enterprise FINANCE

SECOND CHARGE REPORT

EDITION 1

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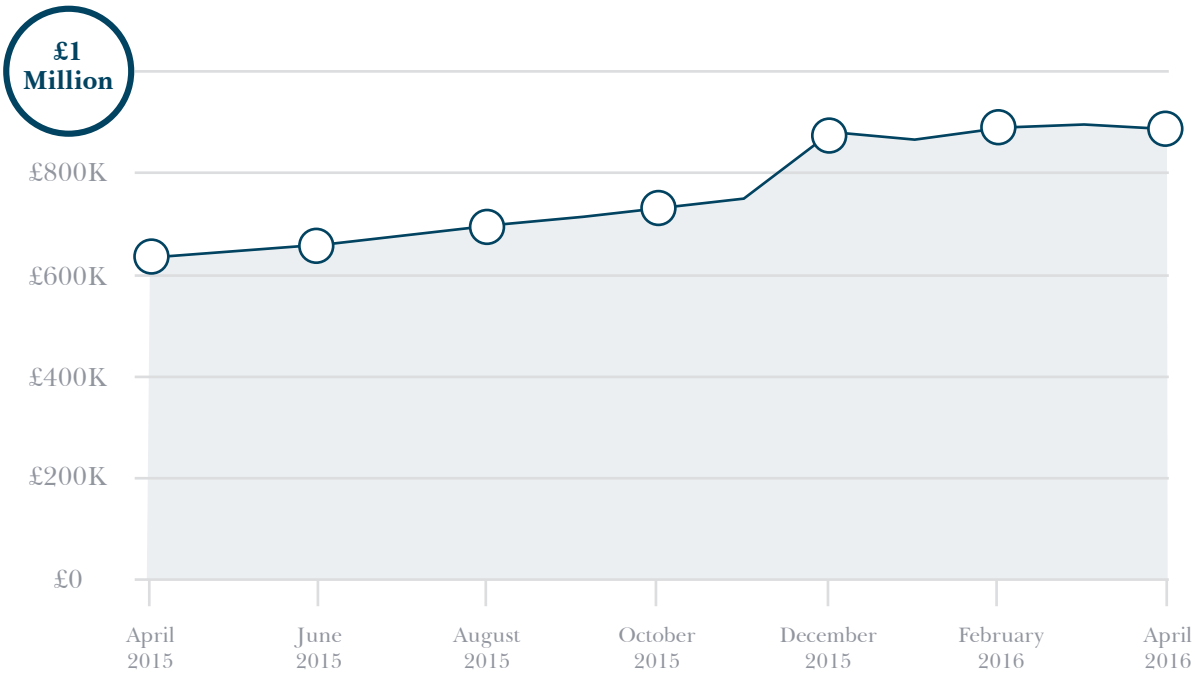
SECOND CHARGE LENDING INTERRUPTED AS MARKET ADJUSTS TO NEW REGIME

THE HIGHLIGHTS

- Mortgage Credit Directive implementation disrupts lending in **April**
- **Home improvements** dominate the uses for second charge finance at the **start of 2016**
- **Brexit** could provide opportunities for secured finance providers in coming months



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HARRY LANDY
SALES DIRECTOR

of Enterprise Finance, said:

The implementation of the new MCD legislation has required second charge lenders to change their systems, launch new portals and ensure staff are fully trained. With all the additional administration required, it’s no surprise that we’ve seen a short-term slowdown in second charge lending. However, this pause in growth has allowed the sector to build the foundations for future long-term expansion. Thanks to the new regulation, brokers should feel more confident in recommending secured loans for their customers where appropriate. With the new systems, expert staff and regulatory backing, the second charge market can now compete effectively against the mainstream remortgaging market.

This has translated into a major rise in conversion rates of applications to completed deals. At Enterprise, we’re seeing an uplift of around 20% to over 60%, as a direct result of the new regulations. Brokers are more familiar with the circumstances where second charges are appropriate and client expectations are being better managed throughout the advised process. Consequently, higher quality applications are being made to lenders and clients are more ready to sign once the offer is made. This proves that, however challenging the changeover from CCA, the industry has moved to a stronger platform for long-term operational efficiency.

So, although there has been a drop in April, our view is that this is a short-term blip because of this operational interruption. Lending volumes for May picked up for us as pipelines rebuilt, and June was better again, suggesting a progressive recovery as processes normalise. When looking at total gross annual lending, the sector has almost doubled in size over the past two years. When moving at such a rapid pace, it’s important that lenders have the steady footing that the new MCD regulation provides.

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Following the implementation of the Mortgage Credit Directive, specialist master broker Enterprise Finance is launching its new Second Charge Report, replacing its Secured Loan Index. This report draws on data from the Finance and Leasing Association (FLA) combined with Enterprise Finance’s expertise and wider market input to analyse trends in the sector. This Second Charge Report will look back at what has happened over the past few months, before looking forward to see what could happen after the EU referendum decision.

This first edition of the report examines the second charge market between February and April. Growth in second charge finance has slowed in April, with FLA figures recording a 19% drop in monthly lending compared to April 2015. This suggests the rapid expansion of the secured loan sector seen during the winter months cooled in spring.

This apparent decline in monthly lending has been mainly caused by disruption following the implementation of the EU’s Mortgage Credit Directive (MCD) in March. As many lenders and brokers chose to spend a significant amount of time and capital, embedding new systems and training staff on how to deal with MCD regulations, the sector’s productivity stalled. The new regime required lenders to create new IT systems to process loans. Lenders also had to ensure all relevant staff are attaining CeMAP qualifications to meet required competency standards. For some second charge providers, the technology may have had teething problems, while others used the month to reorganise before resuming normal lending.

