

## Report of Directors of Resources and Environment & Neighbourhoods

### Report to Executive Board

Date: 7<sup>th</sup> March 2012

### Subject: Local Authority Mortgage Scheme

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Is the decision eligible for Call-In?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

### Summary of main issues

1. The report seeks approval to the establishment of a cash backed Local Authority Mortgage Scheme for Leeds which is aimed at assisting first time buyers to get on the property ladder. The scheme will be applicable across the Leeds area.
2. Under the scheme the Council provide an indemnity to the lender for 20% of the buyer's deposit. It is proposed that the Council make a £2m deposit with a lender as part of the cash backed scheme and this will be funded by investing existing revenue balances.
3. It is proposed that the maximum loan value under the scheme be set at £152,000. This will enable a buyer to buy a property for £160,000 with a 5% deposit.

### Recommendations

Executive Board are asked to approve:

4. the establishment of a Local Authority Mortgage Scheme for Leeds, to be available within the Leeds Metropolitan District area,
5. that £2m, funded from revenue reserves, be placed with a lender for a period of 5 years as the maximum limit for the total indemnity to be offered under the scheme.
6. a maximum loan value under the scheme of £152,000.
7. that approval of detailed matters relating to the scheme is delegated to the Director of Resources.

## **1 Purpose of this report**

- 1.1 To explain the development of a new product, the Local Authority Mortgage Scheme and its applicability to Leeds.
- 1.2 To seek Executive Board approval to establish the scheme to support the housing market in Leeds.

## **2 Background information**

- 2.1 To address the shortage in supply of affordable housing to those who need it, and to help the housing market and the local economy in general, a number of Local Authorities have considered issuing mortgages to potential home-buyers.
- 2.2 Rather than entering into the residential mortgage market themselves, Local Authorities have explored the possibility of entering into a partnership with residential mortgage lenders, with the remit of minimising the financial impact on the Local Authority, and at the same time taking advantage of the expertise already available from existing mortgage providers.
- 2.3 In September 2009, Sector Treasury Services set up a pilot scheme to assess the viability of a new Local Authority Mortgage Scheme (LAMS), with the aim of helping first time buyers who can afford mortgage repayments but not the initial deposit to get on the property ladder. A number of Local Authorities sponsored an initial pilot scheme and in March 2011 the first mortgages under the scheme were launched. Currently 20 local authorities have either launched the product or are preparing to launch. .

## **3 Main issues**

### **How the Local Authority Mortgage Scheme works**

- 3.1 The scheme is aimed at first time buyers, providing help for potential buyers who can afford mortgage payments, but not the initial deposit, to get on the property ladder. Under the scheme, part of the initial deposit required for the mortgage is underwritten by the local authority. Most mortgage lenders are typically prepared to lend a maximum of 75% - 80% loan to value (LTV), even if the applicant can afford a 95% mortgage. This means the applicant requires a substantial deposit, e.g. a first time buyer purchasing a property valued at £100,000 would have to provide a deposit in the region of £25,000.
- 3.2 If a potential buyer meets the strict credit criteria applied by the lender and meets the criteria set out by the Local Authority, the Local Authority will provide a top-up indemnity to the value of the difference between the typical LTV (i.e. 75%) and a 95% LTV mortgage. The potential buyer will thereby obtain a 95% mortgage on similar terms as a 75% mortgage, but without the need to provide the substantial deposit usually required.
- 3.3 It should be stressed that the scheme does not promote reckless lending, it is essential that the applicants meet the standard lending criteria as set out by the lender and that the higher LTV mortgage is affordable.

### Cash Backed Indemnity

The local authority places a cash deposit with the lender for a fixed period of 5 years (which could be extended by two years if the borrower is in arrears at the end of the 5 year term). Interest is paid to the local authority on this cash sum at the prevailing commercial rate (5 year fixed rate) plus a premium. With one of the lenders this currently equates to just over 4%.

### Non Cash Backed Indemnity

Under this option no cash deposit is needed, the local authority provides a guarantee for 20% of the deposit. For each mortgage completed under the scheme, the local authority receives a cash payment of £500.

- 3.4 For both types of indemnity, and assuming no default by the buyer, the indemnity liability would terminate on the earliest of the end of the agreed indemnity period (i.e. 5 years) or an early repayment of the mortgage. In the case of a cash-backed indemnity, the fixed-term deposit would be repaid to the Local Authority at the date of maturity, plus interest due.
- 3.5 If a borrower defaults on the mortgage and the default leads to repossession, the indemnity could be called upon. If this occurred the Lender would invoice the local authority for the indemnity payment, it would not be a call on the fixed term deposit. The indemnity that would need to be paid is illustrated in the examples below:

	<b>Example 1</b>	<b>Example 2</b>
Property value	£100,000	£100,000
Mortgage	£95,000	£95,000
Indemnity	£20,000	£20,000
Sale price	£70,000	£90,000
Indemnity called upon	£20,000	£5,000

