROPERTY IS SOLD?

When the property is eventually sold, the equity is split between the vendor and the housing association or local authority, according to the share of the property that is owned and the proportion that is rented. If the property is not owned outright by the vendor, then they may be required to offer it back to the housing association or local authority, which will then find a suitable purchaser from its own list. In many instances, however, the vendor may be allowed to sell the property on the open market.

The lease

A shared ownership lease is different from a standard long lease. The lease holder of a shared ownership flat will only qualify for the statutory right to extend the lease once they own 100 per cent of the flat, although some landlords may allow an extension voluntarily.

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Most shared ownership leases are in a format approved by the Homes and Communities Agency (HCA), which will contain a number of core clauses common to all such leases, in addition to elements of a standard lease. These core clauses are:

- Restrictions on sales, which could include maximum staircasing allowed, pre-emption period (see below), period between staircasing to 100 per cent and selling.
- Subletting is not permitted.
- Landlord's pre-emption rights if the leaseholder has not staircased to 100 per cent. The owner must first offer the flat to the landlord, or a buyer nominated by the landlord, at a price set by an independent valuer appointed by the landlord. If the right is not exercised within eight weeks, the leaseholder can sell in the open market.
- The right of the landlord to take court action to gain possession in the event of rent arrears. The leaseholder would have no right to receive compensation to reflect any increase in the value of their share.
- The requirement to pay a service charge based on the full value of the property.

25.1.1 SDLT on shared-ownership property

SDLT on shared-ownership property is quite complex. The explanation that follows covers the basic principles but is not the entire picture, which is beyond the scope of this qualification.

IMPORTANT NOTE

The first-time buyer exemption is available on shared ownership property if the buyer is purchasing on a shared ownership basis and meets the eligibility criteria , as described in section 15.9.1.

If the property is purchased from an approved qualifying body, the purchaser has two options for the payment of SDLT. Approved qualifying bodies are:

- a local housing authority;
- a housing association;
- a housing action trust;
- the Northern Ireland Housing Executive;
- the Commission for the New Towns;
- a development corporation.

Option 1 – pay SDLT on 100 per cent of the market value of the property at the time of purchase. For example:

- First-time buyer – property market value below the exemption threshold of £425,000: no SDLT as the full FTB exemption applies, regardless of the cost of the share purchased.
- First-time buyer – property market value between £425,000 and £625,000: no SDLT up to £425,000 and normal rate on the balance.
- First time buyer – property market value over £625,000: no exemption available.
- Second-time buyer – standard SDLT rates on property purchased for more than the standard nil-rate threshold – no exemption.

Option 2 – pay SDLT initially only on the value of the share purchased. For example, property value between £425,000 and £625,000 but the share purchased is below the threshold.

- First-time buyer – opts to pay SDLT on the share purchased within the SDLT exemption, so no SDLT is payable. However, the FTB exemption only applies to the purchase of the initial share – further shares may be subject to SDLT.
- Second-time buyer – no SDLT on the share up to the standard SDLT threshold, and then standard rate above. However, while paying SDLT on the share purchased might seem attractive, there is a catch. In simple terms, once the owner buys a further share (staircasing) that takes their total share above 80 per cent, SDLT is payable on all additional shares bought since the first share was purchased, based on the total price paid up to that trigger point.

The process

- The purchase of the initial portion must be reported to HMRC, regardless of the price.
- Staircasing up to 80 per cent of the property's market value does not incur SDLT at the time.
- Staircasing that takes the proportion owned above 80 per cent must be reported to HMRC and SDLT becomes chargeable.

Once the occupier owns more than 80 per cent of a shared ownership property, SDLT is charged using a complex calculation.

Although opting to pay SDLT on a stage payment basis can provide initial cost savings, it may be a gamble. If it takes the buyer some years to exceed the 80 per cent threshold and property prices have increased significantly, the total SDLT cost may be more than originally paying SDLT on the full market value. Conversely, if the buyer exceeds the 80 per cent relatively quickly, or if prices do not rise significantly, a significant SDLT saving could be made overall. If the buyer has little intention of exceeding the threshold, the stage method is the better option.

25.2 Equity share

An equity-share scheme enables the borrower to buy a property they might otherwise not be able to afford. The borrower will be the legal owner of the whole property and will pay a deposit and arrange a conventional first-charge mortgage on an agreed proportion of the property. The scheme provider will take an equity stake in the balance of the property price through a second charge. Ownership can be on a freehold or leasehold basis, depending on the type of property and the nature of the arrangement.

