DECISION-MAKER:	CABINET COUNCIL
SUBJECT:	LOCAL AUTHORITY MORTGAGE SCHEME
DATE OF DECISION:	16 APRIL 2012 16 MAY 2012
REPORT OF:	CABINET MEMBER FOR HOUSING
STATEMENT OF CONFIDENTIALITY	
Not applicable	

BRIEF SUMMARY

First time buyers meet a number of challenges in the current housing market. This report outlines a scheme known as the Local Authority Mortgage Scheme (LAMS) which enables Local Authorities (LAs) to support first time buyers to obtain a mortgage from existing lenders.

RECOMMENDATIONS:

Cabinet

(i) To consider the information about the Local Authority Mortgage Scheme and make any recommendations to Council that are considered appropriate, subject to resolving the outstanding legal issues to the satisfaction of the Director of Corporate Services.

Council

(i) That the Council adopt the Lend a Hand Mortgage scheme as an initial pilot scheme.

(ii) The Lend a Hand Mortgage Scheme not to be implemented until the Director of Corporate Services is satisfied as to the lawfulness of the scheme.

(iii) To operate outside of current Council Treasury Policy to allow money to be placed on deposit for an initial fixed period of 5 years. The investment of £1 million would be deposited with Lloyds TSB to potentially underwrite a minimum of 40 deposits for First Time Buyers.

(iv) The maximum value of any loan under the scheme is set at £118,750.

(v) That the Cabinet Member for Housing brings a further Executive report to Cabinet and Council once the pilot funding is exhausted, to allow evaluation of the pilot, and consideration of a wider scheme.

(vi) That the Council indemnify the Monitoring Officer against all personal liability he will incur by providing Lloyds Bank with an opinion and by providing Lloyds Bank with a signed opinion letter.

(vii) That the qualifying post codes will include all post codes within the LA boundary area and will exclude any that cross the boundary into a neighbouring authority. The qualifying post codes will be provided to the lender(s) in a schedule to the indemnity deed

(viii) To delegate authority to the Director for Economic Development to enter into agreements with any financial institution pursuant to Section 435 and 442 of the Housing Act 1985 in furtherance of the scheme and in consultation with the Director of Corporate Services.

REASONS FOR REPORT RECOMMENDATIONS

1. First time buyers within the city are struggling to obtain mortgages, largely due to the requirement for larger deposits.

2. The Local Authority Mortgage Scheme is a national scheme that works to enable first time buyers to access mortgages with smaller deposits.

3 Legal Services advise that a further view on the State Aid implications is required before the scheme is launched, this may include the Council filing an application requesting the UK Government make formal notification to the European Commission and seeking clearance on State Aid.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

4 (i) Not to fund the scheme locally. This would mean that the only help for first time buyers requiring financial assistance would be from the national scheme recently launched ('NewBuy'). However, the national scheme only applies to new build homes built by certain developers and the Lloyds scheme specifically excludes new build so they are complimentary in assisting first time buyers.

(ii) To fund mortgages direct.

(iii) Not to fund this scheme at the current time but reconsider this at a future time.

DETAIL (Including consultation carried out)

Background

5 Since the start of the credit crunch in 2007, banks and other mortgage lenders have tightened up on both their lending criteria and the amount of money being lent. At the peak in 2007, £362,632M was lent nationally; by 2009 this had fallen to £142,639M.

6 One change has been the move towards lower Loan to Value (LTV) values, which in practice means borrowers having to find higher deposits than have traditionally been required.

7 Whilst existing home owners may have equity in their homes or savings from another source to enable them to move, it is first time buyers who have felt the greatest impact of changed lending criteria.

8 The Council of Mortgage Lenders (CML) reported that at the end of 2010, the average first time buyer who bought a home, had a deposit of 24%.

9 The PUSH Housing Market Survey of 2010 reported that only 4 lenders nationally were offering mortgages with a LTV of 80% or more. Where lenders will lend higher LTV values, the interest rates tend to be higher, making the loan less affordable.

10 The Southampton Housing Need Survey, updated by DCA Associates (DCA) in 2010, identified that 98% of new households are unable to afford the deposit required to buy a home in the city. Only 21% prospective purchasers have savings of £1,000 to £5,000.

11 On average a deposit of around £25,000- £30,000 would be required to buy a 1 or 2 bedroomed home in the city.

12 DCA have also reported that they found little evidence to support the idea that family members would be able to help first time buyers out in raising a deposit.

13 Lloyds TSB report that for every first time buyer purchase, there are 6 property transactions that take place on average. Without first time buyers coming into the market then, the rest of the property market stagnates and existing owners are unable to move.