### **How could the model support the Leeds housing market?**

- 3.6 Growing the city's housing stock and the development of a functioning housing ladder has been an aspiration of the city for some time and is a theme within Leeds' City Priority Plan. Access to home ownership continues to be difficult as a result of low mortgage availability and deposit requirements. The average age of a first time buyer in Leeds is now around 37 years old and the length of time in which properties remain on the market before they sell is getting longer.
- 3.7 There are a number of schemes which already exist which are aimed at supporting the construction and sale of new build houses (including the government's equity loan product "Firstbuy" for example). There is however a gap in support for the second hand market, further it is estimated that unlocking transactions in the existing (rather than new build) market unlocks up to 5 further transactions.. This in turn will have a beneficial effect on the economy through generating work for

associated businesses for example for refurbishment, moreover it will ease the mobility of people who need to move for employment reasons as well as possibly alleviating pressure on private rented housing and social housing waiting list. As an affordable housing product, LAMS is a tool which contributes to financial inclusion whilst unlocking the housing market in this way therefore contributes to the city's employment and economic growth aspirations.

### **Developing the local criteria**

- 3.8 When a Local Authority decides to participate in the LAMS, they should initially agree the criteria required to qualify for the scheme. Lenders are keen to see as standardised approach as possible however the following local criteria can be set:
- The maximum limit for the total indemnity to be offered under the scheme.
  - The maximum loan size (based on maximum property valuation)
  - The qualifying post codes within the boundary area
- 3.9 The authority can choose how much it would like to deposit to support the mortgage indemnities and can also choose which lender(s) to work with. There are a number of lenders already registered under the scheme; some national and some local and local authorities can choose to work with one or more lender(s). In addition, local authorities can work with Sector Treasury Services to identify and potentially secure an additional Lender to the Panel of Lenders. Some lenders will only offer the cash backed indemnity whilst others will offer non-cash backed.
- 3.10 Criteria that may be applicable for selection of a lender include availability of local branches for borrowers to access and the rate paid on the fixed term deposit under the cash backed option.
- 3.11 The authority can choose the maximum loan size to be made available under the scheme. If, for example, a house was purchased for £160,000<sup>1</sup>, at 95% Loan to Value, the maximum loan would be £152,000 (95% mortgage) and the council's maximum guarantee in relation to a single borrower would be £32,000. The council's underwriting would be partly protected by the borrower's 5% deposit. The choice of maximum loan size will restrict to some extent the area in the City where first time buyer house purchases can be made.
- 3.12 The table below illustrates the number of purchases which could be supported per £1m indemnity, based on a house price of £160,000 or £120,000.

Total Local Authority Indemnity	£1,000,000	£1,000,000
House Price	£160,000	£120,000
Assumed Max Loan Size (95%)	£152,000	£114,000
5% Deposit	£8,000	£6,000
Local Authority Indemnity at 20%	£32,000	£24,000
Potential number of mortgages	31	42

- 3.13 Using a house price of £160,000, 31 people will be able to access home ownership. As previously described if one assumes each unlocks a chain of up to 5

<sup>1</sup> The mean house price – Leeds Neighbourhood Index 2011

transactions this will mean that 155 people are assisted for each £1m of indemnity provided. The scheme is not restricted to people on low incomes, all that is required is that applicants are first time buyers, can demonstrate to the lender that they can afford the mortgage repayments and can provide a 5% deposit.

- 3.14 Lastly, the authority can specify the postcodes in which the scheme can be offered and it is suggested the scheme is available across the Leeds area. The Council will provide the Lender with information relating to the postcodes that will be eligible under the scheme and in particular will identify where Leeds postcodes and local authority boundaries are not co-terminus. Setting the maximum loan size will in itself limit the areas in the city where applicants can buy and this is likely to be in areas of lower house prices and where markets are less buoyant.

## **4. Corporate Considerations**

### **4.1 Consultation and Engagement**

- 4.1.1 The way in which the LAMS scheme operates has already been determined through a pilot scheme involving 11 local authorities and there will be limited opportunity for new authorities taking up the scheme to make changes to its operation. Consultation on the scheme itself therefore will not take place.

- 4.1.2 Due to the national operation of the scheme, the Council will work with Sector Treasury Services to match the Council with a Lender. The establishment of a mortgage scheme falls under the remit of the Financial Services Authority and as such the communication strategy and promotion of the scheme will need to be approved by the Lender.

### **4.2 Equality and Diversity / Cohesion and Integration**

- 4.2.1 It is proposed that the Local Authority Mortgage Scheme is available across the city and therefore there are no specific implications for any minority group within the city.

