TONBRIDGE & MALLING BOROUGH COUNCIL

CABINET

10 October 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 provide the additional information sought by Members following the June Report to Cabinet on the discussions with KCC to date regarding the proposed Local Authority Mortgage Scheme (LAMS) and to determine a way forward.

1.1 Housing Context

1.1.1 Members will recall the June Report to Cabinet describing the work performed to date with KCC regarding the Local Authority Mortgage Scheme (LAMS) devised by Sector. It was noted that the LAMS was aimed at first-time buyers purchasing second-hand properties and was designed to help the local housing market and thereby the local economy by increasing access to affordable housing.

1.1.2 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 the LAMS which is already operating elsewhere in the country and has seen a September launch with Tunbridge Wells Borough Council, with various other local authorities in Kent expected to follow shortly.

1.1.3 Members acknowledged the merits of the scheme while raising questions on certain aspects including the degree of financial risk for the Council and applicants and the possible benefits of undertaking collective negotiation with other Kent district councils. The Council's officers and Members have subsequently met with representatives from KCC and Sector to seek further clarity on a range of issues.

1.1.4 The meeting was very productive, with Sector responding to a range of further enquires, as described in this Report. Members were keen to understand the approach of the lender to the mortgage rate after the initial three year period comes to an end. Sector and Lloyds (the likely lender) have stated that at the end of the three year fixed rate deal, and assuming flat RPI in the period, a given mortgage will be at around 85 per cent Loan to value (LTV). There will be three options available:

- as with all Lloyds customers, there will be a range of products available to them, with both fixed rates and trackers, to which they will be able to transfer;
- as the mortgage will automatically revert to the standard variable rate, customers can choose to stay on that should they wish; and
- equally, customers will be free to remortgage to any other lender offering remortgage products at 85 per cent LTV.

1.1.5 Members were also keen to understand the degree to which the mortgage product would be affordable. Sector and Lloyds responded by stating that at the point of application the lender assess affordability taking into account the customer's income, known household expenditure and credit commitments, plus a 'buffer' reflecting the lender's “risk appetite”. In addition the lender goes to significant lengths to explain the impact of the interest rate in order to be sure the customer will be able to afford the mortgage in a rising rate market. Members were informed that whilst the rate for an 85 per cent LTV mortgage is unlikely to be as cheap as that for a 75 per cent LTV mortgage, the rates will still be competitive.

1.1.6 Lloyds wished to stress that arrears and repossessions reflect badly on their own capital provision requirements and credit ratings, so it is not in their interest to put customers into a position where they think they will default. Sector and Lloyds explained that they generally lose money if they have to repossess, and therefore go to great lengths not to do so. It was explained that mortgage regulations do not allow lenders to make a profit from arrears and possessions even if there was a business case to support it. As an example Lloyds described that the possessions in their mortgage stock run at around 0.1 per cent against an industry level of around 0.3 per cent.

1.2 Financial Analysis

1.2.1 As advised in the last report to Cabinet in June, 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. 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.

1.2.2 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 deposited and will be determined by deposit 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.

1.2.3 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 a default leading to a 'call' on the deposit be met from the General Revenue Reserve.

1.2.4 As discussed at the last Cabinet meeting, the strategic objective of the Scheme is to support Housing policy, and not to achieve financial return in accordance with the Council's Treasury Management Strategy. However, as was demonstrated at the last discussion in June, Members will wish to balance the return on offer (which should be at a premium compared to market rates) with the financial risk of default.

1.2.5 As alluded to above, unfortunately the rate varies from day to day so it is not possible to 'pin down' at this point what rate will be on offer if Members decided to proceed. **Perhaps Members may wish to recommend that, prior to committing to the launch of the Scheme, the Director of Finance in consultation with the Leader and Cabinet Members for Finance and Housing agree that the rate on offer compared to the financial risk is acceptable taking into account the market position?**

1.2.6 One suggestion made during discussions outside of the Cabinet meeting, is that districts, with KCC, work as a group to negotiate more favourable rates with the Lender. As explained, this might be difficult unless all districts 'launched' at the same time and the chances of this happening are perhaps slim.

1.2.7 Finally, as we mentioned in June, the accounting treatment for the deposit is still under discussion with the Audit Commission. Sector's view remains that the deposit is to be treated as capital expenditure for accounting purposes, but our auditors have put forward the alternative view. We await confirmation of that view from our auditors. As suggested previously, if Members do approve participation in the Local Authority Mortgage Scheme, the Director of Finance advises that it 'sit outside' the Council's Capital Plan Review process or the Treasury Management and Investment Strategy counter party exposure limits and duration as appropriate.

1.3 Conclusions

1.3.1 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.

1.3.2 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.

1.3.3 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. If Members are minded to support the Scheme, i**t is important to acknowledge that the strategic objective is to support Housing policy, and not to achieve financial return in accordance with the Council's Treasury Management Strategy.**

1.3.4 The Council currently has sufficient funds to enable this Scheme to be supported in the way set out above. As suggested at paragraph 1.2.5, Members may wish to seek confirmation about the return on offer compared to the financial risk prior to finally committing to launch.

1.4 Legal Implications

1.4.1 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.

1.4.2 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.

1.4.3 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.

1.4.4 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. It would be our intention to adopt the parameters as set out in this report as the basis of the Council's policy.

1.5 Financial and Value for Money Considerations

1.5.1 As set out above.

1.6 Risk Assessment

1.6.1 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 a default leading to a 'call' on the deposit be met from the General Revenue Reserve.

1.6.2 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.

1.7 Recommendations

Council is **RECOMMENDED** to:

1.7.1 **ADOPT** in principle the Local Authority Mortgage Scheme in accordance with the details provided within this report;

1.7.2 **ADOPT** the parameters as set out in this report 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;

1.7.3 **AGREE** to launch the Scheme within T&M only when the rate of return on offer from the Lender is endorsed by the Director of Finance in consultation with the Leader and Cabinet Members for Finance and Housing;

1.7.4 **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.

1.7.5 **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 and duration.

1.7.6 **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.