14 In practice there are first time buyers in the city who could afford a mortgage, but are unable to find the required deposit

Background to the Local Authority Mortgage Scheme (LAMS)

15 Nationally, a number of LAs started to consider ways that they could finance mortgages to potential buyers. However, issues of limited financial resources, limited staffing resources and expertise, and operational risk meant this option was not viable.

16 Rather than lending direct, some LAs began to explore the possibility of entering into partnership with existing mortgage lenders to miminise the financial impact on the LA and to take advantage of the existing expertise of mortgage providers.

17 In late 2009, Capita's Sector Treasury Services (Sector) set up a pilot scheme to assess the viability of a Local Authority Mortgage Scheme (LAMS). Sector, acting for Lloyds, investigated the legal and accounting issues involved. Eleven LAs sponsored the initial pilot.

18 Sector held discussions with potential funders which revealed that funders were only interested in a large national scheme rather than working separately with individual LAs. The idea of a national scheme was also supported by CML.

19 Following the successful completion of the pilot, Sector formally launched the scheme and others LAs are now able to join the scheme.

Details of the Local Authority Mortgage Scheme (LAMS)

20 The scheme is aimed at first time buyers, providing help for potential buyers who can afford mortgage payments, but not the initial deposit. The scheme is standardised as much as possible nationally.

21 If the potential buyer meets the credit criteria applied by the lender to qualify for a mortgage, the LA 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 20% deposit usually required. Under the scheme, applicants must satisfy the Lender's current lending criteria.

22 To enter the scheme, the LA will need to invest a minimum of £1M, which will be held to the Bank's order for a minimum period of 5 years, which will be extended to 7 years if there are arrears in the last 6 months of the 5 year period.

23 When a LA agrees to participate in LAMS, a maximum limit for the total indemnity to be offered under the scheme is set by the LA – currently between £1-£3M. Once this figure has been decided and all the legal documentation completed, the mortgage lender should manage the operational side of the scheme without any direct input from the LA. Sector will undertake an annual audit of the scheme to ensure both parties are fully compliant with the agreement.

24 The indemnity remains on deposit with the Bank but during the lifetime of the agreement the LA will also have to make payments to Lloyds, on demand to cover any losses.

25 The indemnity would only be called upon if a loss is incurred by the lender, e.g. if a property valued at £100,000, with a mortgage of £95,000 and with LA indemnity of £20,000 is sold at £70,000, net of attributable costs, the full value of the £20,000 indemnity would be requested by the lender. If the property is sold at £90,000 net of costs, i.e. an actual loss of £5,000 is incurred by the lender, £5,000 would be requested from the LA. Any loss in excess of the value of the indemnity would be attributable to the lender. The lender would request payment from the LA, who would undertake to make payment within 30 days.

26 The initial £1M deposit is placed in a commercial deposit account where it receives the standard commercial rate of return plus 70 base points. After 5 years the initial deposit matures and a new deposit will be required to the value of any residual mortgages, less any mortgages repaid within the 5 year period. This second deposit account will receive interest at standard commercial rates with no enhancement. Experience from other authorities is that take-up is rapid and the recommendations for the Southampton scheme are quite limited so one might expect to have full take-up within 1 year. In this scenario the LA would be entitled to withdraw all of the second deposit within 1 year of it being made. If the conditions are met for the indemnity period on some mortgages to be extended to 7 years then with good initial take-up some of the second deposit may need to be kept in place for 3 years. In the extreme case where there was not full take-up on the scheme until the end of the 5 year and the indemnity period on some mortgages was extended to 7 years then the council would have to retain some money in the second deposit account for up to 7 years.

27 The table below illustrates how risk is shared between the Mortgagee, the Authority and the Bank on an individual property. It should be noted that it takes no account of costs associated with the sale.

House Price Fall	5%	10%	15%	20%	25%	30%
	Risk to Investment					
Mortgagee 5%	100%	100%	100%	100%	100%	100%
Authority 20%	**0%**	**25%**	**50%**	**75%**	**100%**	**100%**
Bank 75%	0%	0%	0%	0%	0%	7%

It should be noted that the table above is for illustrative purposes only to make the point that the Bank has complete protection under the scheme for a fall in house prices of up to 25%. It is likely that there will be claims on the indemnity where house prices fall by less than 5%. In the event of repossession and resale any costs incurred as a result of the resale will be added to the debt. These costs will include estate agent/auction fees, legal costs, administrative costs and any interest on arrears. It is likely that the majority of the Mortgagee's deposit will be used to cover these costs and that any repossession will result on a claim on the indemnity irrespective of the fall in house prices.