With the additional regulation, there has been a 41% fall in secured lending month-on-month. The decline is somewhat exaggerated by high March figures, when many lenders rushed through existing CCA-regulated deals before the new rules came into place. This decision to maximise business before the new legislation led to record £86m lending in March. Lenders then paused to take stock and rebuild pipelines in April. While monthly lending has declined, gross annual second charge lending has surged. For the 12 months to April 2016, total lending stands at £886m, up 29% on the previous year.

TYPICAL TRANSACTIONS

While the number of monthly transactions has fallen since January, the size of the average second charge loan has risen by **14%** over the last four months. With typical loans sizes remaining over **£60,000**, this suggests that using secured finance for larger projects is a long-term trend that may well continue throughout the year.

Despite a fall in demand in April, lending has remained controlled, with the average loan-to-value ratio only increasing to **60%** from 59% in January. The average loan to value ratio saw a significant fall to **51%** in March, but this appears to be a short-term dip, rather than part of a larger trend.

- **Average loan size** rises to **£62,864** in April, up from **£54,894** at the start of 2016
- Average loan-to-value ratio for second charge finance increases **1%** since January

HARRY LANDY CONTINUED:

It's interesting to note that the average loan size for second charge finance has increased by almost £8,000. This upswing suggests that secured lending is becoming a realistic alternative to remortgaging, with consumers using it to raise more finance than they have in previous years.

Despite a transitional few months in the sector, it's reassuring to see that the loan-to-value ratio for secured lending has remained at around 60% during the first four months of 2016. This will ensure that both consumers and lenders are protected against any economic shocks which may impact house prices, following the recent Brexit vote. With the MCD increasing the level of protection for consumers, they should feel more secure than ever before when deciding to raise additional finance.

BREXIT COULD PROVIDE OPPORTUNITIES FOR SECURED FINANCE IN COMING MONTHS

HARRY LANDY COMMENTS:

It is too soon to say what the full effect of the decision to leave the European Union will involve. While lending volumes could decline, the EU referendum doesn't compare to the last recession when there was a liquidity crisis, followed by huge tightening of risk appetites, which stopped lending dead. Post-vote, deals are still going through and for most lenders it is a case of business as usual. Some customers may take a 'wait-and-see' approach, postponing borrowing until the uncertainty subsides. However, as this won't necessarily happen for months or years, many will want to raise additional finance sooner. Initial signs suggest this may be the case, with loans still being completed and new deals coming in.

AND CONCLUDES:

The fundamental drivers of demand for second charge loans are still in place after the EU referendum. Borrowers will continue to need secured finance for debt consolidation and home improvements – the sector's bread and butter. There may also be more opportunities for lenders, should high-street lending decline. However, lenders will have to be responsible, given the uncertainty in the market. This means we may see a decrease in the average loan-to-value ratio, to ensure lenders minimise exposure to any future economic shocks.

On 24th June the UK received its most significant political news in a generation, as the nation voted to leave the European Union. It's far too early to tell what the long-term impacts will be, with years of trade negotiations and exit talks still to take place. However, second charge lending is still on-going after the referendum, in contrast to the situation after the 2008 Lehman Brothers bankruptcy.

The decision to leave the EU may prove to yield plenty of opportunities for second charge finance lenders in the coming months. This could include an uptick in demand for secured loans, as a method of debt consolidation. Prior to the vote, consumers were increasingly relying on unsecured debt as a source of finance, with Bank of England figures showing consumer credit had risen £1.3bn month-on-month in April. With high levels of uncertainty, borrowers may decide to consolidate their debt to make their payments more manageable. Further, using a secured loan allows borrowers to pay lower interest rates than those on unsecured loans or credit cards, and that will continue to benefit consumers with household equity, regardless of Brexit. Should the Bank of England cut the base rate, this would also make secured finance more affordable for potential customers.

While some businesses in the property sector have been hit by the leave vote, such as investment funds with significant commercial property portfolios, the fundamentals of the housing market remain sound. There is still a shortage of available homes compared to the number of people who want to get on the property ladder, so house prices should remain relatively stable. However, we may see fewer home sales. Homeowners may prefer to stick with their current home but invest money to improve it, rather than move to a better place. This could be good news for secured lenders, as home improvements remain one of the most popular uses for second charge finance.

ABOUT ENTERPRISE FINANCE

Enterprise is a multi-award winning master broker specialising in the safe distribution and packaging of secured loans, bridging finance and commercial mortgages and was established in 2002.

It is widely recognised as one of the largest and most innovative providers of broker services in the UK and its services are offered to many of the UK's major networks. Its network partners include Openwork, Intrinsic, First Complete, Home Loan Partnership, NACFB as well as a large percentage of the directly authorised community.

Since its incorporation, it has sourced and managed more than £800m of secured loans, bridging finance and commercial mortgages.

In 2014, Enterprise Finance was named the 15th fastest-growing company in the UK according to The Sunday Times / BDO Profit Track 100 programme and in 2015 was ranked 22nd in The Sunday Times / Virgin Fast Track 100.

Enterprise Finance would be grateful for any hyperlinks you could provide. For ease, we've provided these links: Enterprise Finance, secured loans or, preferably, commercial mortgages which you can copy and paste directly into the articles.

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Enterprise Finance Sales Director Harry Landy is available for comment on a variety of industry-related topics. Please get in touch for more information.

The Enterprise Finance Secured Loan index is devised using a combination of Enterprise Finance's own management information and data from trade bodies and lenders.