Consultation on Proposals to Exempt Certain Heritable Securities from the ‘20 Year Security Rule’
CONSULTATION ON PROPOSALS TO EXEMPT CERTAIN HERITABLE SECURITIES FROM THE ‘20 YEAR SECURITY RULE’

We are consulting with you to seek your views on our proposals to exempt certain Scottish Government schemes from the right to redeem a heritable security after 20 years.

Background

The ‘20 year security rule’ was enacted in the Land Tenure Reform (Scotland) Act 1974. The 20 year security rule provides that a standard security (i.e. mortgage) over a private dwellinghouse may be redeemed after 20 years on repayment by the borrower of all money advanced under the security together with interest and expenses. One of the main purposes of the 1974 Act was to prohibit the creation by feu superiors of new feuduties (annual payments which the owner of a property had to pay their superior), and this prohibition was supported by the introduction of the 20 year security rule so that superiors could not circumvent the prohibition by creating new sources of income through ground rents and interest payments on very-long-term leases/standard securities.

At the time that the provisions were enacted, it was never intended nor even considered to be a restriction on shared equity and equity release schemes. No such restrictions apply in any other jurisdictions of the UK.

On 1st August 2014, the Housing (Scotland) Act 2014 received Royal Assent. The Act introduces a new section 11(3D) to the Land Tenure Reform (Scotland) Act 1974 and provides that the right to redeem a standard security, as permitted by Section 11 of the 1974 Act, will not be allowed in certain circumstances to be prescribed by the Scottish Ministers by way of an Order.

The new Section 11(3E) of the 1974 Act provides that an Order by Scottish Ministers may disapply the right to redeem a standard security, subject to certain conditions or restrictions. Such an Order may restrict the disapplication of the right to redeem to specified descriptions of debt, to specified creditors or creditors of prescribed descriptions, to specified heritable securities or to heritable securities of specified descriptions.

The policy objectives for introducing the change to the 20 year security rule are set out in the Policy Memorandum that was published along with the Housing (Scotland) Bill 2013.

Proposed Exemptions

Using the new order-making power in section 11(3D) of the 1974 Act, the Scottish Ministers propose to exempt the following Scottish Government schemes from the provisions of the 20 year security rule:

- The Help to Buy (Scotland) Scheme
- Homestake
- Open Market Shared Equity Scheme
- New Supply Shared Equity Scheme
- The Help to Adapt Scheme
The policy reasons for excluding the above schemes from the operation of the 20 year security rule are provided below:

1. **To ensure that Scottish Ministers are not exposed to the financial risks associated with the 20 year security rule**

Shared equity schemes operated by the Scottish Government provide financial assistance to homebuyers, with the financial assistance being secured by the buyer granting a standard security in favour of the Scottish Ministers over the title to the house which is purchased. The financial assistance provided by the Scottish Government is expressed as a percentage of the initial value of the property and is linked to future property values. This means that if a property value increases, both the shared equity owner and the Scottish Ministers will benefit on a shared basis. However, if the buyer was to exercise the right to redeem the security after 20 years, the buyer need only repay to the Scottish Ministers the original amount of the financial assistance, whereas the actual value of the property (and the value of the Scottish Ministers’ “equity stake”) might be significantly greater, assuming that property values will have increased over the 20 year period.

In order to avoid the difficulty of the 20 year security rule, the schemes, until recently, included a contractual clause which would be triggered in year 19 of each shared equity transaction. Buyers are required in year 19 to grant a new standard security in favour of the Scottish Ministers in substitution for the original standard security, thereby avoiding the buyer attaining the ability to acquire the right to redeem under the 20 year security rule. If for any reason a buyer refuses to grant a substitute security in year 19, then this triggers a payment event which requires the buyer to immediately repay the whole of the Scottish Ministers’ equity stake.

These arrangements ensure that the Scottish Government is not exposed to the financial risks of the 20 year security rule, i.e. the risk that borrowers would be able to redeem their loan after year 20 at its original value by reference to pounds and pence, rather than by reference to property value.

