JULIAN HARRIS

A GUIDE TO SECOND CHARGE MORTGAGES

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Background

The second charge industry has changed significantly over the past few years. The market reached its peak in 2007 when gross lending was around £7bn – this is a significant figure but one which was symptomatic of the various poor practices throughout the industry at the time.

When the credit crunch hit, second charge lending initially dropped by 84% and in December 2010 the market hit an all-time low with only £16m reported as being lent.

The market has been recovering since 2011 and in March 2015 alone £75.5m in second charge loans were taken out by homeowners.

Historically, clients and advisers have accessed secured loan products via Master Brokers. Under the Consumer Credit Act, second charge borrowers could not be charged for any fees upfront which meant the Master Broker would have to foot the bill for the application assessment and valuation with no guarantee the loan would complete. They would use this as justification for charging high completion fees of between 10% - 15% - this fee was set at this level to compensate the Master Broker for losses incurred on applications which failed to complete.

It is clear that the FCA are now determined to bring down the cost to the customer for these loans.

In order to be more in line with what the regulator is expecting, we decided to bring the packaging of second charge mortgages in-house. This enables us to create a fee structure which is competitive for your clients, whilst still providing the adviser with good remuneration.

The Mortgage Credit Directive

On the 21st March 2016, the MCD brought second charges into line with first charge mortgages as regulated mortgage contracts. This was done to provide consistency across the mortgage market and appropriate protection to the consumer.

The consultation paper stated that '***all customers considering taking out a first or second charge mortgage will be made aware that alternative finance options may be available'.***

The MCD also ensures that properly qualified advisers are an integral part of the sales process.

The new disclosure requirements for advisers will undoubtedly prompt clients to ask for further information about second charge mortgages. Whilst a remortgage or a further advance can offer attractive rates, it may be that a second charge mortgage offers a more appropriate and bespoke solution for your client. This must now be considered in all cases where a client is looking to borrow additional funds against their property.

The entire process, including the sales process has now been aligned with the first charge mortgage market, making it easier to identify and compare second charges against first charges.

Clients can now be charged fees upfront reducing exposure to abortive costs and providing greater transparency.

Where a second charge mortgage should be considered

A Further Advance from the customers' existing lender must always be considered. It may be the best option if available. However, a further advance may not be available for several reasons and a second charge should be considered:

- When you, the adviser, has determined that it is in the clients' best interest to remain on their existing interest-only mortgage, a second charge mortgage can allow the customer to borrow additional money without the need to disturb the existing mortgage.

- Early redemption charges may apply on the existing mortgage. 5 and 10 year fixed rate products have become more commonplace over the past few years.

- Some clients may find themselves trapped in their current deal as a result of lenders tightening their criteria after the MMR.
- Where the client has run into difficulty over the course of their existing mortgage and may be declined a remortgage due to adverse credit or increased risk profile
- Customers who are looking to consolidate debt to reduce their outgoings but do not wish to drag the repayments over the length of the mortgage term.

A second charge mortgage will allow the customer to keep their existing mortgage in place. The second charge sits behind the customers' existing first charge mortgage – there would be no exit fees or changes to the existing mortgage terms and conditions.

The term of the second charge mortgage can be different to the first charge mortgage allowing for more flexible repayment terms which could potentially save the client thousands of pounds in interest.

Consolidation of existing credit is one of the most common reasons for a second charge mortgage. It is however important to note that moving debt from an unsecured basis to a secured basis could be putting the clients home at risk and if the term is much longer, more interest could be payable.

Second charge mortgages are not just for subprime customers; these mortgage loans can help a variety of clients looking to raise additional funds. Increasingly, high-net-worth individuals are using second charge mortgages as a more flexible and affordable method in raising finance compared to an unsecured personal loan.

On the other hand, a second charge mortgage can be used by clients who have fallen victim to circumstance and gives them the opportunity to rebuild their credit rating.

Our packaging service has access to lenders who will consider a wide range of customer types from 'super' prime up to heavy adverse.

<u>Opportunities for Second Charge Mortgages</u>

The following are circumstances where a second charge mortgage may be a better option for a customer:

- ***The customer wishes to retain their existing mortgage***
- ***The customer wants flexibility in the repayment of the loan***
- ***The customer wants to use the money for reasons not permitted by a first charge lender***
- ***They need a higher LTV than is otherwise available***
- ***They wish to secure the loan against a BTL property***

The following are examples where a client may be declined for a further advance or remortgage but may fit with a second charge mortgage lender:

- ***The lender has not included all of the clients' income***
- ***The client has been in an IVA or Debt Management Plan***
- ***They have recently changed jobs***
- ***They have recently become self-employed***
- ***They have a poor credit rating or adverse credit***

Second charge mortgages – the process

If you are new to second charge mortgages or have only previously introduced them to a third party, now is certainly the time to become more involved in this market.

