

TONBRIDGE & MALLING BOROUGH COUNCIL

CABINET

20 June 2012

Joint Report of the Director of Health and Housing, Director of Finance and Chief Solicitor

Part 1- Public

Matters for Recommendation to Council

1 LOCAL AUTHORITY MORTGAGE SCHEME INITIATIVE

Background

The purpose of this Report is to summarise to Members the discussions with KCC to date regarding the proposed Local Authority Mortgage Scheme (LAMS). The Report will also consider the financial and housing benefits to the residents of Tonbridge & Malling of possible participation in a LAMS in association with Kent County Council.

1.1 Housing Context

- 1.1.1 The turmoil in the financial and banking market has had a severe impact on both the local economy and on local housing. House prices have fallen, and the outlook continues to remain uncertain. The lack of buyers, together with the ongoing lack of mortgage availability, means house prices are unlikely to pick up in the near future.
- 1.1.2 First time buyers, in particular, are struggling to provide the substantial deposit now required by mortgage providers. This in turn is stifling new development and causing the wider housing market to stagnate as first time buyers are vital to the flow of properties changing hands.
- 1.1.3 Where lenders are lending at a higher Loan-To-Value (LTV), they are doing this at higher rates of interest, which may mean that the repayments for first-time buyers are unaffordable.
- 1.1.4 While mortgage insurance, shared ownership and product innovation can all potentially play a part, none will provide a single solution to normalise the mortgage market for first time buyers. Such "normalisation" 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 mortgage is therefore expected to continue to restrict first time buyers in the current financial environment

- 1.1.5 House prices in Tonbridge and Malling are among the highest in Kent and are out of reach for many first time buyers and local people on average incomes. It should be noted that there are already schemes in place to help first time buyers purchase newly-built properties such as the government's New Buy scheme (this works in a similar way to that proposed below) but crucially not for second hand properties.
- 1.1.6 Most mortgage lenders are typically prepared to lend a maximum of 75 per cent of the property value, even if the applicant can afford a 95 per cent mortgage. For example, a buyer purchasing a property valued at £100,000 would have to provide a deposit in the region of £25,000. Sadly, many potential first time buyers do not have the funds needed for a deposit of this size.
- 1.1.7 As a result of the very challenging current economic environment and the difficulties in obtaining an affordable mortgage, many potential (and previously suitable) homebuyers may remain in affordable housing units, thereby reducing the availability of affordable housing for those who may have a greater need.
- 1.1.8 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, the County Council has been discussing with a number of local authorities the possibility of issuing mortgages to potential home buyers. However, given limited financial resources and a lack of specialist skills required to manage a mortgage portfolio, there would be considerable operational risks associated for a local authority to enter into this type of activity. For example, when talking to a member of the public, information about mortgages and giving of advice is regulated under the Financial Services and Markets Act 2000. Therefore, an organisation called Sector has been involved in the development of a scheme that permits such assistance without encountering these obstacles.

1.2 Sector and the LAMS

- 1.2.1 Sector is the trading name of Sector Treasury Services Limited, which is authorised and regulated by the Financial Services Authority (FSA) for the provision of the investment advisory services it provides as part of its Treasury Management Service and is also a member of the Finance and Leasing Association (FLA). Sector has developed a scheme where local authorities can help people (who can afford to make regular mortgage repayments but cannot afford the significant deposit) take the step of buying their first home. This initiative is called the Local Authority Mortgage Scheme (LAMS).
- 1.2.2 The scheme went "live" in March 2011 and mortgages were initially launched in Blackpool and Warrington. A further 10 local authorities have since joined and approximately 20 other authorities plan to launch in mid 2012 including Kent County Council.
- 1.2.3 The scheme works by local authorities placing on deposit a sum of money with the lender, (the scheme currently has a small number of lenders including Lloyds

TSB). The lenders still apply their normal strict lending criteria to ensure that borrowers can afford the regular repayments. In basic terms, the applicant is able to take a 95 per cent LTV, but at 75 per cent LTV rates, as 20 per cent of the initial mortgage is effectively underwritten by the local authority (in the form of an indemnity) through use of the initial deposited funds placed with the lender by the local authority. As the scheme will be managed by external lenders, there will be no additional administrative burden for the authority, however, regular updates (as described later) will be provided in order for the authority to monitor the effectiveness of take-up of the scheme.