While this workaround operated satisfactorily, changes to Financial Conduct Authority guidance (related to affordability tests and mortgage duration) has meant that lenders were unwilling to participate in the Help to Buy (Scotland) scheme and the Scottish Government’s Low Cost Initiative for First Time Buyers (LIFT) schemes on the basis of the scheme documentation making provision for a payment event being triggered in year 19. Without lender participation these schemes will not be viable and so, in order to secure lender participation, the Help to Buy (Scotland) scheme since it was launched in September 2013 has operated without a year 19 payment event clause. Similarly the LIFT schemes have operated without this clause since April 2014, although buyers have been made aware that the Scottish Ministers intend to remove the right to redeem that the 20 year security rule would otherwise give them.

If the 20 year security rule is disapplied from these schemes, potential losses could be prevented with Scottish Ministers being able to benefit if property values will have increased over the 20 year period. In relation to the Help to Buy (Scotland) scheme, for a three-year £275m scheme, these foregone receipts are estimated to be between £120 million and £320 million (nominal) but could be, subject to high house price growth, as high as £850 million.
For the Help to Buy (Scotland) scheme, there is also a risk that the operation of the 20 year security rule might mean that repayment of the financial transactions for the scheme by the Scottish Government to HM Treasury would not be covered, particularly if house price growth is lower than expected.

The proposed disapplication of the 20 year security rule will also cover transactions under the LIFT shared equity schemes. Based on a one-year, £50m LIFT scheme, potential losses of foregone receipts could again be prevented with Scottish Ministers being able to benefit if property values will have increased over the 20 year period. These foregone receipts are estimated to be between £20 million and £55 million (nominal) but which could be, subject to high house price growth, as high as £150 million.

2. To facilitate lender participation in Scottish Government shared equity loan and equity release schemes.

The Mortgage Market Review changes came into force on 26 April 2014. The changes were intended to reinforce consumer protection and they introduce greater scrutiny for lenders relating to affordability tests and mortgage duration. The changes will be overseen by the industry regulator, the Financial Conduct Authority.

Lenders were unwilling to participate in the Help to Buy (Scotland) scheme unless the year 19 payment event trigger clause in the shared equity documentation was removed. Prior to the launch of the scheme in September 2013, the Scottish Government therefore removed the trigger clause from the draft legal documentation.

In April 2014, the trigger clause in the shared equity agreement for the LIFT schemes was also removed, to ensure that those lenders currently participating in the schemes would continue to do so.

Removing the trigger clause in the shared equity agreements for the Help to Buy (Scotland) scheme and the LIFT schemes exposes the Scottish Ministers to the financial risks associated with the 20 year security rule as explained above. The Scottish Government therefore proposes to exclude these schemes from the impact of the 20 year security rule.

One of the main aims of the Help to Buy (Scotland) scheme is to help stimulate housebuilding, helping to support jobs in the construction sector and allied industries and increasing choice and availability of homes for prospective purchasers. The Scottish Government’s LIFT scheme also generates activity in the Scottish housing market by helping existing home owners to buy another property since they are able to sell their current home to a first-time buyer supported by LIFT.

The disapplication of the 20 year security rule from these schemes should therefore promote the continuation and success of the schemes by ensuring continued lender participation.

3. To increase consumer confidence in equity release schemes

Equity release schemes are designed to help people access funds while staying in their homes and these schemes can amongst other things help people avoid having to downsize. Under the Help to Adapt scheme, an equity
loan needs only to be repaid when a homeowner sells their property or dies. While this means there are no affordability issues like those that will affect the Help to Buy (Scotland) and LIFT schemes, because the amount to be repaid by the homeowner will be expressed as a percentage of the value of the house and not a fixed amount, contractual agreements would still need to include a trigger clause provision at year 19 because of the potential impact of the 20 Year Security Rule. This additional complexity could potentially undermine take up levels for the scheme and it could also potentially undermine confidence in the scheme.

4. The changes will provide potential savings to existing homeowners

For all homeowners who have entered into a shared equity agreement with the Scottish Ministers that contains a trigger clause at year 19, there are potential savings relating to avoiding the legal costs of putting a new replacement standard security in place in year 19. These legal costs have been estimated at around £900 per property. The changes will also reduce any uncertainty that homeowners have about what the future legal position is relating to the property at the expiry of the 19 year period.

Shared Ownership

We do not propose to exempt Shared ownership transactions as they do not need to be exempted from the 20 year security rule because the sharing owner only takes title to what the share of the home that he or she has purchased and they do not take a loan from, nor grant a security to the Scottish Ministers.

