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The debt-free RISER: a new method of house purchase

Relational Investment for a Shared Equity Residence (RISER)

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Abstract

Having worked in the financial services industry as a mortgage broker and financial advisor for over 10 years, and witnessed the effects of the credit crunch in North West England, Matthew Gray has sought to 'break the mould' of conventional debt-based financing for households, as well as providing a responsible and relational alternative for investors. The result of this is a product called the '**Relational Investment for a Shared Equity Residence**' or **RISER** Product.

Understanding the issues facing home occupiers, the RISER Product seeks to provide a genuine alternative to mortgage-based house purchases and conventional assured shorthold tenancies. It provides all the benefits and securities of home ownership, without the overhanging problems of negative equity and debt in less favourable economic conditions. Unlike mortgages, the RISER Product offers the same limited levels of market risk for all levels of deposit, and also can offer more flexible, relationally-fairer arrears management.

Understanding the workings of the property and investment markets, the RISER Product seeks to provide an attractive alternative for investors, which allows them to develop a responsible and relational approach to investment whilst providing a credible return. The RISER product contains within it balances which allow it to perform in both a booming or falling market, and offers taxation advantages for cashflow return. There is also a significant benefit to society in terms of reducing volatility in the economy.

One special feature of the RISER product is that it irons out many potential conflicts of interest between the investor and occupier by means of its unique terms and repayment formulae.

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Features of the RISER method on house purchase

There is a big problem with negative equity in the housing market. Negative equity is when the value of an asset used to secure a loan is less than the outstanding balance on the loan.

Mortgage finance is debt-based. RISER is not a mortgage, not a short-hold tenancy, but a trust. It can be used appropriately for transfer of financing of freehold and long-term leasehold property arrangements.

1. It is relational

i. Financial institutions are not relational. They abdicate responsibility. They impose broad brush criteria to get what you need.

ii. RISER seeks to bring home occupiers and investors together. Bringing people who have capital, together with people who need a home and a third-party facilitator to correct any emergent imbalance in a particular relationship.

iii. Flexibility - it is designed with flexibility in mind. The terms can be negotiated between the parties and can be made to work to the benefit of both of the parties. The return the investor might require and how much can the borrower afford? What is the local housing market like? Rent levels?

iv. It is co-investment. It is fundamental to our sense of intrinsic worth of goods and actions. If you buy a child presents all the time, do they appreciate it? But if that child is encouraged to save for it then they do appreciate it. Because there is personal investment and understanding of what you are doing it raises the intrinsic worth. It's the only product on the market that for every pound invested on an ongoing basis there is the same intrinsic worth for both parties. You are both working together to achieve the same end: ownership of the property for the occupier and fair return for the investor.

v. All are on an equal footing in regards to market fluctuations. In a mortgage, if the market goes down 5% the mortgage doesn't! It stays where it is. The only person who suffers is the person whose equity has been stripped out of the value of their property. In the RISER scheme, if the market goes down 5%, everybody shares the market rise and falls together.

vi. The occupier, because it is in shared equity (even if they only own 1%), has a legal and equitable interest in the property and therefore have an insurable interest. This is an incentive for them to maintain the property and look after it because they are living in it and own some of it.

vii. In a traditional landlord-tenant relationship, the landlord has to pay to insure the building and the landlord has to maintain it. The tenant cannot insure the property because they don't have an insurable interest. In the RISER they can.

viii. It is a shared investment between the parties and fewer abnormalities arise due to things like interest rate fluctuations. Regular reviews are carried out annually to take into account market rises and falls, and the prices at which you would buy back equity or pay for the opportunity to inhabit the property. In the annual review, the usage payment is also adjusted.