### **4.3 Council policies and City Priorities**

- 4.3.1 The scheme would support the objectives of the City Priority Plan (CPP) & the Leeds Housing Investment Plan (LHIP) by providing a new affordable housing product in turn supporting labour market mobility and economic growth.
- 4.3.2 The LAMS product will compliment the range of models which have been successfully used in Leeds to support new house building, including Equity Loan Shared Ownership and Rent to Mortgage, by stimulating the second hand housing market.
- 4.3.3 The scheme will sit alongside the Government's mortgage indemnity product, developed through the Home Builders Federation and a number of house builders, called the New Buy Guarantee scheme. This is a similar product in that it indemnifies lenders against loss although again is a product available for new build properties which is targeted at first or second time buyers.

#### **4.4 Resources and value for money**

- 4.4.1 Once set up the operation of the scheme is via lenders' normal mortgage application procedures without direct input by the local authority. Sector Treasury Services will provide monthly management information and will undertake an annual audit of the scheme.
- 4.4.2 The £2m investment under the cash backed indemnity arrangement would be made from the Council's revenue reserves. Interest will accrue on the deposit and will be at a premium to the usual commercial rate, agreed with the lender at the time of deposit.
- 4.4.3 Whilst it does not entail a call on staff resources to operate the scheme, where default does occur the authority may feel bound to offer mortgage advice or other support.

#### **4.5 Legal Implications, Access to Information and Call In**

- 4.5.1 Under the scheme, standardised legal documentation has been produced, including how the scheme sits in relation to state aid rules, and this is currently being considered by the Council's legal team. In addition, when the Council has chosen a lender, a specific indemnity deed will be produced and agreed by both parties. It is proposed that approval of detailed matters under the scheme is delegated to the Director of Resources.
- 4.5.2 This report is eligible for call in.

#### **4.6 Risk Management**

- 4.6.1 The potential risks associated with the scheme are set out in Appendix 1 together with preventative measures to mitigate the risk.

### **5 Conclusions**

- 5.1 The Local Authority Mortgage Scheme is designed to help increase the supply of affordable housing for those who need it, and to help the local housing market and thereby the local economy.
- 5.2 The scheme requires the Local Authority to provide a financial indemnity of up to 20% of a mortgage for potential home-buyers who qualify for Local Authority support, and who meet the strict lending criteria set by the lender.
- 5.3 Lending would be subject to normal lending criteria (applicants must be able to afford mortgage payments but not a deposit, although would benefit from lending conditions associated with a lower LTV) and therefore cannot be seen as sub-prime.
- 5.4 The scheme could provide a valuable stimulus to the housing market in addition to supporting affordability and mobility within the labour market.

### **6 Recommendations**

Executive Board is asked to approve:

- 6.1 The establishment of a Local Authority Mortgage Scheme for Leeds, to be available within the Leeds Metropolitan District area,
- 6.2 That £2m, funded from revenue reserves, be placed with a lender as the maximum limit for the total indemnity to be offered under the scheme.
- 6.3 A maximum loan value under the scheme of £152,000
- 6.4 That approval of detailed matters relating to the scheme is delegated to the Director of Resources.

**7 Background documents<sup>2</sup>**

None

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<sup>2</sup> The background documents listed in this section are available for inspection on request for a period of four years following the date of the relevant meeting. Accordingly this list does not include documents containing exempt or confidential information, or any published works. Requests to inspect any background documents should be submitted to the report author.

## Appendix 1

Risk	Preventative Measure
<b>Financial Risks</b>	
Lending to sub-prime applicants	Use of the Lender's credit criteria in assessing applicants.
Applicant affordability	Borrowers will be subject to the lender's normal criteria and controls.
Counterparty Risk	Partnership with highly reputable financial institutions for deposits.
Costs incurred in the event of a guarantee being called	The rate of default anticipated in 2011, as published by the Council for Mortgage Lenders, is 0.35% of all mortgages rising to 0.4% in 2012. If a 1% default rate is assumed for 95% mortgages and if each default leads to 100% loss of the value of the indemnity, the potential loss for £2m of indemnity would be £20,000.
Fall in house prices - in the event of default where the value of the mortgage is not covered by the value of the home	Prices are currently low as a result of the recession Price premium is often paid on brand new properties and second hand market prices might be more stable.
Opportunity cost of depositing the cash for 5 years	Interest is paid on the sum deposited and the rate is at a premium to the usual commercial rate.
<b>Reputation</b>	
Poor publicity / bad press re use of public monies	Joint promotion /publicity strategy with the Lender. Promotion of the benefits of the scheme i.e. supporting the local housing market and local economy.
Repossession in the hands of the lender, therefore outside the Local Authority's area of responsibility	The Lender will inform the Local Authority when an applicant is facing repossession. Local Authority may be able to provide support.
<b>Political</b>	
Lack of political support	Member briefings on scheme progress and level of indemnities offered.
Change of Political priorities	Existing scheme would continue until expiry of indemnity but

	future support could be withdrawn.
<b>Operational</b>	
Adverse impact on staffing levels	Local Authority has no input into the assessment / processing of applications.