UK Home Finance Options

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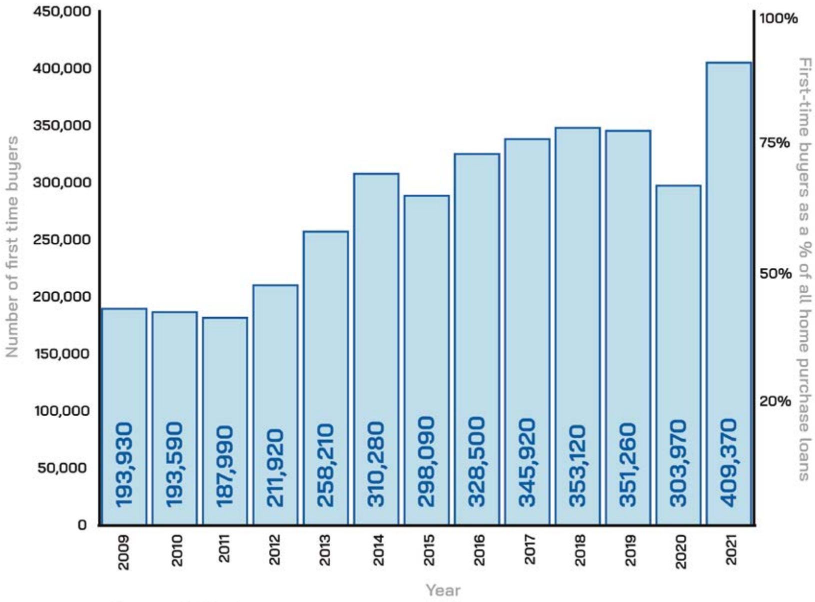
First-time buyer mortgages have been on a steady rise since 2009, from around 193,000 to almost 410,000 in 2021. A slight drop to just under 304,000 in 2020 can be attributed to Covid-19, when mortgage applications were extremely low across the country.[1]



(Source: Halifax)

Whether buyers are looking to finance a new home purchase, remodel an existing property, or refinance an existing loan, there are home finance options available catering to different needs. This article will provide insight into some of the most common home financing options available in the UK and explore alternative sharia compliant solutions. The UK is one of the leading countries in the world for home finance options. With a wide variety of options available, homeowners can easily access the resources they need to purchase, refinance, or remodel their property.

Cash Purchase

Although uncommon, the cheapest, and arguably most simple, choice when making a large purchase such as a property is to fund all or part of it without the need to borrow or finance the purchase. If you're able to pay the whole price in cash, you'll own the property outright at its spot-sale price. Although it is common for banks and solicitors to question origins of large cash amounts and you will need extra money aside for stamp duty, surveyor, and other fees.

Unsecured Personal Loans

Another option when looking to make a large purchase is for an individual to obtain a personal loan via friends and family. This is usually only done when buyers have some cash already and are

1 UK Mortgage Statistics 2022.
https://www.uswitch.com/mortgages/mortgage-statistics/#:~:text=The%20number%20of%20UK%20first,to%20almost%20410%2C000%20in%202021.

looking to supplement this with a relatively smaller loan to enable a cash purchase outright with a separate outstanding debt obligation with the creditors/lenders.

From an Islamic perspective, borrowing money which is to be returned with interest from a commercial bank, or from any interest-bearing lender, irrespective of source, to purchase a property or any other asset, whether secured or otherwise, is impermissible. This is the purest form of a ribawī (interest-based) contract.

Mortgages

Mortgage, the etymological roots of the word are from two Old French and Latin words ‘Mort’ meaning ‘death’ and ‘Gage’ meaning ‘pledge’, literally translating ‘mortgage’ to ‘death pledge’.

A mortgage is an interest-bearing lump sum loan to buy property or land for both commercial and personal use. The loan to an individual is secured against the value of your home until completion, enabling the bank to get at least part of its money if you default. Applying for a mortgage usually involves the bank calculating how much you can afford to take as a loan, with evidence of income and expenditures, and what type of mortgage you would require.