A number of different schemes have been introduced during past decades but a typical scheme might involve the borrower financing 80 per cent of the purchase price through a deposit and a repayment mortgage, and the provider taking a second charge over the other 20 per cent. The second charge is repayable on the earlier of the property being sold or the end of an agreed term, which would usually coincide with the first-charge term. The provider's stake is usually based on a straightforward equity arrangement, which means that no interest is charged on their 'share', but if the property was sold at some point, the provider would receive that percentage of the sale proceeds.

Less commonly, some providers charge a low rate of interest or charge a fee on their share while still taking their part of the proceeds on sale.

Some providers only offer equity share schemes on a leasehold basis.

Equity share appeals mainly to first-time buyers who may be borrowing at the maximum and who wish to keep their monthly payments to a minimum, or who may not be able to arrange a mortgage large enough to purchase in the conventional way.

There are drawbacks: if the original loan-to-value ratio was high and property price inflation has remained low for some time since the purchase was completed, it may make it difficult for the borrower to trade up in the property market because the already limited equity will be further reduced when the lender takes its share. If the property was later sold for less than the original purchase price, the provider would receive their share of the lower price, which means they would also share in any downside.

25.3 What government schemes are available to help people to purchase property in England, Wales and Northern Ireland?

There have been a number of government initiatives to help those who could not otherwise afford to buy a property to do so.

> **!**
>
> **CHANGES TO SCHEMES**
>
> New initiatives are announced relatively frequently, and existing schemes are changed or withdrawn. This text will provide an overview of the main types of arrangement currently available. You can find details of current schemes at: https://www.gov.uk/affordable-home-ownership-schemes

25.3.1 Shared ownership (England)

The government shared-ownership scheme operates as described in section 25.1. Applications cannot be accepted from those with combined income above £80,000 (£90,000 in London), and priority may be given to armed forces personnel where available housing is limited. Where a local authority provides shared ownership property, it may establish other priority groups based on local needs. There are no other restrictions on who may apply for help and applicants may be first-time buyers, those who previously owned a property but cannot afford to buy one now or those who wish to move from an existing shared ownership property.

The buyer will need to find a deposit of at least 5 per cent of the value of the share being bought. The balance of their share is usually paid by arranging a mortgage.

Following a government consultation, while the basic principles of shared ownership remain the same, some of the rules were changed with effect from April 2021. From that date, new build shared ownership properties are subject to the 'new model' of shared ownership. Homes purchased before that date are subject to the original rules (old model).

As an adviser could meet customers who would be affected by either regime, we will consider the key changes.

- **Minimum initial share purchase** – under the old model, the minimum initial share was 25 per cent. From April 2021 this was reduced to 10 per cent.
- **Maximum initial share purchased** remains at 75 per cent.

- **Minimum additional share purchased (staircasing)** – under the old model, the minimum additional share was 10 per cent. From April 2021 the minimum was reduced to 5 per cent. Some providers may allow a minimum of 1 per cent to be purchased each year for a maximum of 15 years.
- **Shared ownership properties are leasehold.** Under the old model the standard lease was for 99 years. Since April 2021 the standard lease is 990 years to help owners avoid the need to extend their lease relatively soon after buying the property.
- **The Right to Shared Ownership scheme** allows eligible tenants living in qualifying social or affordable rented properties funded through the Affordable Homes Programme 2021 to 2026 to buy a share in their homes under the new model rules.
- **The remaining share is held by the provider**, with the buyer paying rent of up to 3 per cent of the value of that portion of the property.

Shared ownership (Wales)

A similar scheme was launched in Wales in February 2018. The basic principles are the same as the English scheme, but there are some differences:

- The maximum combined household income is £60,000 a year.
- The applicant must be a first-time buyer, a newly-forming household (eg someone starting again after a relationship break-up) or relocating for work to an area where property prices would otherwise prevent the purchase of a home suitable for the size of the family.
- The minimum share at outset is 25 per cent, and the minimum further purchase (staircasing) is 10 per cent.

25.3.2 Help to Buy Equity Loans (England)

The Help to Buy Equity Loan scheme in England closed for applications in October 2022. We will consider the basic details here because many people will have bought their homes under the scheme.

- First-time buyers only.
- Minimum deposit 5 per cent.
- New-build property up to a specified purchase price.
- The balance of the purchase must be arranged through a repayment mortgage.
- The government provided a further equity loan to help with the purchase, secured on a second charge basis.