- 1.2.4 Each local authority will be able to specify three qualifying criteria. These criteria together with the proposed parameters are set out below.
- the maximum level of total support (indemnity) - £1,000,000;
 - the maximum loan size - £40,000 indemnity; and
 - qualifying post codes – (all within Tonbridge and Malling).
- 1.2.5 The eligibility criteria for a property are simply based on the cost upper limit and the necessity to have a postcode within the borough. The scheme has two aims; to assist in stimulating the local housing market and to assist first time buyers. As designed, it assists applicants wishing to purchase within Tonbridge and Malling whether they are local residents or whether they are seeking to move into the borough, for example, for employment reasons. Local residents wishing to locate away from the borough are not eligible unless the area to which they are moving offers the scheme. The scheme will assist residents of the borough looking to join the property ladder for the first time, as well as promoting movement in the wider housing market.
- 1.2.6 The maximum size indemnity proposed is £40,000 (equivalent to a purchase price of £200,000) is based upon the approximate amount required to purchase a family home such as a two or three bedroom house in the south (more expensive) part of the borough. It is expected that for the majority of first time buyers it will be a two bedroom property (house or flat) they will wish to purchase. The average two bedroom property value across the borough is currently in the region of £175,000 ranging from £225,000 in the south to £135,000 in parts of the north. Average property prices, borough-wide, are £275,000 and range from £300,000 in the south of the borough down to £145,000 in parts of the north (Land Registry Data, Quarter 1, 2012). It is felt that a limit of £200,000 purchase price offers scope for the purchase of two bedroom properties across most parts of the borough and some scope to purchase three bedroom properties where that is necessary.
- 1.2.7 The scheme will not be available to any applicants wishing to purchase a Registered Provider (housing association) owned property, as this is specifically excluded within the contract agreement underpinning the scheme.

- 1.2.8 The local authority indemnity is only valid for a period of five years from the start of an individual mortgage. Borrowers are not able to re-mortgage to borrow more during the five years. However, this period may be extended for a further two years if a mortgage is in arrears in the last six months of the initial five year period.
- 1.2.9 A potential buyer, who meets both the criteria of the lender and local authority, will only be required to provide a five per cent deposit, the local authority will provide 20 per cent in the form of a cash backed indemnity thus enabling the potential buyer to obtain a 95 per cent mortgage on similar terms to a 75 per cent mortgage, without the need to provide the substantial deposit usually required.

Table 1 below illustrates the basic premise of the scheme:

Table 1 Basic Scheme Illustration

Maximum Property Value	£200,000
5% Buyers Deposit	£10,000
95% Lenders Mortgage	£190,000
Local Authority Indemnity	£40,000

1.3 The Kent Wide LAMS

- 1.3.1 Following discussions at the Kent Forum, Kent County Council has set up a Kent-wide LAMS scheme. KCC is proposing to invest up to £12,000,000 in a Kent-wide LAMS, equivalent to £1,000,000 per district and borough. KCC will use this to match-fund any investment into LAMS made by ourselves, doubling the number of mortgages that could be provided in Tonbridge and Malling and helping to share the risk of default.
- 1.3.2 Table 2 below shows the potential number of first time buyers the scheme may initially assist based on a £1 million advance from the Council and £1 million from KCC, over a range of maximum levels of indemnity.
- 1.3.3 Table 2 – The potential number of beneficiaries of a Kent-wide LAMS Scheme.

No.	Total Scheme Indemnity Amount	Max House price based on 95% mortgage	Maximum Property Mortgage	Customer Deposit (5%)	Indemnity Value (20%)	Total Mortgages
1	£2,000,000	£100,000	£95,000	£5,000	£20,000	100
2	£2,000,000	£150,000	£142,500	£7,500	£30,000	67
3	£2,000,000	£175,000	£166,250	£8,750	£35,000	57
4	£2,000,000	£200,000	£190,000	£10,000	£40,000	50

- 1.3.4 KCC's matched funding will be provided in the form of a conditional loan for the relevant district and borough to invest in the scheme. This will be governed by a Matched Funding Agreement between KCC and the district or borough Council.

1.4 LAMS Assistance Levels

- 1.4.1 The number of mortgages the authority would be able to offer will depend upon the maximum loan size. Tonbridge and Malling is a diverse housing market within itself, and it is imagined the scheme is seeking to assist those buying their first family home (typically ranging from a two bedroom terrace house to a three bedroom semi). In order to achieve this aspiration from Snodland through to West Malling and Tonbridge, our view is that the limit should be set at £200,000 per property.
- 1.4.2 It is expected that most properties purchased will be in the £130,000 to £175,000 range and hence the number of applicants assisted will be around the 60-65 range. All applicants will be subject to the normal vetting process applied by lenders in order that affordability limits are not exceeded. This is not about helping applicants, able to afford a two bedroom first-time purchase, to purchase a larger home. It is about helping applicants, who otherwise would be unable to afford to buy a home, to access home ownership. At the point at which all funds have been utilised for indemnities, no further assistance would be provided by the lenders.

