

# REPORT TO CABINET

**REPORT OF:** Strategic Director – Corporate focus.

**REPORT NO:** SD001

**DATE:** 5 DECEMBER 2011

|   |   |                                  |
|---|---|----------------------------------|
| <b>TITLE:</b>                                     | <b>Local Authority Mortgage Scheme</b>  |                                  |
| <b>KEY DECISION OR POLICY FRAMEWORK PROPOSAL:</b> | Key decision  |                                  |
| <b>PORTFOLIO HOLDER: NAME AND DESIGNATION:</b>    | Cllr Mike Taylor<br>Assets and Resources Portfolio Holder   |                                  |
| <b>CONTACT OFFICER:</b>                           | Daren Turner<br><a href="mailto:d.turner@southkesteven.gov.uk">d.turner@southkesteven.gov.uk</a><br>01476406310   |                                  |
| <b>INITIAL IMPACT ASSESSMENT:</b>                 | Carried out and Referred to in paragraph (7) below:   | Full impact assessment Required: |
| <b>Equality and Diversity</b>                     |   | Yes                              |
| <b>FREEDOM OF INFORMATION ACT:</b>                | This report is publicly available via the Your Council and Democracy link on the Council's website:<br><a href="http://www.southkesteven.gov.uk">www.southkesteven.gov.uk</a> |                                  |
| <b>BACKGROUND PAPERS</b>                          | Sector State Aid Paper<br>Sector Accounting Principles Paper<br>Sector Risk assessment  |                                  |

## 1. RECOMMENDATIONS

1. That Cabinet recommend to Council participation in the Local Authority Mortgage Scheme (LAMS), initially in partnership with a recognised national provider for £1m;
2. That Cabinet recommend that Council approve plans to extend the scheme across other lenders as they enter the scheme, or with Lloyds plc, up to a total value of £5m subject a full analysis of impact against priorities of the first £1m;
3. That the Resources PDG undertake initial development of a local policy for the scheme eligibility for Council approval;
4. Delegate to the Strategic Director (corporate services) the authority to investigate and where required execute the required legal documentation in order to satisfy scheme participants.

## 2. PURPOSE OF THE REPORT

2.1 The purpose of this report is to seek Cabinet approval for the Council to participate in the Local Authority Mortgage Scheme and seek initial approval to partner with recognised national provider to launch the scheme in the District of South Kesteven.

## 3. BACKGROUND

3.1 The Cabinet in the last six months have been working with the Corporate management team to refresh the Councils priorities and redraft the corporate plan. After an intensive period of information and data gathering about the challenges faced by the people of the district and consultation four key themes; **growing the economy, green and clean, leisure culture and the arts** and **balanced housing** have evolved from the Councils existing priorities. These new themes have been approved by Council and the revised corporate plan will be presented to Council on 8<sup>th</sup> December 2011.

3.2 Whilst gathering information to form the priorities Cabinet became aware of the plight of home buyers in the district, particularly first time buyers, as a result of the economic down turn and the increasing requirement as regards deposits by mortgage providers. This was leading to growth in the Councils own housing register and stagnation at the lower end of the property market in the district. This in turn could be inhibiting key works staying in or moving to our district and also young families staying in the area.

3.3 House prices nationally have continued to fall over the last 12 months, and the outlook remains uncertain. This pattern is followed in our district. The lack of buyers, together with the ongoing lack of mortgage availability means house prices are likely to continue to slide. Nationwide Building Society predicts house prices in 2011 to stay weak as a result of the uncertainty surrounding the economy and the Government's massive spending cuts.

3.4 There is still considerable concern about some areas of the housing market, particularly the low percentage of first time buyers. According to the Council of Mortgage Lenders (CML) mortgage lending in July 2011 fell by 6% compared to July 2010. The CML believes the housing market will remain subdued in 2011 due to uncertainty surrounding the economy and the ongoing mortgage rationing by lenders. The level of activity in the mortgage market is therefore expected to remain subdued.

3.5 Current constraints are a particular problem for first-time buyers, especially those unable to provide a substantial deposit. While mortgage insurance, shared ownership, and product innovation can all potentially play a part, none will provide a panacea to normalise the mortgage market for first-time buyers. This is likely to be a gradual process as confidence in funding markets and lending decisions is restored in the light of a more stable market environment. The preference for low loan to value mortgages is therefore expected to continue to restrict first time buyers in the current financial environment.

3.6 As a result banks and building societies will not lend to those home buyers who cannot provide up a deposit of 20 to 25 per cent I.E they are only prepared to lend 75%-80% loan to value (LTV). The typical entry level price for a property in the District is around £112k which would mean a deposit of around £28k is needed. With other costs on top of this, including stamp duty and other costs, this is effectively preventing most first time buyers from entering the property market.