28 Due to the changing economic environment, further legal and / or accounting advice may be required during the life of the LAMS. Sector state that during the lifetime of the scheme, it may need to obtain updated advice. Any additional fees incurred by Sector in this respect will be payable by the LA in advance.

29 The scheme is currently supported by one major mortgage lender, Lloyds TSB. However, it is a requirement of the scheme that mortgage applicants should have a choice of mortgage providers and the scheme should be available to all lenders on a national basis. Lloyds TSB require a cash backed indemnity.

30 Sector is currently in dialogue with other new lenders who may join the scheme. Some of these lenders may not require a deposit and may offer a non-cash backed financial guarantee with a premium. Sector advise that due to the State Aid position, a non-cash backed guarantee without a premium is not an option.

31 By the end of May 2012, there will be 35 authorities in England that have launched LAMS and there have been about 230 mortgage offers. There are around 250 LAs looking at the scheme.

The Southampton scheme

32 It is proposed that a pilot scheme is undertaken by the Council.

33 Currently, Lloyds TSB are the only main lender signed up to lend in this area. Most other lenders currently signed up to the LAMS scheme nationally are smaller local building societies working in restricted locations.

34 It is proposed that £1 million is placed with Lloyds TSB to facilitate lending. This is the minimum indemnity Lloyds TSB will accept.

35 Interest will be received on the deposit at a rate of 70 base points (bps) above normal commercial rates for a 5 year deposit. For a £1M indemnity there would be an annual income of £7,000 above normal interest rates. Over the 5 year period of the scheme there would be £35,000 available to contribute to the cost of claims against the indemnity.

36 There are limited aspects of the national scheme that the Council can influence. These are:-

(i) Total level of investment i.e. £1-£3M;

(ii) Maximum loan size; and

(iii) The postcode where first time buyers can buy using the scheme, although these have to be within the city boundary.

Nothing else can be altered.

37 It is proposed that the maximum value of any property under the scheme is set at £118,750. This is considered a reasonable level to find a suitable first home, whilst allowing adequate choice for purchasers.

38 The DCA study found that the city average for entry level 2 bed properties is £124, 950. Their evidence is that first time buyers do not generally buy the cheapest properties on the market because these homes often need work to bring them up to standard, and first time buyers lack both the capital and the experience to do such work.

39 Assessment of the local market in September 2011 (via the Rightmove property search website) showed that there were 323 properties for sale at £125,000 or less. 172 of these were 1 bedroomed homes, 132 were 2 bedroomed and 19 were 3 bedroomed.

40 At a purchase price of £125,000, the purchaser would need to find a 5% (£6,250) deposit. The Council will indemnify 20% (£25,000), with the purchaser taking out a £118,750 mortgage. These examples are indicative based on a 5% deposit.

41 If every purchaser on the scheme bought a property at the full value of £125,000 then the pilot scheme would be able to support 40 mortgages (£1m divided by £25,000 per mortgage). However, there may be purchasers who do not require the full amount, which would mean more first time buyers could be assisted.

42 It is proposed that there are no restrictions on the areas within the city where purchasers on the scheme can buy. This will allow maximum choice for purchasers. Purchases will however, be restricted to postcodes within the city.

43 Lloyds TSB will not lend on new build apartments - this is their general lending criteria and is not specific to this scheme.

RESOURCE IMPLICATIONS

Capital/Revenue

44 The Council has already paid a £3,000 "research and joining fee" to give access to legal advice written by Sector's solicitors including a paper on State Aid. The funding also includes any support needed from Sector Treasury Services to help the Council set up the scheme and an annual audit where Sector Treasury Services will ensure the lender(s) have complied with requirements.

45 As noted above, the Council will receive an additional income of £7,000 per annum over and above Lloyds normal commission rates for a 5 year deposit, assuming a scheme value of £1M. Should there be no call on this money the Council may expect to see a small profit.

46 There are risks associated with the scheme, which the Council would need to consider how to manage and the mitigating controls to be put in place. A Risk Assessment, outlining the risks and potential mitigating controls has been produced by Sector and made available to Legal and Finance. Some of the risks though are inherent in the scheme and cannot be mitigated against.

47 A further Risk Assessment compiled by the Council with significant input from Finance and Legal Services is attached at Appendix 1. The main risks of entering the scheme are seen as:-

- the possibility of default by the borrower , causing a shortfall to be paid by the Council;
- Lloyds assigning their interest to a 3rd party,
- Lloyds or a 3rd party assignee changing their lending criteria,
- Continuing falling house prices resulting in a shortfall upon sale.