Islamic Mortgages in Scotland

In 2009, the Islamic Bank of Britain introduced a model in Scotland utilising the Musharaka structure. As far as we are aware, this is one of the most common Islamic funding structures currently used by purchasers in Scotland. Under this structure, the initial purchase of the property is made jointly by a lender and a purchaser in proportion to their contributions to the purchase price. The purchaser then buys out the interest of the lender over the term of the mortgage arrangement, and during that time the parties enter into a co-ownership agreement under which the purchaser obtains exclusive possession of the property in return for a further periodic payment. The lender also obtains a standard security over the purchaser’s interest in the property.

Purchasers in Scotland are also able to use the Murabaha Structure which is essentially an instalment sale. Under this structure, a lender will purchase the property, and agree to sell it to the purchaser at an agreed higher price, which the purchaser pays by way of instalments over time. The title to the house is held by the purchaser who pays his lender an increased purchase price on a deferred basis. Under this method, a lender will require to take a Standard Security over the property and so, if it is assumed that the period over which the purchaser pays the purchase price on a deferred basis is typically twenty five years in line with a conventional mortgage, then that Standard Security could be caught by the twenty year security rule. However, it could be argued that there are no undesirable implications of this, since while the purchaser could in theory exercise their right to redeem the standard security after 20 years by repaying the original amount of the "borrowing" – i.e. the balance of the deferred purchase price - that should simply result in the lender receiving
restitution of all that they are due. This contrasts with the Scottish Government’s shared equity schemes where the Scottish Ministers’ equity stake is variable and what is due to be repaid in year 20 may well be different from what was due to be repaid at the outset, but equally it is no different to the position which applies to the vast majority of mainstream secured mortgages.

**Impact of the 20 Year Security Rule on Islamic Mortgages**

The Scottish Government has considered whether the 20 Year Security Rule has any impact on the above two structures of Islamic mortgages. Based on the summaries provided above, it would appear it does not. However, as part of this consultation, it would be helpful if you could share your views on whether there are any changes that you feel could help provision of Islamic mortgages in Scotland.


**Proposed Exemption of All Existing Securities**

The proposed disapplication of the 20 year security rule will not only apply to home owners who have entered into a shared equity agreement with the Scottish Ministers which does not contain a year 19 trigger clause as discussed above. It will also apply to existing home owners who have previously purchased a home under the specified schemes.

While a consequence of the rule being disapplied will be that these existing home owners would lose a potential right to redeem the equity loan at its original value after 20 years, for most this loss is only theoretical. The reason for this is that all, apart from the most recent of these home owners have entered into a shared equity agreement which contains a trigger clause at year 19 allowing the Scottish Ministers to require that the homeowner grants a new Standard Security prior to the expiry of 20 years. If a homeowner does not agree to grant a new security, the Scottish Ministers could take legal action to recover their equity share in full and in practice would almost certainly do so due to the financial risk which would otherwise arise. Therefore these home owners would never acquire the right to redeem. The exception is those who have recently entered into shared equity agreements, but there is no detriment to them from removal of the (unacquired) right, as they have been told of the intention to prevent them being able to exercise the right.

In either case, we expect that many homeowners may either sell their home before year 19 or alternatively they may have purchased additional equity shares over a period of time so that they have full ownership before year 19. The advantage of including existing securities in the provision is that there will be no need for the Scottish Ministers to invoke the ‘trigger’ at year 19 to ask the homeowner to grant a new heritable security. This is also an advantage for homeowners who will not need to grant a new security, with all the associated costs, and they will not have to face a calling up notice (for the Scottish Ministers’ equity share) if they do not grant the security. It will also provide homeowners with additional comfort that no action will be taken by the Scottish Ministers at year 19 to recover its equity share.
A further advantage of excluding existing securities is that each scheme will continue to operate with one category of security rather than have two different categories of securities – i.e. one with no need for homeowners to grant a new security at year 19 and one where homeowners must grant a new security at year 19.

We are seeking your response and comments to the five questions set out in Annex C.
Annex A
Partial Equalities Impact Assessment – Consultation on Proposals to Exempt Certain Heritable Securities from the ’20 Year Security Rule’

Executive Summary

This Partial Equalities Impact Assessment (‘EQIA’) builds upon the findings of the EQIA which was undertaken on the Housing (Scotland) Bill 2013 and was published in 21st November 2013. This EQIA reflects the proposed changes in this consultation paper and in order to ascertain views on the equality impact of the proposals there is a specific question on equalities in Annex C.