1.5 Financial Analysis

- 1.5.1 The deposit (indemnity) is placed (valid) with the lender for a period of five years from the start of an individual mortgage. This period may be extended for a further two years if a mortgage is in arrears in the last six months of the initial five-year period. At the end of the period, the amount placed on deposit is either returned to the Council or can be re-invested in the scheme.
- 1.5.2 If Members are minded to approve participation in the Local Authority Mortgage Scheme it would be our intention to place on deposit with a suitable lender the sum of £1 million and for this to be match funded by the Kent County Council. At a maximum indemnity size of £40,000 this would facilitate at least 50 mortgage advances to first-time buyers. It is expected that not all advances would be at the maximum. The Lender will invest the cash deposit on our behalf and pay TMBC a higher, premium rate of interest than would normally be offered, for an initial five-year fixed-rate term. The rate of interest earned will be agreed on the day the money is sent and will be determined by money-market rates on that particular day. At the end of the initial five-year fixed-rate term, sufficient deposit will need to be reinvested to cover the outstanding amount of indemnity (or guarantee) and the interest rate then paid will be a standard commercial rate with no additional premium.
- 1.5.3 It is expected that defaults will be kept to a minimum by the application of strict lending criteria by the lender. The national average mortgage default rate taken from The Council of Mortgage Lenders published 2010 statistics was 0.3 per cent

of all mortgage advances made. Sector has suggested a default rate of up to two per cent for this scheme due to the fact that lending to first time buyers is deemed to carry a higher risk. To put this into perspective a default rate of two per cent would result in a 'call' on the deposit of up to £40,000 to be shared equally between this Council and Kent County Council. It is suggested that defaults leading to a 'call' on the deposit be met from the General Revenue Reserve.

- 1.5.4 The deposit is to be treated as either capital expenditure or an investment for accounting purposes. Sector's view is that the deposit is to be treated as capital expenditure for accounting purposes, but we await confirmation of that view from our auditors. It is suggested that if Members do approve participation in the Local Authority Mortgage Scheme that it 'sit outside' the Council's Capital Plan Review process or the Treasury Management and Investment Strategy counter party exposure limits as appropriate.

1.6 Scheme Monitoring

- 1.6.1 Once the parameters have been agreed, the mortgage lender should manage the operational side of the scheme without any direct input from the Council. Sector Treasury Services Ltd will undertake an annual audit of the scheme to ensure both parties are fully compliant with the agreement. It should be noted that Sector Treasury Services Ltd do receive a commission on each loan from the lender.
- 1.6.2 Each Council will receive a report from Sector, via the lender, on the 15th of each month. This will show three categories; the number of mortgage applications, the number of mortgage offers and the number of mortgage completions. If an account is more than three months in arrears, this will also be flagged up in the report.
- 1.6.3 Due to the changing environment, further legal and/or accounting advice may be required during the life of the LAMS. To ensure consistency, it is anticipated that Sector Treasury Services Ltd will obtain updated advice on behalf of participating authorities. Any additional fees incurred in this respect will be agreed with all parties in advance.

1.7 Conclusions

- 1.7.1 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. It does not promote reckless lending or provide un-affordable mortgages; it simply reduces the value of deposit currently required.
- 1.7.2 In terms of strategically seeking to address housing need in Tonbridge and Malling the LAMS serves a very useful purpose as part of a wider diverse mixed economy of homeownership initiatives.
- 1.7.3 The LAMS is targeted at second hand properties, and therefore complements existing HomeBuy products which are aimed solely at new-build dwellings. By

providing both of these schemes in the borough first time buyers will have access to new and existing properties and therefore help in restoring the bottom rung of the housing market ladder.

- 1.7.4 The Council is also confident that the LAMS is truly an initiative that assists those that could not otherwise enter the housing market and will not be used simply as a tool for betterment, allowing those to purchase at a level that previously would have been unobtainable.
- 1.7.5 The scheme has been designed to minimise the financial impact on the Council and to work in partnership with a range of experts in the market, i.e. residential mortgage lenders.
- 1.7.6 The Director of Finance is satisfied with the financial security of the potential lender and confirms that the return should be at a favourable rate of interest.