- A monthly fee of £1 is charged from the start of the arrangement until it ends.
- No interest is charged on the equity loan for the first five years, after which an annual charge of 1.75 per cent (paid monthly) of the equity loan is made from the start of year six, and the charge will increase in line with the RPI plus 1 per cent in each subsequent year.
- The ground rent on a leasehold property bought through the Help to Buy scheme is nil.
- The buyer can repay some of the equity loan at any time, subject to a minimum repayment of 10 per cent of the property's market value at the time. For example, a repayment of 10 per cent of the market value would represent repayment of 10 per cent of the original loan. The equity loan must be repaid by the end of the mortgage term.
- At the end of the mortgage term, or on earlier sale, the equity loan must be repaid. The repayment is based on the market value at the time of sale, using the same percentage of the original purchase price represented by the equity loan. Repayment at the end of the term can be by using savings, remortgaging or selling the property.

For example, if the property was purchased for £200,000 with a 20 per cent equity loan of £40,000 and was valued at £250,000 when repayment was due, the owner would have to repay £50,000 – 20 per cent of the market value at that point. If some repayments have been made, the final repayment will be based on the percentage of the initial loan outstanding.

There were two schemes – one for London and one for the rest of England.

- The London scheme has higher maximum property values, and the maximum loan is 40 per cent of the full purchase price, giving a maximum government loan of £240,000. The purchaser must arrange a conventional mortgage up to 55 per cent of the full purchase price which means, together with the minimum 5 per cent cash deposit, the purchaser must be able to fund at least 60 per cent of the purchase.
- The scheme for the rest of England requires a deposit of at least 5 per cent, and provides an equity loan for between 10 and 20 per cent of the purchase price. The maximum property value varies between regions.

Wales

A similar scheme is operated by the Welsh government, available until April 2025.

Northern Ireland

There is no Help to Buy scheme available in Northern Ireland.

Scottish schemes are detailed in section 25.4.

25.3.3 First Homes initiative (England)

The First Homes initiative started in June 2021. It enables first-time buyers in England to purchase a new-build house with a discount between 30 and 50 per cent, funded by the developer.

The basic details are as follows:

- The scheme is offered by developers on a voluntary basis as part of local developments, and in co-operation with local authorities. Developers must meet specific criteria regarding developments in order to offer the scheme, which includes a requirement for 25 per cent of affordable housing in a development to be included in the First Homes scheme.
- Eligible buyers are first-time buyers aged 18 plus with a combined income not exceeding £80,000 (£90,000 in London).
- Within the national criteria, local authorities can apply their own eligibility conditions, such as prioritising certain workers, setting lower income levels, local connection requirements or employment status.
- The buyer(s) must have a mortgage or home purchase plan to fund at least 50 per cent of the discounted purchase price.
- After the discount has been applied, the initial purchase price must be no more than £250,000 (£420,000 in Greater London).
- Resales can only be to someone who is eligible to buy under the scheme. The buyer must be given the same percentage discount as the initial purchaser received, based on the home's market value at the time of sale.
- The discount will be applied again each time the property is sold to subsequent first-time buyers, but the price cap will not apply. The principle is that these homes always attract the discount.

25.4 What schemes operate in Scotland?

There are a number of schemes available in Scotland through partnerships between the Scottish government, social landlords, and participating builders and lenders. The Scottish government establishes available funding for the schemes each year, and once the funding has been exhausted no further help is available until the next year.

25.4.1 Help to Buy (Scotland)

Two Help to Buy schemes became available in Scotland from 1 January 2016 for new-build properties offered by participating builders but both have now closed.

25.4.2 Open Market Shared Equity Scheme (Scotland)

The Open Market Shared Equity Scheme is designed to help people on low to moderate incomes to buy 'starter' homes on sale in the open market. In simple terms these are homes with one more room (referred to as an 'apartment') than the people who will be living in the property need, not including kitchens, utility rooms, hallways, box rooms and bathrooms. For example, a couple would be able to buy a property with three 'apartments' (two bedrooms and a lounge, or one bedroom and two reception rooms). Where the full budget for the scheme is utilised in any given year, the Scottish government can stop accepting applications for that year, as it did in 2023/24. When the new Budget is announced, a decision will be made to reopen applications.

- The scheme is available to:
  - first-time buyers;
  - those aged over 60;
  - those who rent from a local authority or housing association;
  - people with disabilities;
  - members of the armed forces;
  - veterans of the armed forces who have left service within the past two years;
  - spouses and partners of service personnel who were killed within the past two years while serving in the armed services.
- The buyer must buy between 60 and 90 per cent of the property, and will be expected to provide a 'modest' deposit. If the buyer has savings, they can keep £5,000 to pay for the costs of moving or as an emergency fund, but must use at least 90 per cent of the balance towards the purchase.
- The balance of the purchase price (10–40 per cent) is provided by the Scottish government, which takes a share of the equity. The government's share is secured on the property and will be repaid when the property is sold.
- The scheme is administered, and applications assessed, by registered social landlords on behalf of the government.
- There are limits on the value of property eligible for the scheme. The threshold depends on the town/city where the property is located.
- Once the initial share has been purchased, the owner can 'tranche up' (the same as 'staircasing'), to eventually own all the property.
- In certain areas where there is a shortage of eligible property, the government will retain a 10 per cent share, known as the 'golden share', which means the buyer can only ever own 90 per cent outright.