Background

Section 77 of the Housing (Scotland) Act 2014 introduces a new section 11(3D) to the Land Tenure Reform (Scotland) Act 1974 that provides a power for the Scottish Ministers to exempt heritable securities from the provisions of the 20 Year Security Rule.

The Scottish Government proposes to exempt the following shared equity and equity release schemes from the 20 Year Security Rule:
- The Help to Buy (Scotland) Scheme
- Homestake (which went on to form the Low Cost Initiative for First Time Buyers (‘LIFT’) schemes comprising the Open Market Shared Equity and New Supply Shared Equity scheme)
- Open Market Shared Equity Scheme
- New Supply Shared Equity Scheme
- Help to Adapt Scheme

We also seek views from respondents on whether there are any changes that they feel could help introduce more Islamic mortgages in Scotland, or improve the way they operate.

Who will the changes affect?

Under proposals to exempt the above noted schemes from the 20 year security rule, owners of properties who have received assistance from the Scottish Government under these schemes would be affected. Shared equity schemes operated by the Scottish Government make loans available with buyers and these loans are linked to property value. Buyers are required to grant a standard security in favour of the Scottish Ministers. In order to avoid the difficulty of the 20 year security rule, the schemes, until recently, included a break clause at year 19 in shared equity agreements that were entered into with buyers. Buyers are required at year 19 to grant a new standard security in favour of Scottish Ministers. This ensures that the Scottish Government is not exposed to the financial risks of the 20 year security rule, i.e. that borrowers would be able to redeem their loan after year 20 at its original value by reference to pounds and pence, rather than by reference to property value.

Under the proposals, buyers would lose the right to redeem Ministers equity share at its original value after 20 years. However, this loss of right to redeem is only theoretical as buyers are required at year 19 to grant a new standard security in favour of Scottish Ministers.
**Seeking Views from Equalities Bodies**

The Scottish Government has issued a copy of this consultation paper to representative equalities bodies to gather information on whether the proposed changes are likely to impact on any specific groups.

The Scottish Government plans to consider all responses to the consultation paper and publish a report on these responses to the consultation paper in 2015.
RESPONDENT INFORMATION FORM AND QUESTIONS

Consultation on Proposals to Exempt Certain Heritable Securities from the ‘20 Year Security Rule’

Please Note this form must be returned with your response to ensure that we handle your response appropriately

1. Name/Organisation
Organisation Name

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(a) Do you agree to your response being made available to the public (in Scottish Government library and/or on the Scottish Government web site)?

Please tick as appropriate
[ ] Yes  [ ] No

(b) Where confidentiality is not requested, we will make your responses available to the public on the following basis

Please tick ONE of the following boxes

(c) The name and address of your organisation will be made available to the public (in the Scottish Government library and/or on the Scottish Government web site).

Are you content for your response to be made available?

Please tick as appropriate
[ ] Yes  [ ] No
(d) We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

Please tick as appropriate

☐ Yes  ☐ No
ANNEX C
Consultation Questions

Question 1
Do you agree with the proposals to exempt specified Scottish Government schemes from the effect of the ’20 Year Security Rule’?

Yes □ No □

Question 2
Section 11(3E) of the Land Tenure Reform (Scotland) Act 1974 provides that an Order by the Scottish Ministers may disapply the right to redeem a standard security subject to certain conditions or restrictions. Such an Order may restrict the disapplication of the right to redeem to specified descriptions of debt, to specified heritable securities or heritable securities of specified descriptions.

Do you think that an Order should disapply the right to redeem a heritable security after 20 years for any specified securities or specified creditors other than the Scottish Government schemes discussed in the foregoing consultation paper?

Yes □ No □

If you do, please explain your reasons why and describe what security or securities you consider should be affected.

Question 3
The draft Order proposes that the exemption for the LIFT schemes will apply to all existing homeowners who have previously purchased a home under these schemes. Do you agree with this approach?

Yes □ No □
**Question 4**

Over and above the existing Islamic Funding structures that are currently operating in Scotland, do you think that there are any changes that could help provision of Islamic Mortgages in Scotland, or make them operate better?

Yes ☐ No ☐

If yes, please provide detailed information explaining what these changes are.

**Question 5**

In relation to the Partial Equalities Impact Assessment, are you aware of any potential impacts, either positive or negative that you feel the proposals in this consultation paper may have on any particular groups of people?