The lender or mortgage broker will begin a full affordability assessment using the evidence and ‘stress test’ your financial situation. This has become stricter after the 2008 financial crisis, in which a contributing factor was people being given a ‘NINJA loan’, a slang term for foregoing the verification process and giving a substantial loan knowing the person is likely to default as they have ‘No Income, No Job or Assets’.[2]

The larger deposit you can contribute towards the property, the better your interest rate will be. The cheapest rates are typically available for buyers with a 40% deposit or a 60% LTV. Loan to Value (LTV) is a common term you will hear from the bank or mortgage advisor and is simply the percentage of your property that is being secured against the loan.[3]

2 For further reading on ninja loans and their contribution to the 2008 financial crisis: Outbreak: U.S. Subprime Contagion. https://www.imf.org/external/pubs/ft/fandd/2008/06/dodd.htm

3 Mortgage information has been shared to help generate greater clarity. From an Islamic perspective, Interest-based Mortgages are considered Haram (forbidden). For more on this, please refer to the following presentation: https://online.iceurope.org/home-ownership.

Repayment Mortgage

A repayment mortgage is a type of mortgage where you repay some of the capital amount you've borrowed, as well as some of the interest on the loan every month. The aim is to pay back the original loan amount plus interest over the term agreed when you take out the mortgage, allowing you to build equity over time and eventually own your home outright. Almost every type of mortgage is a repayment mortgage.

- You will be paying monthly instalments which will be split into two aspects, part for the interest and part for the capital. The ratio will vary during the life of the mortgage, in the earlier years being majority interest and paying a minimal amount towards the capital of the loan.
- At the end of the mortgage, you will have paid the property off and it will be completely yours to own.

Interest-Only Mortgage

An interest-only mortgage requires you to pay the interest on the mortgage amount each month, but not any repayment towards the capital you've borrowed. Instead, the loan amount is paid back at the end of the mortgage period, so you will need to make sure that you have the means to repay the whole debt. This differs from a repayment loan described above, where the amount is paid back incrementally alongside the interest.

- With interest only mortgages, you only pay off the interest of the loan and never contribute towards the capital. The advantage is a lower monthly cost as there is never any capital contribution in the composition of your monthly payments.
- You will usually have a separate method for paying the original loan at the end of the loan term, whether that is saving over the course of the mortgage or selling the property at the end to give the lender their money.

Variable-rate Mortgage vs Fixed-rate Mortgage

Once you have decided which method to go with, you will have to decide on a fixed or variable interest rate. The banks will usually give a fixed 'offer' rate for a certain period, usually around 2-5 years and then you will be put onto their considerably higher variable rate. Variable rates usually move up and down with the base rate set by the Bank of England. Most homeowners shop around after this offer period and try to remortgage for a better rate, like how someone would look for a better priced phone contract after the contract comes to an end and you are put onto higher tariffs for data and calls.

Being moved from a fixed 2.5% to variable 3.5% for instance may not sound like a great change, however over the course of a 25-year mortgage for £100,000 the repayment at 2.5% and 3.5% would amount to £134,585 and £150,187 respectively. An increase of £15000, or 15% of the initial loan given a 1% increase in interest. The reason is the way interest is applied onto your loan, called Compound Interest. Compounding interest is the addition of interest principal sum of the loan, in simpler terms, interest on interest.

Graph 1 Example:

Original Amount: £100,000 **Interest Rate:** 3%

Year	Loan Amount	Interest	Total Owed	Loan Repayment
1	£100,000	£3,000	£3,000	£6,000
2	£97,000	£2,910	£2,910	£6,000
3	£93,910	£2,817	£2,817	£6,000
4	£90,727	£2,722	£2,722	£6,000
5	£87,449	£2,623	£2,623	£6,000
6	£84,073	£2,522	£2,522	£6,000
7	£80,595	£2,418	£2,418	£6,000
8	£77,013	£2,310	£2,310	£6,000
9	£73,323	£2,200	£2,200	£6,000
10	£69,523	£2,086	£2,086	£6,000
11	£65,608	£1,968	£1,968	£6,000
12	£61,577	£1,847	£1,847	£6,000
13	£57,424	£1,723	£1,723	£6,000
14	£53,147	£1,594	£1,594	£6,000
15	£48,741	£1,462	£1,462	£6,000
16	£44,203	£1,326	£1,326	£6,000
17	£39,529	£1,186	£1,186	£6,000
18	£34,715	£1,041	£1,041	£6,000
19	£29,757	£893	£893	£6,000
20	£24,649	£739	£739	£6,000
21	£19,389	£582	£582	£6,000
22	£13,971	£419	£419	£6,000
23	£8,390	£252	£252	£6,000
24	£2,641	£79	£79	£2,721