25.4.3 New Supply Shared Equity Scheme

Under this scheme the Scottish government provides grants to registered social landlords to build new homes for sale and sell them to tenants on a shared equity basis.

It operates on a similar equity share basis to the Open Market scheme, but buyers can buy an initial stake of between 60 and 80 per cent of the property. In exceptional cases the buyer may be allowed to buy an initial stake below 60 per cent. An example would be where their existing property is subject to a demolition programme and they wish to buy a replacement property in the same area.

25.5 What is right to buy?

Right to buy is not a mortgage scheme, but gives the tenants of social landlords in England and the Northern Ireland Housing Executive (the House Sales Scheme) the right to buy the property they are renting.

Right-to-buy legislation was included in the Housing Act 1985 and revised in the Housing Act 2004. It enables a secure tenant of a local authority, district council, London borough council or certain registered social landlords to purchase their property at a discounted price. The basic rules are shown in Table 25.1.

The right to buy was abolished in Wales by the Abolition of the Right to Buy and Associated Rights (Wales) Act, with effect from 6 January 2019.

RIGHT TO BUY IN SCOTLAND

In Scotland, the Housing Act (2014) ended right to buy with effect from 1 August 2016.

TABLE 25.1 RIGHT TO BUY: BASIC RULES

	England	Northern Ireland*
Minimum period as secure tenant to acquire right to buy	3 years	5 years
Discount available for houses	35% (after minimum tenancy period)	20%
Discount available for flats	50% (after minimum tenancy period)	20%
Additional discount on houses for tenancies held over 5 years	1% per year	2% per year
Additional discount on flats for tenancies held over 5 years	2% per year	2% per year
Maximum % discount**	70%	60%

*The purchase of certain types of home particularly suitable for disabled people may not be eligible for the scheme in Northern Ireland due to a shortage of similar stock to meet the region's needs.

** There is also a maximum monetary discount that increases annually by the CPI.

The Northern Ireland scheme also allows the purchase of part of the property, minimum 25 per cent, and the subsequent purchase of additional equity, minimum 5 per cent.

WHAT IS A 'PRESERVED RIGHT TO BUY'?

Where a tenant had a secured tenancy with a local authority and ownership of the property was transferred to a housing association while they were a tenant, the tenant will have a 'preserved right to buy', which means they have the right to buy based on their combined tenancy.

25.5.1 Discounts

In addition to the percentage maximum discount, the government imposes a monetary limit on the actual amount of discount that can be given by the landlord. The limit in England is increased by the CPI in April each year. Limits in Northern Ireland are not index-linked.

FACTFIND

For further information and to check the current monetary limits on right-to-buy discounts, go to:

England

www.gov.uk/right-to-buy-buying-your-council-home

Northern Ireland

www.housingrights.org.uk/housing-advice/social-tenants-rights/buying-your-home

Subsequent sale of a property bought under right to buy

If the tenant sells the property within a certain period, some, or all, of the discount may be repayable (see Table 25.2).

TABLE 25.2 DISCOUNT REPAYABLE ON SALE AFTER EXERCISING RIGHT TO BUY

Property sold during . . .	Discount repayable
Year 1	100%
Year 2	80%
Year 3	60%
Year 4	40%
Year 5	20%
Year 6 onwards	No repayment required

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The ‘discount’ to be repaid will be calculated as a percentage of the sale price. For example, if the buyer received a discount of £20,000 on a £100,000 house, the discount will be 20 per cent of the price. On sale after three years, the discount repayable would be 20 per cent of the sale price multiplied by 40 per cent.

Additionally, those who exercised the right on, or after, 18 January 2005 who wish to sell within ten years of exercising the right must offer it first to their former landlord or another social landlord at full market price.

%

DISCOUNT REPAYABLE ON SALE OF PROPERTY AFTER EXERCISING RIGHT TO BUY

Purchase price	£100,000
Discount (20%)	£20,000
Subsequent sale price in year 4	£150,000
Discount to be repaid (20% of sale price x 40% – ie discount repayable in year 4)	£150,000 x 20% = £30,000 £30,000 x 40% = £12,000

25.5.2 Mortgages on right-to-buy property

Most lenders will consider mortgage applications from tenants wishing to purchase under the right-to-buy legislation. Lenders' attitudes vary – some will lend based on the market value of the property, while others will base lending on the discounted price.