Yes ☐ No ☐

If yes, please provide detailed information explaining what these changes are.
Annex D

How to Respond to the Consultation

Consultation is an essential and important aspect of the Scottish Government's working methods. Given the wide-ranging areas of work of the Scottish Government, there are many varied types of consultation. However, in general, Scottish Government consultation exercises aim to provide opportunities for all those who wish to express their opinions on a proposed area of work to do so in ways which will inform and enhance that work. The Scottish Government encourages consultation that is thorough, effective and appropriate to the issue under consideration and the nature of the target audience. Consultation exercises take account of a wide range of factors and no two exercises are likely to be the same.

Typically Scottish Government consultations involve a consultation paper inviting answers to specific questions or more general views about the material presented. Consultation papers are distributed to organisations and individuals with an interest in the issue, electronically or in hard copy and are placed on the Scottish Government's consultations webpage to allow for participation from a wider audience. Consultation exercises may also involve seeking views in a number of different ways, such as through public meetings, focus groups or questionnaire exercises. Copies of all the written responses received to a consultation exercise (except those where the individual or organisation requested confidentiality) are placed in the Scottish Government library at Saughton House, Edinburgh (K Spur, Saughton House, Broomhouse Drive, Edinburgh, EH11 3XD, telephone 0131 244 4565).

The Scottish Government also has an email alert system for all consultations (SEconsult: http://www.scotland.gov.uk/consultations/seconsult.aspx). This system allows stakeholder individuals and organisations to register and receive a weekly email containing details of all new consultations. SEconsult allows you to register for consultations on specific topic areas across the Government. Please follow the SEconsult link above if you wish to register.

Responding to this consultation paper

We are inviting written responses to this consultation paper by noon on Friday 2nd January 2015.

Please send your response to:

securityruleconsultation@scotland.gsi.gov.uk

or

John Mcrorie
8th Floor, Highlander House
58 Waterloo Street
Glasgow
G2 7DA
Please make sure you return your:

1) Response
2) Respondent Information Form
3) Any comments on the partial Business Regulatory Impact Assessment

If you have any queries on the content of the consultation paper or the consultation process, please contact john.mcrorie@scotland.gsi.gov.uk
Please indicate in your response which questions or parts of the consultation paper you are responding to as this will aid our analysis of the responses received.

Handling your response

We need to know how you wish your response to be handled and, in particular, whether you are happy for your response to be made public. Please complete and return the Respondent Information Form which forms part of this consultation paper as this will ensure that we treat your response appropriately. If you ask for your response not to be published we will regard it as confidential, and we will treat it accordingly.

All respondents should be aware that the Scottish Government is subject to the provisions of the Freedom of Information (Scotland) Act 2002 and would therefore have to consider any request made to it under the Act for information relating to responses made to this consultation exercise.

While details of particular circumstances described in a response to a consultation exercise may usefully inform the policy process, consultation exercises cannot address individual concerns and comments, which should be directed to the relevant public body.

Publishing responses

Where respondents have given permission for their response to be made public (see the attached Respondent Information Form), these will be made available to the public in the Scottish Government Library and on the SEconsult web pages within 6 weeks of the close of the consultation. Where agreement to publish has been given, we will check all responses for any potentially defamatory material before logging them in the library or placing them on the website.

You can make arrangements to view responses by contacting the Scottish Government Library on 0131 244 4552. Responses can be copied and sent to you, but a charge may be made for this service.

What happens next?

Following the closing date, all responses will be analysed and considered along with any other available evidence to help us reach a decision on the draft regulations. Final regulations will require to be laid in Parliament.

All Scottish Government consultation papers and related publications (eg, analysis of response reports) can be accessed at: SEconsult (http://www.scotland.gov.uk/consultations).
The views and suggestions detailed in consultation responses are analysed and used as part of the decision making process, along with a range of other available information and evidence. Depending on the nature of the consultation exercise the responses received may: indicate the need for policy development or review inform the development of a particular policy help decisions to be made between alternative policy proposals be used to finalise legislation before it is implemented

Final decisions on the issues under consideration will also take account of a range of other factors, including other available information and research evidence.

**Comments and complaints**

If you have any comments about how this consultation exercise has been conducted, please send them to john.mcrorie@scotland.gsi.gov.uk