3.7 This issue could adversely impact the delivery of the Council's priority themes of growing the local economy and balanced housing. The current economic environment may continue to bring uncertainty in the housing market and with the difficulties in obtaining an affordable mortgage; many potential home-buyers may remain in social / affordable housing units, thereby reducing the availability of social / affordable housing for those who may have a greater need. The lower end of the private housing market will remain slow which has connotations for the housing market generally.

#### **4. Local Authority Mortgage Scheme**

4.1 Sector Treasury Management services (currently the Council's treasury advisers) have developed a national scheme, initially in conjunction with the Lloyds banking group, to allow Councils to provide support to first time buyers. 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 to the property ladder. There are 6 providers currently listed as “providers” in the scheme, they are Lloyds PLC, Leeds BS, Furness BS, Teachers BS, Saffron BS, and Leek BS (clearly the Council would look to a partner with a presence across our District to ensure maximum participation and impact)

4.2 The scheme would operate as follows:

- The Council would specify the qualifying characteristics for those who should qualify for a mortgage under the scheme (see section 5 below). The Council would also specify whether there would be a maximum loan value, and the total level of support offered by the council;
- Potential Buyers would approach the lender directly and the lender would deal with the Council. The Council will not know the identity of the individuals concerned, and have no role in approving individual mortgages;
- The Bank will assess the buyer against its own credit criteria, as well as the Council's criteria;
- If a potential buyer meets the strict credit criteria applied by the lender, and meets the criteria set out by the Local Authority to qualify for a mortgage under the scheme, the Local Authority will provide a top-up indemnity to the value of the difference between the typical Loan to Value (LTV) ratio of around 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;

- The Council will deposit a sum with the bank equal to the total value of the overall indemnity offered (assuming cash backed lender requirement – see section 4.3);
- The bank would lend all the money agreed under the mortgage to enable the purchase to be made;
- The buyer would make repayments to the bank, and liaise with the bank on all issues relating to the mortgage; and
- The indemnity provided by the Council will last for 5 years. After this time the sum deposited with the bank is returned to the Council with interest.

4.3 The scheme can be supported by the Council in two ways, in that the indemnity is either cash backed or unfunded as follows:-

- If the indemnity is un-funded, the Local Authority will receive a premium a fixed amount of the value of the indemnity actually provided, typically in the region of £500 per mortgage.
- If the indemnity is “cash backed”, i.e. supported by a deposit, the Local Authority will be required to place a 5-year deposit at the start of the financial year to the full value of the indemnity being offered. The deposit will be in place for the term of the indemnity – i.e. 5 years (with the possibility of a further 2 year extension if the mortgage is in arrears at the end of the initial 5 years) - and may have conditions / structures attached. The Local Authority will receive a 5-year commercial deposit rate + a premium of 0.70% from the first lender to join the scheme, other lenders will offer similar terms.
- In accordance with the legislation, the lender will not have a legal charge over the deposit. In the event of an indemnity being called and an amount being payable by the Local Authority to the lender, a request for payment would be made by the lender. The Local Authority will undertake to settle the amount payable within 30 days.

4.4 The indemnity would only be called upon, leading to a cost for the Council, if a loss is crystallised by the lender. This would require a default by the buyer, repossession by the bank and then the property to be sold for less than the value of the mortgage.

By way of example:

- Property valued at £100k, mortgaged at £95k (funded Local Authority indemnity £20k, Bank Mortgage £75k), was subsequently sold for £70k, the bank would request the full £20k indemnity from the Local Authority. In this case the value of the property would need to have fallen by 30% from the original valuation;
- If the property was sold for £90k the bank would request £5k from the Council. In this case the value of the property would need to have fallen by 10% from the original valuation.

4.5 The Council will only face costs if both these situations arise – that there is default, and the subsequent resale value is less than the value of the mortgage. Such

costs would be funded from the interest gained in depositing the indemnity funds. Information from the Council of Mortgage lenders indicates that the number of repossessions by first charge mortgage lenders in 2010 was 0.3% of all mortgages. Over the five year period, the following would need to happen for the costs to the council to exceed the interest income (assuming a cash backed scheme):

- Defaults to be ten times higher than the 2010 level indicated by CML; AND
- Property prices to drop 10% from the level at the time the mortgage is approved

4.6 The scheme was initially launched through Lloyds Banking Group, however it is anticipated that more mortgage lenders will be invited to join the partnership as it progresses (six are currently on the list). Sector has been in discussions with the FSA approved mortgage lenders in the UK to raise awareness of the scheme. The scheme will operate on a nationwide basis and there will be no restrictions on the type and number of banks who will be entitled to participate (providing they have the necessary authorisation to offer residential mortgages in the UK). So far Blaby DC, Warrington and Blackpool Councils have formally adopted the scheme.