The valuer will also look carefully at how the location of the property might affect its resale value. An owner-occupied property that is situated in a road or area where almost all other properties are still tenanted may have limited appeal, and very few lenders will lend on flats in tower blocks.

25.6 What is the 'right to acquire'?

The 'right to acquire' gives tenants of housing associations broadly similar rights to those who have the right to buy. They may acquire (ie buy) their housing association property after three years of tenancy. The main difference is that right-to-acquire discounts are based on a flat rate monetary amount, varying with the location of the property. The length of tenancy does not affect the discount, and the landlord does not have to sell the specific property the tenant lives in – they could choose to offer an alternative property to the tenant.

In some cases local authority properties were sold to housing associations, and existing tenants became housing association tenants. Those tenants may also have a 'preserved right to buy' under the same terms as a local authority tenant.

Voluntary right to buy

In 2016 the government put in place measures to extend the right to buy to all housing association tenants at some point in the future; this scheme is referred to as 'voluntary right to buy', because housing associations came to an agreement with the government to implement the necessary measures on a voluntary rather than statutory basis. A two-year pilot scheme involving a small number of housing associations was established in 2016, with further pilot schemes following. Eligibility and discount levels were the same as those of the standard right-to-buy scheme.

In June 2022 the Prime Minister announced that he wanted the government "to deliver on the long-standing commitment, made by several governments, to extend the right to buy to housing associations" (House of Commons Library, 2023). The Minister for Housing said in a later statement: "We will work closely with the housing association sector as we develop the scheme and will announce more details in due course" (House of Commons Library, 2023). Further details are yet to be released.

25.7 What is equity release?

Equity-release plans are designed to enable homeowners who do not have a mortgage on their property to release some of the equity in order to provide capital or supplement their retirement income. Most of the schemes are available only to property owners aged at least 55, and some have a minimum age of 70. While aimed at those who do not have a mortgage, these schemes are also available to those with small mortgages, although the prior mortgage would have to be paid off as part of the arrangement.

Some of these schemes involve mortgages – known as lifetime mortgages – and some involve the sale of the property to a provider in exchange for a benefit: the latter are known as home reversion plans.

25.8 Lifetime mortgages

The FCA defines lifetime mortgages as regulated mortgage contracts that are available only to older borrowers over a certain age and where the lender cannot seek full repayment until one of the following events occurs:

- the borrower's death;
- the borrower moves to live elsewhere without the reasonable expectation of returning – into residential care or sheltered accommodation, for example;
- the borrower moves to another 'main residence';
- the borrower sells the property;
- the lender exercises its legal right to take possession under the mortgage contract.

✓

CHECK YOUR UNDERSTANDING

What is a regulated mortgage contract?

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While the borrower occupies the property as a main residence, the definition of a regulated lifetime mortgage allows a number of ways in which the arrangement can operate, as outlined in Figure 25.2.

FIGURE 25.2 LIFETIME MORTGAGE OPTIONS

LIFETIME MORTGAGE OPTIONS

No regular payments of capital or interest required. Interest accrued can be 'rolled up' to be paid at end of mortgage	Payment of interest required but capital not repaid until end of mortgage
Payment of interest and partial repayment of capital may be required, but full repayment of capital not required until end of mortgage	Payment of interest required, but borrower has option to convert to 'roll-up' basis in future (hybrid scheme)

WHAT ARE THE RISKS RELATING TO INTEREST ROLL-UP?

Where interest is rolled up, the debt is likely to double approximately every 11 years at 6.5 per cent interest, around 14 years at 5 per cent and around 18 years at 4 per cent. Lenders are cautious – they limit roll-up mortgages to relatively low loan-to-value ratios and only consider borrowers with a minimum age between 55 and 60, for the following reasons:

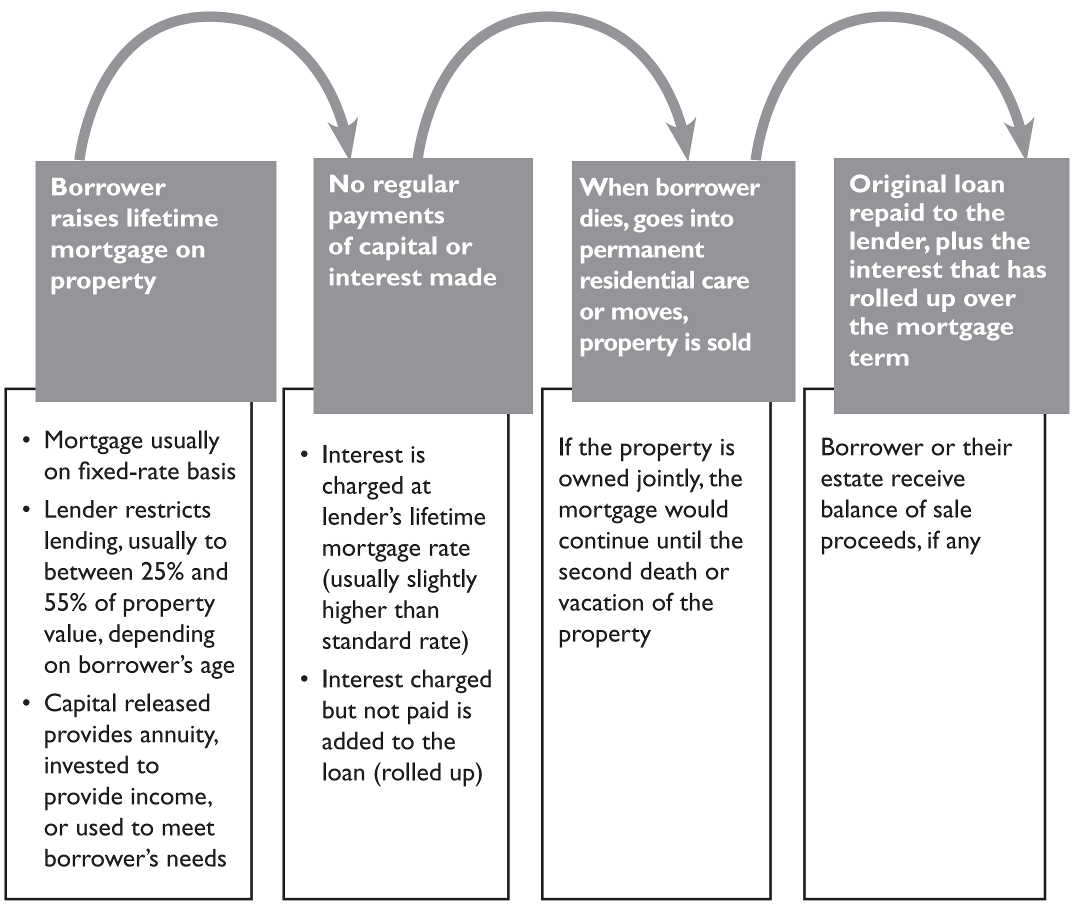
- Increases in life expectancy mean a mortgage could run for several decades.
- Property prices are not guaranteed to rise, and could even fall over time.
- In the worst case, a combination of these two factors could see some borrowers with debts approaching (or even exceeding) the value of their property. This would be a concern for lenders because their security would be threatened, and for borrowers, who might have hoped to be able to leave some of the value in their property to their heirs.
- Most schemes impose early repayment charges if the mortgage is repaid before the borrower dies/vacates the property. Such charges typically apply for at least five to ten years, and some may apply for the life of the plan.

> Despite the risks involved in interest roll-up, the majority of lifetime mortgages are arranged on this basis. Most lenders provide a no-negative-equity promise, which means that the borrower cannot owe more than the value of the property when the loan is due to be repaid.

Capital repayments

Many modern lifetime mortgages allow the borrower to make penalty-free lump-sum payments during the life of the mortgage. A typical scheme would allow up to 10 per cent of the initial mortgage to be repaid each year. This allows those with sufficient resources to either repay some of the lending or, at least, pay sums to reduce the effect of interest roll-up.

FIGURE 25.3 HOW DOES A LIFETIME MORTGAGE WORK?



25.8.1 Hybrid schemes

Hybrid lifetime mortgage schemes are lifetime mortgages initially arranged on an interest-only basis, with the borrower making regular interest payments. However, the contract gives the borrower the right at any time to switch to an interest roll-up basis and stop making interest payments.

Hybrid schemes are helpful for borrowers who are a few years below the lender's minimum age for an interest roll-up scheme, but intend to take advantage of roll-up as they get older. Examples would be people who are working now, need to raise some capital and can afford to make interest payments now, but would prefer not to do so when they retire. They may also be helpful to many of those approaching retirement who have an interest-only mortgage but no way of repaying the capital or affording a normal mortgage in retirement.

In the case of hybrid arrangements, the lender is not required to carry out an affordability assessment when the mortgage is arranged, because the borrower can switch to an interest roll-up basis if, and when, they choose.

25.8.2 Drawdown

A lifetime mortgage can be arranged on a drawdown basis. The lender agrees a maximum lending limit and the borrower can draw down lump sums as they wish, subject to a minimum withdrawal, typically £2,000 to £5,000. Interest is charged on the amount outstanding, but is rolled up rather than paid each month.