48 Clearly the main risks are the possibility of default by the borrower and, if this happens, the costs of the guarantee that the Council would pay to the lender. Nationally, latest CML figures show 0.3% of first time buyers default on their mortgages in the early years. A £1M facility would assist around 40 purchasers. Historic trends indicate the number of defaults on 40 mortgages would be very low but clearly these trends do not necessarily indicate what might happen in the future.

49 The cost of a default depends on the way property values have changed since the purchase was made, and the table at paragraph 27, shows how the risk is split between mortgagee, authority and bank when property prices fall. Increasing property values would lead to a very low (if any) guarantee payment as the purchasers equity would have increased. However, if property prices fall rather than increase in the short term then this is the scenario where guarantee payments are more likely to arise.

50 The extent of the payment is capped at the maximum value of the guarantee for each property. The annual surpluses referred to in paragraph 45 above would be sufficient to fund 1 full guarantee payment over 5 years, after which there would be an unbudgeted cost to the General Fund.

51 The main marketing for the scheme will be carried out by Lloyds. The Council may need to make some funding available for the marketing of the scheme and this will have to be absorbed within existing budget lines as there is no separate provision for this activity.

52 There is no staffing resources implication for the Council. Any work required in monitoring the pilot will be undertaken within the existing Housing Development and Strategy Team.

53 The Treasury Management Strategy for 2012/13 to 2014/15, as approved by Council on the 15 February 2012, does not allow the Council to place money on deposit with any financial institutional for a fixed period of more than one year. The maximum length of time the Council would normally place money on deposit is determined by the prevailing economic conditions. Current advice from the Council's Treasury advisors is that money should not be placed on deposit with Lloyds for more than 3 months. The money placed on deposit to indemnify LAMS therefore requires a specific decision to operate outside the Council's approved Treasury Management scheme.

54 The table at Appendix 2 provides details of the 8 schemes currently known to the Council. The Co-op do not currently have a scheme but are looking into the possibility of launching something in the future or to join LAMS. Five of the remaining schemes are local based and do not cover the Southampton area. The only viable alternative scheme to Lloyds is with Leeds BS and this only offers 40 bps above normal commercial deposit rates so would provide a smaller contribution to the cost of any claims against the indemnity.

55 Lloyds is considered to be the bank with least risk as it is of national importance to the economy and likely to receive state support should it run into difficulties. The other banks are much smaller and of lesser national importance so are less likely to receive support if they were to get into difficulty.

Property/Other

56 None

LEGAL IMPLICATIONS

Statutory power to undertake proposals in the report:

57 The Council has powers under Section 435, and S442 of the Housing Act 1985 to enter into an agreement with a body making an advance on security of a house. There is a possible issue though of the lawfulness of the scheme if the Bank's interests were assigned but it is more likely than not that the Council would be empowered to enter into contractual relations with the assignee of the Bank's rights by section 111 of the Local Government Act 1972.

58 This scheme could amount to unlawful State Aid and Legal Services recommend that Cabinet/Council do not implement the scheme until the Council is satisfied that any State Aid issues have been resolved satisfactorily

59 There is a possibility that the Indemnity in the Deed falls inside the scope of the Public Contracts Regulations 2006 and Directive 2004/18. Further

information about the scheme is required before additional advice can be given.

60 The Monitoring Office (Mark Heath) has to sign an Opinion Letter and Indemnity Deed to the bank. This is a Mandatory requirement by the Scheme. This imposes personal liability on the Monitoring Officer who will need to be satisfied about all aspects of the scheme before signing the documents. The Council will need to sign an indemnity Deed which indemnifies the Monitoring Officer in respect of any personal liability.

Other Legal Implications:

61 There is a 3-party indemnity agreement between Lloyds, Sector and the Local Authority.

62 Legal services advise that Appendix 1 “Risk Table” is considered in detail in conjunction with this report.

POLICY FRAMEWORK IMPLICATIONS

63 There would be no policy implication to the scheme as all decisions about lending etc will be made by Lloyds TSB under strict Financial Services Authority regulations.

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KEY DECISION? Yes

WARDS/COMMUNITIES AFFECTED:	All

SUPPORTING DOCUMENTATION

Non-confidential appendices are in the Members’ Rooms and can be accessed on-line

Appendices

1.	Risk Table
2.	Summary of banks and building societies involved

Documents In Members’ Rooms

1.	None

Integrated Impact Assessment

Do the implications/subject of the report require an Integrated Impact Assessment (IIA) to be carried out.	No

Other Background Documents

Integrated Impact Assessment and Other Background documents available for inspection at:

Title of Background Paper(s) — Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)

1.	None	