Let us take the example of a £100,000 mortgage and apply a 3% interest rate. The amount owed back to the bank in Year 1 would be £103,000. If the buyer is repaying at a reasonable £500 a month, this would accumulate to £6,000 of repayment to the bank. The amount owed to the bank would be reduced to £97,000 at the end of year 1. However, in Year 2 this £97,000 would again be considered borrowed from the bank at a 3% rate, resulting in the borrower owing £99,910 to the bank. This is almost equivalent to the £100,000 originally borrowed and from the second year onwards is interest on interest, compounding interest. **I have elaborated the example to its 24-year term in Graph 1 on the left.**

This accumulation of interest is what makes Ribā oppressive in its essence. It goes “against the laws of entropy that exist within the universe” and “allows a given monetary value to merrily march the path of geometric increment towards infinity”[4]

An Islamic Perspective to Transactions

Conventional Sales

Purchasing a property in a single transaction with both property and cash exchanged immediately is a perfectly acceptable transaction. Purchasing a house with immediate exchange of property and paying in instalments under a non-interest credit line is also a halal transaction and would be permissible.

If a bank was to purchase a house of its own accord, hold that property as an asset and then sell it at a higher markup under a Murabaha contract to an individual there would be no issues within the Muslim community.

The contention is that banks are not property traders, despite how they may package their financial products, the business of a bank is to make money through lending. Conventionally a bank would purchase a house with a pre-agreed obligation or promise from the borrower that he will in fact buy the property from the bank at an agreed price and payment plan. The bank takes no risk in this transaction and is looking to use the house as an intermediary to loan money and receive interest. The bank takes no interest in the actual product, other than the value to ensure it can secure them their money if a buyer defaults on the initial loan that they assessed the buyer’s financial situation against. This same transaction could be accomplished with any intermediary ranging from a house to a boat to a bottle of water. The bank’s risk profile will not change if they have secured their loan against something of adequate value. The demand for mortgages is abundant due to a property usually being the largest purchase in any individual’s life, followed second by a car. Similarly, it is possible to have a car secured against a loan for a lesser amount.

4 The Problem With Interest. 3rd Ed. 2010. (See p. 8-13 for a more detailed discussion on Interest and Entropy.)

Contemporary Views Allowing Mortgages

This commonly misunderstood fatwa is based on two major juristic considerations:

- The agreed upon juristic principle which asserts that extreme necessities turn unlawful matters lawful. This is derived from five Qur'anic texts, amongst them:
- "But whoever is forced [by necessity], neither desiring [it] nor transgressing [its limit] - then indeed, Allah is Forgiving and Merciful.[5]"

The Shari'ah is all encompassing and takes all scenarios into account. When dealing with the categories and levels of Masālih, they are categorised into the following 3:

1. Necessities (Darūriyāt)
2. Needs (Hājiyāt)
3. Embellishments (Tahsīniyāt)

As Muslims we need to show integrity and faithfulness to our rules and definitions. An accepted definition of darūriyāt is that without which one's life would be in danger. Necessities such as food, water, clothing, and shelter would be considered darūriyāt as it would be the danger of losing a life or limb.

Is Owning a Home Really an Extreme Necessity?

We need to be consistent and continue to adhere to our definition of necessity when considering turning unlawful matters lawful. As such we would have to exhaust all other options before going ahead with this to ensure we have strived to please Allah ﷻ with the capacity we have. An individual could consider a few cheaper alternative solutions, before going into alternative home-financing options later:

- Renting
- Living with family
- Shared housing
- Council Housing
- A smaller property
- Relocation to a cheaper area in which the buyer could afford a purchase with

5 An-Naḥl 16:115.

Naturally these come with very high opportunity costs. If someone had to relocate to a cheaper area, it could mean a change of job, children's schools and all the difficulties with an unfamiliar area and stability required for a family. This is a very difficult decision for most of us, however sometimes it can be the price of Īman.