Now that these mortgages are aligned with first charges, the sales process is very similar.

The Twenty7tec sourcing system includes our panel of second charge mortgage lenders. The system enables you to carry out a 'Combined Source' which will compare a second charge mortgage against a capital raising remortgage.

When you have identified that a second charge mortgage is the more suitable option, you can contact the packaging team to confirm that the client is likely to meet the lenders criteria.

Working from the factfind, proof of income, bank statements, illustration etc. the packaging team will obtain a decision a principle from the lender.

The majority of our lenders use an online system which produces all of the required documents, including the application form, which will be forwarded to the adviser for completion, signature and return. Most of the systems will pre-populate all of the required documents.

The lender will require the case to be fully packaged before being submitted – this will typically include the following:

- **Fully completed and signed application form**
- **Credit search**: carried out by the packager
- **Mortgage reference** (if not available on credit search): packager to obtain
- **Copy of Land Registry Title:** packager to obtain
- **Affordability assessment and proof of income**
- **Copy of the mortgage illustration (ESIS)**
- **Buildings Insurance Certificate**
- **Direct Debit Mandate**
- **Valuation report or AVM**: In certain circumstances the lender will not require a full valuation of the property. This is dependent on the lender, loan amount, loan to value, property location & property type. Where a full valuation is not required, the lender may accept a Home-Track valuation (AVM) or a Drive-By valuation. – packager will advise following assessment of the case.
- **Consent in favour of the second charge mortgage lender from the first charge mortgage lender:** The packager will write to the first charge lender to obtain this.
- **Debt Consolidation Form** (if applicable): Where the clients are consolidating debt, the lenders may pay the creditors directly. Alternatively, the lender will

issue cheques addressed to the creditors – the customer is responsible for ensuring the cheques are forwarded to the creditor and paying any residual balance if the account is to be cleared in full.

- **Interest Only Declaration** (if applicable)
- **Occupiers consent** (if applicable)
- **AST** (if BTL)
- **Lending into Retirement Declaration** (if applicable)

Customer call – In all cases the lender will telephone the customer when assessing the application. Telephone numbers for home, work and mobile should be provided with the application. The lender will need to speak with both parties if the application is in joint names. It is important that your clients are aware that this call will need to take place prior to the loan being approved. Each client will be contacted by phone and asked to verify key information in relation to their application. The lender will also ensure that they are fully aware of the terms of the loan and may be asked to provide any clarification, if necessary, prior to completing the loan.

Independent Legal Advice – In certain circumstances there may be a requirement for the customer to receive independent legal advice and have the Legal Charge witnessed and advised upon by a solicitor. These circumstances would include:

- Partners / couples where the purpose of the loan is for business investment
- Where the applicant is aged 70 years or older
- If the client is not able to understand the terms of the legal agreement
- For divorced / separated couples
- Larger loans
- Parent and child borrowers

If Independent Legal Advice is required, the borrower is able to use a solicitor of their choice and it will be the borrowers' responsibility to pay the solicitor directly for this advice.

Why you and your clients should be comfortable with second charge mortgages

We hope that this guide has given you useful information about second charge mortgages. The market is growing and these products give you the opportunity to add a potentially valuable income stream to your business. In summary, here are five reasons why we believe you should actively add these products to your toolkit:

1. The market is regulated by the FCA and these loans are now 'regulated mortgage contracts' meaning greater customer protection and more consistent standards across the market.

2. The entire process, including the sales process is aligned with the first charge mortgage market, making it easier to identify and compare second charges against first charges

3. The lenders will always verify declared income. Combined with our own procedures, this will ensure that the loan is affordable for your customer by checking all income and expenditure and stress testing all loans to protect against future interest rate rises.

4. The lenders must adhere to a stricter regulatory regime which sets high standards, offering your customers peace of mind.

5. A second charge mortgage is a flexible option and can provide a genuine alternative to a remortgage, particularly where the customer does not want to disturb their first charge mortgage.

If you would like to find out more information, please contact our packaging team on 01748 810177 or email secondcharges@julianharris.net