1.8 Legal Implications

- 1.8.1 Local authorities are empowered under section 442 of the Housing Act 1985 to enter into "indemnity" agreements with a mortgagee lending on the security of a house.
- 1.8.2 The power to enter into such an agreement may only be exercised if the purpose of the advance is for one or more specified purposes (set out in section 335 of the Act). These purposes include acquiring a house; constructing a house and converting an existing building into a house.
- 1.8.3 Whilst Sector has obtained the opinion of London Solicitors on the legality of the scheme, each authority is still required to ensure that it is satisfied with the advice provided. In accordance with this process, it is a requirement of the scheme that the Monitoring Officer provide an Opinion Letter confirming that the Council has the power to enter this scheme. The Council will also be required to indemnify the Monitoring Officer in respect of any personal liability attached to providing the Opinion Letter.
- 1.8.4 The legal advice provided by Sector considers that, should Members agree to proceed with the scheme, the Council should adopt a policy as to how the scheme will work. In practice, this will either be subsumed as part of the Housing Strategy or be a sub-strategy of it.
- 1.8.5 Our advice is that the parameters of such a policy should be drawn from paragraphs 1.2 to 1.5 within this report and be incorporated within the impending review of the Housing Strategy.

1.9 Financial and Value for Money Considerations

- 1.9.1 As set out above.

- 1.9.2 Bearing in mind the comment at paragraph 1.5.4, the District Auditor has been provided with a copy of this report, and if any comments are forthcoming we will advise Members at the meeting.

1.10 Risk Assessment

- 1.10.1 It is expected that defaults will be kept to a minimum by the application of strict lending criteria by the lender. The national average mortgage default rate taken from The Council of Mortgage lenders published 2010 statistics was 0.3 per cent of all mortgage advances made. Sector has suggested a default rate of up to two per cent for this scheme due to the fact that lending to first time buyers is deemed to carry a higher risk. To put this into perspective, a default rate of two per cent would result in a 'call' on the deposit of up to £40,000 to be shared equally between this Council and Kent County Council. It is suggested that defaults leading to a 'call' on the deposit be met from the General Revenue Reserve.
- 1.10.2 The upper purchase price limit of £200,000 and maximum indemnity of £40,000 is suggested to enable first time buyers to acquire a two bedroom property in both the north and south of the borough and a three bedroom property where appropriate in some parts of the borough. A limit of £175,000 would allow the purchase of small two bedroom properties in many parts of the borough but probably exclude the opportunity for purchase of a three bedroom home in most areas. The main risks to there being a mortgage default, leading to a call on the indemnity cover offered by the scheme, are where households over-stretch their borrowing and interest rates rise or household income changes dramatically. Our view is that these potential eventualities have to be assessed by the lender in the application of their lending criteria. It has to be recognised that setting the limit of £200,000 does increase the margin of default risk and financial exposure faced by the Council. This risk is, however, shared equally by the Borough and County Council.

1.11 Recommendations

Council is **RECOMMENDED** to:

- 1.11.1 **ADOPT** the Local Authority Mortgage Scheme in accordance with the details provided within this report;
- 1.11.2 **ADOPT** the parameters explained in paragraphs 1.2 to 1.5 as the basis of the Council's policy, the finalisation of the precise wording of which to be delegated to the Director of Health and Housing;
- 1.11.3 **APPROVE** the following local criteria to be incorporated within that policy;
- the maximum level of funding support for the scheme to be £1,000,000
 - the maximum loan size (indemnity) to be £40,000; and

- qualifying post codes – all within the Borough of Tonbridge and Malling.

1.11.4 **NOTE** that the final clarification regarding the accounting treatment for the deposit is awaited; and **ENDORSE** that:

- in the event that the deposit is to be treated as capital expenditure, the expenditure of £1million sit outside the Council's Capital Plan Review process; **or**
- in the event that the deposit is to be treated as an investment, the investment of £1million sit outside the Council's Treasury Management and Investment Strategy counter party exposure limits.

1.11.5 **INDEMNIFY** the Chief Solicitor and Monitoring Officer in respect of any personal liability in providing the Opinion Letter to the Lender.

Background papers:

contact: Chris Knowles
Neil Lawley

Nil

John Batty
Director of Health and Housing

Sharon Shelton
Director of Finance

Adrian Stanfield
Chief Solicitor

Screening for equality impacts:		
Question	Answer	Explanation of impacts
a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community?	No	

Screening for equality impacts:		
Question	Answer	Explanation of impacts
b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality?	Yes	Assists first time buyers, often young families, acquire their own home.
c. What steps are you taking to mitigate, reduce, avoid or minimise the impacts identified above?		

In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above.