The benefit of this type of loan over a standard lifetime mortgage is that interest only accrues on the amount actually borrowed, so the borrower has a degree of control and the debt will not increase as rapidly. It will allow the borrower to provide an annual income by drawing down capital, while maintaining control over the speed at which the debt builds up.

Retirement interest-only mortgage

As a result of demand due to the number of borrowers unable to repay, or finding difficulty in repaying, interest-only mortgages at the end of the term, the FCA introduced a new regulatory category of interest-only mortgage from March 2018. Known as the retirement interest-only mortgage, lenders are permitted to arrange mortgages on an interest-only basis, with no specified term, for borrowers above an age specified by the lender. Affordability can be assessed on an interest-only basis, with no requirement to account for a repayment vehicle.

The retirement interest-only mortgage is defined in MCOB as:

“An interest-only mortgage:

1) which is not an interest roll-up mortgage;

2) entry into which is restricted to older customers above a specified age; and

3) under which the lender is not entitled to seek full repayment of the loan until the occurrence of one or more of the specified life events, unless the customer breaches their contractual obligations (including any obligation to pay interest during the term) in a way which allows the lender to terminate the agreement."

Although we have included the retirement interest-only mortgage in the lifetime mortgage section of this text, it is a separate regulatory category and is not subject to lifetime mortgage rules.

25.9 What is a home reversion scheme?

Home reversion schemes are an alternative to lifetime mortgages. The homeowner sells all or part of their property to the lender in return for a capital sum, an income or both. The original owner then enters into a lifetime lease agreement with the provider, usually at a nominal annual rent, which guarantees them lifetime occupation.

Home reversion plans are defined in the following way:

- a person (the reversion provider) buys all or part of a qualifying interest in land from an individual or trustees;
- the reversion occupier (the previous owner) or a trust beneficiary (or a related person) is entitled under the arrangement to occupy at least 40 per cent of the land as, or in connection with, a dwelling.

The arrangement specifies that the right to occupy the property will end:

- when the occupier moves into residential care on a permanent basis;
- on the death of the occupier;
- after a specified period of at least 20 years from the date of the arrangement.

Home reversion plans that comply with the Equity Release Council's Code of Conduct (see below) must allow the planholder to move to a different property, subject to certain conditions.

Other key points relating to home reversion plans are as follows:

- **Legal ownership** – the arrangement involves the transfer of legal ownership to the provider. In the case of partial reversion, where only part of the property is entered into the plan, the provider usually takes full legal title to the property, but the previous owner becomes the beneficial owner of the part they retain. The tenant is responsible for basic maintenance of the property. Although they are protected by a legally binding lifetime lease, many people feel uncomfortable living as tenants in their former home.
- **Funds released** – home reversion plans usually allow the homeowner to release more capital than they could by taking out a lifetime mortgage at

the same age. The amount the provider gives the homeowner in return for the property (or share) is based on estimates of the borrower's life expectancy, and always represents a substantial discount on its true market value. For example, on a house worth £200,000, £70,000 to £100,000 might be released, depending on the borrower's age. If the homeowner sets up a home reversion plan on half the property, the homeowner might receive £35,000 to £50,000. The large discounts on the market value are to allow for the fact that the lender does not receive any interest payments on this type of arrangement and has to wait for the death of the borrower(s) to receive most of the profit.

- **Minimum age** – the minimum age for a home reversion plan is higher than that for a lifetime mortgage – typically 60.
- **Taxation** – the capital can be used as the homeowner wishes and, because it comes from the sale of a main residence, is not subject to tax. As an alternative, some schemes use the cash released to buy an annuity, thereby increasing the individual's income. Note, however, that annuity income is potentially subject to income tax (depending on the recipient's overall income).
- **Drawdown** – many providers allow the owner to enter a minimum amount of the property value initially, and draw down further amounts later, subject to minimum and maximum amounts.
- **Sale of the property** – when the tenant dies or moves into residential care, the provider sells the property and retains all the proceeds from the percentage of the property it owns. Where only part of the property is held in the plan, the provider will retain that percentage of the property value when it is sold. For example, if 50 per cent of the property is sold to the provider, 50 per cent of the final proceeds will be retained by the provider and 50 per cent passed on to the estate.

In general, home reversion plans provide more cash when compared to lifetime mortgages. This is because the mortgage lender must take a conservative approach to excessive interest charges eroding the equity, whereas the reversion provider owns the property from the outset and knows that only unexpectedly poor property growth can affect its position.

THE LENDER'S RISK – A COMPARISON

Let's consider a property valued at £150,000 today, owned by a single man aged 70. We'll assume that property prices increase by 2 per cent per annum over the next 15 years, at which point the owner dies and the property is worth £202,000. To make things simple, we will not consider the cost to the provider of funding the arrangement or any other costs the provider might face. The examples below illustrate why lifetime mortgages provide lower amounts.