Let us take an example of Suhaib ﷜ who was captured by the Quraish as he was travelling towards Medina to join the Prophet ﷺ. He told the Quraish he would guide them to all his wealth if they leave him alone. They agreed, and he proceeded to take them to where he had hidden his fortune. After they left him, and he reached the Prophet ﷺ, the Prophet ﷺ called to him cheerfully, "O Abu Yahia! A profitable sale! A profitable sale!". It was then an ayah from the glorious Qur'an was revealed "And of the people is he who sells himself, seeking means to the approval of Allah. And Allah is kind to [His] servants.[6]"

Given all of this, if a buyer thinks they are truly in need, and it is necessary then the buyer should consult with a scholar or Shari'ah council to derive a situation and individual specific fatwa which should not be taken generally, even if it seems similar to a situation in which a scholar had previously given concession.

Shari'ah Compliant Alternatives

Diminishing Partnership

A diminishing partner allows the bank and home buyer to enter a partnership in buying the house. The house is then rented to the home buyer at a rent in line with LIBOR (London Inter-Bank Offered Rate) whilst the home buyer simultaneously buys out the shares of the bank at a pre-agreed price until it is completely owned by the home buyer. The portion of the home owned by the bank would be proportional to the rent paid and would decrease as the buyer acquired more shares in the property.

Issues can arise if the home buyer is legally obligated to buy the shares of the bank, guaranteeing the bank profit, and makes it a clause in the tenancy agreement as part of the property purchase agreement.

6 The Qur'an Al-Baqara 2:207. Trans. Sahih International, Almunatada Al-Islami, Abul Qasim Publishing House (1997).

Direct from Developer

Some developers and investment companies allow buyers to pay for a property directly in instalments, usually asking for a higher deposit than a mortgage would require at around 50%. The overall price paid is usually above what the current property value is to account for how the investment company would value the risk of a monthly payment and potential default. These types of sales between two entities are completely permissible if an agreed fixed price is paid over a period for a property.[7] This financing option would also take into account the financial situation of the buyer and would have an associated affordability test by the developer or investment company.

So, What Shari'ah Compliant Options Exist in the Market Currently?

Despite there being limited options at the time of writing, there are a few options which Muslim buyers may want to consider, all of which have received Shariah-compliant certifications from the Islamic Finance Advisory (IFA), which are to be renewed by the IFA every 12 month pending successful completion of the IFA's diligence process. Accordingly, these options should be checked for certification validation before contracting is completed, as they can change from the time of writing and could contain non-Shari'ah compliant components.

Pfida

Pfida (formerly Primary Finance) operates on the Shared Ownership model in which the buyer purchases a portion of the property and pays rent for the outstanding equity in the property. Primary Finance also allow the buyer to purchase extra equity in the house without any obligations to do so.[8]

Heylo Housing

Heylo housing is a residential property company operating with local authorities to allow shared ownership leases and tenancy agreements without any obligation to buy more from them. Heylo's part buy – part rent solutions bring owning a home within reach for millions of previously excluded potential buyers.[9]

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7 Buy a home 'without a mortgage'. https://new-homes.co.uk/buy-a-home-without-a-mortgage-courtesy-of-new-payment-plan/
8 https://www.pfida.com/products/finance/home-finance/how-it-works/
9 https://yourhome.org.uk/?_ga=2.141748018.1261904499.1670552239-631283644.1670552239

Wayhome

Wayhome, formerly Unmortgage, helps you buy a home on a part buy, part rent basis, with a 5% deposit, and the allowance to gradually buy out the remaining 95% of the home over time.[10] Wayhome does not confine its offering to new builds, require you only to cover your share of the purchasing costs, do not stipulate fees when increasing your ownership share, and shares most of the maintenance costs of the property during the relationship of the agreement.

Please note that at the time of publishing this article Wayhome have closed applications to their first fund, but it is possible to sign up to their waitlist for their second fund via their website.[11]

10 https://www.wayhome.co.uk/
11 https://www.wayhome.co.uk/suitability

About the Islamic Finance Advisory

The Islamic Finance Advisory (IFA) offers tailored Shari'ah consultancy services to ensure financial and business activities align with Islamic principles. From Shari'ah compliance checks, certification for businesses, investments, and fintech, to guidance on zakah, waqf, wills, and inheritance, the IFA helps Muslims achieve Islamically ethical financial solutions. With expert adjudicators for dispute resolution and a commitment to wealth-building based on divine guidance, the IFA ensures equitable financial practices for individuals and businesses alike.

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