2. Shared equity

Because it's in shared equity there is a total absence of debt. They are co-investors in the property. No one is indebted to the other. Nor does this product allow people to borrow against their stake. Current housing association and shared ownership schemes allow people to borrow against their 50% or whatever. This product does not allow that. You can't borrow to fund the money. You have to have it. It's also shared equity in proportion. All stakeholders' capital values fluctuate in proportion to the market even if you only have a 1% stake it is impossible to go into negative equity because it's the same intrinsic risk of capital which is very much not the case in mortgage arrangements. If you put a 5% deposit down that is very much at risk to market fluctuations.

i. The occupier inhabits as the co-owner. They pay regularly to the other co-owners (i.e. the investors) an amount linked to the proportion of equity held as the investment. It is not interest for the provision of money. They are paying for the provision of accommodation. It is not interest and it is not pegged to interest either. o This product also allows charitable investors to come along and waive their rights to commercial levels of ongoing income return which can reduce occupier payments. They could take a stake in the property but waive their rights to ongoing payments and just hold the capital appreciation in the property.

3. Benefits to the occupier

i. Gives confidence to them. First time buyers don't have confidence because any money you put in the house is at risk. This means that a small investment is never totally eroded by negative equity in an uncertain market. We need confidence in uncertain markets and one way of achieving that is not to use debt.

ii. They have optional overpayments to buy equity shares at a market price from the other investors. So they are having a rising ownership over time (that's where the RISER name comes in as well). They also get an insurance and maintenance discount on the full market rent. So they will never pay the full market rent for the property because the landlord can delegate insurance and maintenance to the occupier.

iii. As ownership increases, regular payment levels reduce. That's a tax-free incentive to save because it's a reduction in outgoings, not the earning of interest. As they put more money into the property, the cash flow is better. There is an incentive for them to save into the property.

iv. Unlike other products — such as the Islamic Bank of Britain's product or HSBC's sharia compliant product — the RISER contains no obligation to buy back the equity from the investor. If you can't buy it back then you are under no obligation to do so. Just pay the minimum level required, which will always be less than the market rent. But of course there are advantages to buying the equity.

v. All payments are linked to the current market rates, reviewed annually. So they are in line with the collective experience of the population and economic climate and arrears management can be gradual. In a landlord-tenant relationship if you fall into arrears that's it. You'll be kicked out. In a mortgage as soon as you fall into arrears there's the threat of repossession. In the RISER it is possible to negotiate with the investor to put the product into reverse gear and say can you please recapitalise my ongoing payments at the market rate for the time being until I find another job etc.

4. Benefits to the investor

i. Security. This is a more secure investment than most buy-to-let in the market. Why? Because the investor has an opportunity to invest in the property where the occupier has their own vested interest to keep up with the payments and so they don't lose their own stake. Because they are maintaining their own property, there is more security. There is relational security.

ii. It is hassle-free. The investor can delegate the responsibility to maintain the property to the occupier.

iii. It's tangible. How many investors are crying out for tangible investment? We talk about these mutual life funds etc. but people don't understand where the money is going. They don't know where the money is going. It's intangible. This is a tangible investment because you can see it and you know where your money is. That is why people are investing in gold at the moment because they like to hold it in their hands.

iv. It's accessible. You can only borrow off the bank at the moment if you can prove you don't need to. This one is accessible because you can invest in the housing market without the need for consumer credit criteria to be met. You don't have to have borrowed lots of credit cards and got a credit score. If you have been prudent and have saved, and have not needed to borrow, then why not invest? No credit scoring on this.

v. Reduced conflicts of interests. One of the key conflicts of interests is 'why should the investor relinquish anyone of their equity to the occupier?' If the market is going to go up why should the investor relinquish equity to the occupier? There is a good commercial, not just charitable reason for this. The investors total running yield, the RISER product and the formulae in it are structured such that at an equity level of, say, 90% that the investor starts with (occupier puts in 10%) you would get a running yield of around 6% if the capital appreciates by 1% in that year (this is based on a 2 bed semi in the north of England worth f 100,000 with a f500 a month market rental). Ceteris paribus at 60% your running yield is 6.41%, so you wouldn't mind releasing equity to get a slightly higher running yield. At 30% equity you would get a running yield of 7.64%. This is the opposite of annuities where if someone buys an annuity for their pension the actual running yield over time decreases. With RISER your running yield increases over time.

vi. Why then should the occupier buy back? Just so the investor benefits?

