Mortgage chief feels assured of success with new take on lending

NIALL BRADY

Fergal McGrath is confident his buy-to-let firm Dilosk will be the leader in its class by 2020

Dilosk has a lot of history for a company that has been lending for less than three weeks. Home is a Georgian townhouse on Dublin's Hume Street that served as Fine Gael headquarters before the party's disastrous defeat at the 1977 general election.

The company's trading name, ICS Mortgages, dates from 1864 with the founding of the Irish Civil Service building society. A framed photograph of ICS's former head office — a gothic-revival landmark overlooking O'Connell bridge — hangs in the first-floor boardroom.

Despite the long lineage, Dilosk takes a thoroughly modern approach to lending. "We saw the need to do things differently: a new entity, new culture, new management, preferably with international experience," says Fergal McGrath, the chief executive.

Dilosk's corporate identity carries the fingerprints of an on-trend branding consultant. Dilosk stands for "solid capital": the first five letters are "solid" spelled backwards, and the "k" is economists' shorthand for capital.

Like many former bankers, McGrath spotted a gap in the mortgage market in the aftermath of the financial crash. Banks were bust and had stopped lending, while at the same time quantitative easing provided a ready supply of cheap funding looking for a home. All that was missing was somebody to join the dots.

In some ways it is no surprise that buy-to-let is Dilosk's chosen niche. Banks have all but abandoned the sector, which accounted for 2.5% of the €5.6bn they loaned in mortgages last year.

"The reality is banks aren't lending for buy-to-let," says McGrath. "This was a €6bn-a-year market that has dropped to €160m. The demand is there but it clearly isn't being met on the finance side. This has a knock-on effect on housing supply and is driving rents higher."

McGrath believes buy-to-let could support lending of €1bn-€1.5bn a year. "Our goal is to be the undisputed leader in buy-to-let by 2020," he says.

Prospective landlords may feel the establishment is out to get them, however. The government has capped rents in urban areas following a tenant revolt, and the Central Bank of Ireland requires landlords to have a minimum 30% deposit to prevent them borrowing too much. Interest on buy-to-let mortgages is only partially deductible against landlords' tax bills, although the government has promised to relax the rules gradually.

"I can understand why the government introduced rent caps — something had to be done — but it's not a long-term solution," says McGrath.

"Residential property is an attractive investment class. Rental yields are attractive, and

the demand for rental properties will remain strong."

McGrath set up Dilosk in 2013 with his brother Oran, who is chief operating officer. Oran used to run Medentech, a pharmaceutical company with about 80 staff in Wexford, where Fergal was an investor and a non-executive director. When Medentech was sold, Oran joined Fergal in his start-up mortgage company.

"He's 11 months older than me. He's a physicist, I'm an economist," says Fergal.

"We look at things differently, and it has been useful to have someone who wasn't tainted by the crisis in the banking world."

McGrath cut his teeth in lending as a college graduate, trying his luck in America on a Morrison visa in 1992. This led to a role as a property investment analyst for Sun Life Financial of Canada.

Although based in Boston, McGrath was responsible for all commercial lending west of the Mississippi. "I was given a lot of responsibility at a young age, travelling around the US with Sun Life's chequebook."

He recalls being asked by the developer of a San Diego shopping mall how an immigrant in his mid-twenties had sole responsibility for such a large investment — different times. After five years in America, the career opportunities created by the International Financial Services Centre led McGrath to return to Dublin. By 2007 he was looking after €200bn as global head of portfolio management for Dexia, a Franco-Belgian lender.

Divided loyalties were always an issue within the bank, especially when Dexia was bailed out by its respective governments in 2008.

"There were political clashes between the two nationalities. I used to joke that we [in Dublin] were the blue helmets, because we were neutral and just got the job done."

Tensions reached breaking point in 2011 when Dexia became the first big casualty of Europe's sovereign debt crisis, precipitating its eventual break-up along national lines.

McGrath's responsibilities increased as Dexia declined. "Assets under management were centralised and I was given a wider mandate to cover Dublin, New York, Tokyo, Singapore, Paris and Berlin."