Home reversion

A reversion provider might advance as much as 50 per cent of the property value, giving a sum of £75,000 today. On sale of the property 15 years from now, this would result in a simple profit of £127,000 for the provider (ie £202,000 – £75,000). The provider would only face the prospect of losing money if property prices had fallen by the sale date.

Lifetime mortgage

If the mortgage provider lent 50 per cent of today's value and charged a fixed interest rate of 7.5 per cent, the debt plus accrued interest in 15 years would be £222,000, ie £20,000 more than the value of the property. If the lender limited the original loan to 35 per cent (£52,500), the debt would be £155,000 in 15 years' time, thus allowing the lender to receive all the money it was owed.

25.9.1 What is the Equity Release Council?

The Equity Release Council (ERC) is a trade association where for equity release providers members are required, as a condition of membership, to adhere to the Council's statement of principles, rules and guidance and product standards, which replace the previous Code of Practice. The main safeguards the ERC offers are summarised in Figure 25.4. Although not a regulator, the ERC standards work in tandem with FCA standards, and in the areas listed below include requirements not covered by regulation.

Although equity release plans are now regulated, the ERC remains a strong force in the market.

FIGURE 25.4 MAIN SAFEGUARDS PROVIDED BY THE ERC RULES AND GUIDANCE

Legal advice

Applicant must be encouraged to seek independent legal advice to ensure they fully understand risks involved and fact that any children and other beneficiaries will receive a reduced inheritance.

No negative equity guarantee

Provider gives a 'no negative equity' guarantee, ie the amount that has to be repaid will not be more than the price obtained when property is sold.

Right to remain in home

Borrower is entitled to remain in their home for rest of their life – in case of joint borrowers this applies to each of them.

Portability

Borrower must be allowed to transfer loan to another property, subject to the lender being satisfied that the new property represents adequate security for the loan.

Right to penalty-free payments

Products should include a facility for borrowers to make voluntary repayments.

THINK AGAIN . . .

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- explain how shared ownership works?
- describe the two different ways in which SDLT can be paid on a shared-ownership property?
- explain how equity share schemes differ from shared-ownership schemes?
- give an overview of government schemes that are available to help people to purchase a home?
- summarise the criteria for right to buy in England and Northern Ireland?
- explain how a lifetime mortgage works?
- explain how a home reversion scheme works?

Go back over any points you don't understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.

References

GOV.UK (no date) *Right to buy: buying your council home* [online]. Available at: www.gov.uk/right-to-buy-buying-your-council-home/selling-your-home

House of Commons Library (2023) *A voluntary right to buy for housing association tenants* [online]. Available at: commonslibrary.parliament.uk/the-right-to-buy-in-england/

Test your knowledge

?

Use these questions to assess your learning for Topic 25. Review the text if necessary.

Answers can be found at the end of this book.

1) Which of the following is **untrue** in relation to shared ownership?

   a) The property is bought on a freehold basis.

   b) It involves paying rent to the provider.

   c) The maximum initial share is 75 per cent.

   d) The property is valued at its open market value.

2) A shared-ownership mortgage is one on which part of the loan attracts zero or very low rate of interest. True or false?

3) In an equity-share mortgage arrangement, the borrower pays rent for a portion of the property while owning the remainder. True or false?

4) Ben and Gerry are hoping to buy a property in London, using the First Homes initiative (England) scheme. Which of the following is true?

   a) They must arrange a mortgage to fund at least 75 per cent of the discounted price.

   b) Their combined income cannot exceed £80,000.

   c) The property price cannot exceed £420,000.

   d) The discount will be 20 per cent of the market price.

5) Jay and Emma are buying a 50 per cent share in their new shared ownership home for £100,000. What is the maximum annual rent they will pay on the share owned by the provider?

   a) £150.

   b) £300.

   c) £1,500.

   d) £3,000.

6) Under the right-to-buy scheme, in England the maximum discount on a flat is 60 per cent. True or false?

7) Gary and Ayesha are buying their local authority flat in Leeds under the right-to-buy scheme, having been tenants for six years. What is the maximum discount they could claim?

8) Moira and Ken (both aged 67) are considering an equity release scheme because they would like to improve their standard of living. Their three daughters are all in favour, although Moira and Ken are concerned that the scheme would prevent them leaving as much of their estate as they would like to their daughters and grandchildren. Why would an adviser suggest a drawdown roll-up lifetime mortgage might be best for them?

9) The minimum age for a home reversion plan is usually lower than for a lifetime mortgage. True or false?

10) Home reversion plans generally allow more capital to be released than lifetime mortgages. True or false?