- Greater capital growth potential because they have a stake in the property. They will start to get the lion's share of the capital growth.
- The total effective return in this same example, if they save into the property they are effectively going to get a 5.18% running yield on what they are investing, because they are going to save 5.1% on any money they put in. Put £1000 in he will get 5.18%. That's not always fixed, it depends on what the market does. What's more it's tax free because it's a reduction in outgoings rather than the earning of interest.

5. What does this look like compared with other products?

i. On a 90% mortgage a 5 year fixed is 5.69%. The monthly payments are £562 per month. If you pay £562 into the RISER product, which is only £62 more than the market rent, it will pay the same off as a mortgage would without the risks of negative equity. That's in a flat market. It is comparable.
ii. In a climbing market a RISER product is not quite as efficient as a mortgage. It will not pay off as quickly as a mortgage does. But if the market is climbing and income is going up, why not pay an extra 1% a year in? Not much and then you will get a similar return on a mortgage.
iii. In a falling market, it beats it hands down. The occupier would find the repayments profile better than in a mortgage. That is the beauty of this.
iv. Benefit to the investor. If you invest £90,000 as a lump sum and 10 years later you come out with £150,000 the rate of return is 5.24%. If you invest it and after year 4 you get back £50,000, year 7 £50,000 and year 10 £50,000, the total you get back is £150,000 but your cashflow rate of return is actually 7.83% because you have got your money back as you go along. The RISER takes advantage of that for the investor and this is a hedge in a falling market because in a falling market you'll get your capital back quicker and it's a higher rate of return.
v. It is tax efficient. Capital gains tax calculation - £90,000 invested. £150,000 after 15 years. Take off your allowance and a higher rate tax payer would have £13,000 of capital gains tax. In the RISER product you put £90,000 in and over 15 years you get £10,000 a year back. So you get £150,000 back. Under the law at present, there would be no capital gains liability.

6. Possible applications of the new approach to housing finance

We currently have a 'laboratory prototype' of the product that have been agreed in principle by a solicitor but exact terms have not been fully drafted and the legal structure has not been fully realised.

This is virgin territory. It is not a mortgage and it is not a short hold tenancy. It's somewhere in between. The applications of this are wide and varied. It's flexible and adaptable: you can apply this to the open market unlike many other staircasing schemes.

i. It can be used on new builds or second hand unlike most of the builder's arrangements.
ii. It can be used for first time buyers or next time buyers.

iii. It can be in the context of tied accommodation such as Church Manses or accommodation provided by a university to their faculty. Because the institution has a legal stake in the property there are more legal benefits than putting a legal charge on the property.

iv. This could also be applied to re-mortgage situations. There is no reason why an investor can't come in and buy out someone's existing mortgage. However, under present financial regulations, there would be some issues to be addressed.

v. In essence, this product will not be subject to FSA regulation because it is about the provision of accommodation rather than the provision of finance. There is no interest to be paid.

vi. Where could this be rolled out in the UK? First time buyers would be best. Smaller value properties would be best because there are no stamp duty problems.

7. The need for regulatory oversight

In recent housing market developments, builders commonly offer the buyer shared equity of 30% of property but charge them something like 60% of the cost. There would be great benefit in the long-term for the RISER product to come under investment brokerage rules by having the facilitator accountable for representing both sets of interests

Note to readers

This RISER housing financial product was developed by Matthew Gray, along with Gregor Moss, a long-standing Birmingham-based solicitor. A legal structure for this unique product has been formulated. Anyone interested in to learn more, or to use the RISER product in the market, is invited to get in touch with Gregor Moss at the following email address gregormoss1@live.co.uk.