Time differences meant the business was open for 22 hours a day. "Emails were coming in at all hours. It was a busy role, but exciting."

McGrath was picking up contacts as well as experience, and these included Alexandre Joly, the scion of a wealthy French family: "When the French government imposed a new board [at Dexia], Alexandre was appointed deputy to the chief executive, and I worked closely with him."

Joly's family backed McGrath when he decided to set up on his own — and his timing was good. Shortly after Dilosk was founded, the European Commission told Bank of Ireland to offload ICS, a former building society that had morphed into its broker-based mortgage arm, as a condition of the state aid received during the financial crisis.

The deal included €223m of ICS's existing mortgage book of €6.4bn. Not one of the 2,000 mortgages on the table was a loss-making tracker; all were performing.

"It was a one-in-a-100-year opportunity. We wanted to buy an existing book to seed the business and get scale," says McGrath.

"It's very difficult to establish as a lender without an existing book, as the costs are too great. One of the conditions for bidding was that you had to be a new lender. This gave us a unique opportunity, and it was evident we had to go for it."

Trying to convince potential backers was a challenge, because Ireland's mortgage arrears crisis was still growing.

"I went to London and discussed it with the investment banks. Some were lukewarm on Ireland, but others could see the opportunity."

It was "a complex transaction", involving many parties: the Central Bank, the Department of Finance, the European Commission, Bank of Ireland. "Many people said we were wasting our time, but we got there in the end."

Dilosk still waited almost three years before using ICS as a springboard for new lending.

"Everything takes longer than you expect," says McGrath.

The chances of picking up more performing mortgage books from other lenders is less likely. The field is more crowded now, because the mainstream banks are chasing the same assets. Frustrated by a housing shortage that is holding back mortgage demand, they are also trying to grow through acquisition.

"We're always looking for performing and reperforming books to grow the balance sheet," says McGrath. "We're competing against the pillar banks. Maybe we've got more flexibility in our criteria."

On buy-to-let, Dilosk differs from the banks by allowing landlords to borrow interest-only for up to 10 years. The new lender also sets itself apart by lending solely on the merits of a particular property and the rent it generates.

"Our underwriting principle is that the property has to wash its own face. We do not look beyond the property to the individual to see whether he or she is good for the debt [from their other earnings]," says McGrath.

This focus on the property rather than the individual allows Dilosk to experiment with non-recourse lending. If an investment goes sour, a non-recourse loan means the borrower is free to hand back the keys with no liability for any shortfall on the mortgage.

While Dilosk currently restricts non-recourse to properties bought within a pension structure, McGrath says it may extend the facility to other borrowers.

He rules out entering the market for home loans, at least for now, claiming it is best left to the banks. His reticence is no doubt influenced by political pressure from Fianna Fail to force down the cost of home loans through regulation.

Irish mortgages will never be as cheap as those in France or Belgium, says McGrath, unless Irish lenders are given the same freedom to foreclose in the event of default.

"When we go on investor roadshows in London or Paris to raise capital, one concern that comes up is the time it takes for repossessions in Ireland. The reality is good customers are having to subsidise bad customers."

If this is allowed to continue, "there will always be a premium for Ireland over continental Europe", says McGrath.

The life of
Fergal McGrath

Age: 47
Home: Clontarf
Family: Married to Elaine, an Aer Lingus captain. We have two children
Education: BA and master's in economic science from University College Dublin
Favourite book: 23 Things They Don't Tell You About Capitalism, by Ha-Joon Chang
Favourite film: The Great Escape, *pictured*

Working day
In general I'm up at 6am and start with a 7am spinning class. If I don't get the workout done in the morning, it won't happen. If I don't have work dinners in the evening, I'm back home at 8pm to 8.30pm.

Downtime
Walking in the park with the family and our 13-year-old dog, or playing the piano. Cycling helps to clear the head, and I've completed numerous long-distance charity cycles. I cycle with Ray McMahon, a fellow director. I'm a member of Clontarf golf club and enjoy watching rugby. The powder on the ski slopes of Les Arcs in France is a real passion.

BRYAN MEADE

McGrath focuses on the property rather than the person at Dilosk, a name that spells "solid" backwards with a "k" for capital