4.7 Cabinet recommend that the Council should initially approve £1m (cash backed) of indemnity to support the scheme with a recognised national provider. It should be noted that the scheme with Lloyds does not currently cover new build properties Lloyds may review this in time, other institutions offer this facility. It is further recommended that this is extended up to a maximum of £5m, following a review of the success of the initial £1m indemnity, as follows:

- Extending the scheme to cover other lenders as they enter the scheme, providing additional choice locally. Sector are currently in discussion with a number of lenders about entering the scheme, including lending on new build properties;
- Increasing the indemnity if the first tranche of funding is Exhausted and the scheme has delivered the outcomes required.

4.7 Extending the indemnity to £5m does not alter the financial risk profile. Whilst the possible sums payable following default could increase, so does the interest income to cover this.

4.8 Sector Treasury Services will undertake an annual audit of the scheme to ensure both parties are fully compliant with the agreement. The Council will agree with Lloyds a monthly performance report, so that it is able to demonstrate clear links to strategic objectives and also review the performance of the scheme in relation to its investment.

## **5. Legal position and local eligibility policy**

5.1 Sector Treasury Services have sought Counsel's opinion on the legal basis for Councils to be able to support this scheme, along with the position regarding state aid. The Council continues to seek advice from its own legal advisers prior to formal adoption of the scheme

5.2 The Housing Act 1985 (as amended) provides the statutory framework for the scheme. The Act allows Local Authorities to "advance money to a person for the

purpose of acquiring a house” (section 435 of the act). Section 442 of the act allows a local authority to grant an indemnity to a lender to enable the lender to give the potential buyer a mortgage.

5.3 In order to participate in the scheme on this basis, the Council will need to develop a local policy for scheme eligibility. Resources PDG could be tasked to undertake some initial work in this respect once the overall principle of participating has been approved. The key elements of the policy will be to confirm the scheme as being cash backed, the areas of the District to be covered and the size of mortgage to be supported. The PDG may also consider the success factors for decision making on the additional £4m. The Council will then need to incorporate the policy into the local housing strategy and the treasury management policy, which will also need to be approved by Full Council as part of the Major Policy Framework. It is recommended that this is undertaken in time for consideration by Council at the meeting of March 1<sup>st</sup> 2012. Once the policy is approved, and associated legal agreements completed, the scheme can be launched.

## **7. OTHER OPTIONS CONSIDERED**

To be considered further in policy development

## **8. RESOURCE IMPLICATIONS**

Discussed in main body of the report.

## **9. RISK AND MITIGATION (INCLUDING HEALTH & SAFETY AND DATA QUALITY)**

## **10. ISSUES ARISING FROM EQUALITY IMPACT ASSESSMENT**

## **11. CRIME AND DISORDER IMPLICATIONS**

None

## **12. COMMENTS OF FINANCIAL SERVICES**

The scheme will commit, initially, £1m of the councils funds that would ordinarily be invested. Research tell us that at any one time the Council has in excess of £10m that is always invested in the markets and therefore not required for daily, weekly and monthly funding of services. This would reflect the level of reserves and balances the council carries. At present the Council is recouping 1.58% on longer term deposits, investment rates have seen dramatic falls since the onset of the economic downturn in 2008. The Lloyds LAM's scheme offers 70bbs premium on top of their existing 5year commercial deposit rate as at today's date that would return the council £43,000 pa and £215,000 over the five year term. Cleary this is multiplied by fivefold if the indemnity increases to £5m. Risk will relate to the likelihood of default and sale at less than purchase value. History dictates that default levels run at less than 0.5% of mortgages that sales proceeds would need to drop significantly if the Council was to put at risk its initial deposit as the interest earned would potentially out way any losses in the unlikely event they would occur.

### **13. COMMENTS OF LEGAL AND DEMOCRATIC SERVICES**

Local authorities have the power to provide the indemnity referred to in this report in accordance with s. 442 of the Housing Act 1985 (as amended). The indemnity in the scheme proposed requires the deposit of security with a bank. Individual indemnities will be required in respect of legality. That legality will depend on the policy created to adopt the scheme, how that policy will contribute to the Council's strategic objectives and priorities, the process for financing the scheme, the eligibility criteria and, generally, how the policy will be implemented.

### **14. APPENDICES:**