Nottinghamshire County Council

Report to POLICY COMMITTEE

12 December 2012

Agenda Item: 5

REPORT OF THE CHAIRMAN, FINANCE AND PROPERTY COMMITTEE

LOCAL AUTHORITY MORTGAGE SCHEME

Purpose of the Report

1. To recommend that the County Council participates and provides finance for the Local Authority Mortgage Scheme (LAMS), which will make it easier for first time buyers to enter the property ladder and assist in alleviating some of the issues around lack of availability of social housing and affordable private rented accommodation.

2. Whilst the County Council is not a housing authority it clearly has a very significant role in terms of promoting economic prosperity within the County. Participation in LAMS, by way of lending to banks in a manner which allows them to make more affordable mortgages available to people who do not currently have the resources to put a significant deposit into a house, will make a significant difference to the property market within the County. There is a potential to aid about 500 first time buyers with a proposed total investment of £15 million in the Nottinghamshire scheme. In addition, there are expected to be knock-on economic benefits to the County of the scheme, although these are more difficult to quantify.

Information and Advice

The need for support of first time buyers

3. The turmoil in financial and banking markets in recent years has impacted on both the local economy and in particular the local housing market. The requirement by the Bank of England for financial institutions to hold larger amounts of capital has made it less financially viable for banks and building societies to continue to offer mortgages at attractive rates when the prospective purchaser has a relatively small amount of savings to put into the deposit. They are typically now only able to lend to potential house purchasers a maximum of 75% - 80% of the value of the house at attractive mortgage rates. Mortgages are available for some borrowers with a lower deposit, but these tend to be at high interest rates, and greatly reduce the chances of first time buyers obtaining an affordable mortgage.

4. Despite all the economic and financial difficulties, 81% of British adults hope to be home-owners in ten years' time, and 74% aspire to it within two years, according to a new YouGov research article published by the Council of Mortgage Lenders. Aspirations are much higher than current home-ownership levels among those aged under 35, but it is far from clear whether and how people will achieve their home-ownership goal. Notably, most of those who are renting privately or sharing with family or friends are under 35, and more than half of

these (54%) would like to become home-owners over the short term. However, only a third (33%) of those who hope to be home-owners in two years' time actually expect it to happen.

5. Saving a 20% - 25% deposit at the same time as paying rent for either social or private housing is clearly a problem, and one which is impacting greatly on the number of first time buyers who are entering the property market. Without first time buyers there is likely to be a significant period of stagnation within the property market and this is unlikely to be healthy for economic growth – as a simple example, people who are currently saving a large amount of their disposable income with a view to buying their first property could divert this into spending on household goods if they can be released from this need to save.

6. 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. Under the scheme, each Local Authority will be able to specify three qualifying criteria; the maximum level of indemnity, the maximum loan size (based on 95% of maximum property valuation) and the qualifying post codes.

7. In addition, it is estimated that each first time buyer that enters the property market produces a further 4 or 5 transactions further up the chain. This is not the case for newly built houses, where the chain does not exist, and whilst new builds are not specifically excluded from LAMS, not all financial institutions will support new builds through a LAMS. A separate Government backed scheme exists for newly built properties.

8. Consequently, it can be seen that setting up a scheme to help first time buyers has a potential to have a tremendous impact upon the housing market in the county and upon the local economy in general.

9. It should be noted that LAMS will not bypass the normal credit checks that are applied to the granting of a mortgage and will not lead to lending to inappropriate borrowers. Exactly the same credit checks are carried out for a LAMS mortgage that would be carried out for a 95% mortgage where the financial institution is taking all the risk.

How LAMS Works

10. The County Council will lend an amount of money (initially expected to be about £2 million) to a financial institution that has agreed to be part of the scheme. This loan will be for a 5 year period and the interest payable will be a market rate for a 5 year loan plus an additional margin to protect against some of the risks associated with the default by mortgage holders.

11. The loan made to the financial institution is not used to provide the finance for individual mortgages and is merely used as an indemnity against any defaults on the mortgages that occur in the five year period. After this five year period the lender assumes full responsibility for the mortgage and any subsequent defaults, and the loan is returned to the County Council. If there are mortgages that are in arrears by more than a specified period at the end of the five year period, there will be an agreed 'hold back' to cover the possibility of these mortgages ultimately ending in default.

12. For any mortgages granted, the mortgagee will put down a deposit of at least 5% and the County Council's loan to the financial institution will indemnify the rest of the loan, down to a 75% level. In the event of a default on the mortgage the County Council would be required to

cover the amount of the indemnity provided against the mortgage, less any monies recovered as part of the repossession and sale of the property.

13. A limit for the maximum loan value per property will be agreed with the financial institution and this will in effect, and subject to the personal deposit available from the mortgage applicant, set a maximum indemnity per property on which the lender will provide a mortgage under LAMS. As this scheme is specifically for first time buyers and is intended to benefit those who will find it difficult to enter the housing ladder without LAMS, it is proposed that the limit be set to allow properties of up to about £150,000 to be purchased, based on a 5% deposit from the applicant.

14. It is necessary, as part of LAMS, to specify the maximum amount of mortgage that the County Council is willing to guarantee. Assuming a 5% deposit on a £150,000 property (£7,500) is put down by the mortgagee, the mortgage would be for £142,500. This is the maximum mortgage amount that it is recommended that the County Council allows to be made available within the Nottinghamshire LAMS. As a result the maximum indemnity per property that the authority will be liable for is £30,000 (i.e. 20% of £150,000).

15. Each lender will only run one scheme in any given area at any one time, defined by post codes. However, this does not prevent any Authority running a LAMS with any other lender operating in the same defined area. Consequently, since Gedling Borough Council currently operates a scheme though the Lloyds Banking Group the County Council could not also run a scheme with the Lloyds Banking Group in the Gedling area.

16. Each scheme runs for the length of time the invested sum is consumed by successful mortgage applicants (i.e. until the sum has been set to indemnify successful mortgagees). This is a shorter period of time than the money is invested by the County Council in the financial institution (5 years). Hence, based on assumption that all mortgage values are at the maximum of £150,000, up to 33 first time buyers would be supported by every £1 million invested in the scheme (i.e. £1m/£30,000). This indicates that schemes would finish within a shorter period and suggests, hopefully, that it would not take long before the Gedling LAMS nor our first scheme completes and would enable a future County Council LAMS to extend across all of the County area using the Lloyds Banking Group.

17. A full list of post codes to be included within the scheme will be provided to the financial institution, with the exception of post codes within Gedling – which is slightly more complicated due to the fact that it has already launched LAMS within the District, and this is covered later in this report. It is the intention that all post codes that are wholly within the county area (but excluding Nottingham City) will be included within the Nottinghamshire LAMS.

18. Other local authorities that have launched LAMS have had issues with post codes which span more than one district, and on occasions this has led to bad publicity (e.g. a mortgage application was denied on a home that was within a district with a LAMS because it had a post code that encompassed homes in a different district and had been excluded from the scheme). From Nottinghamshire’s perspective it is post codes which are shared between Nottinghamshire and Nottingham City and other neighbouring Counties which are an issue and there is no avoiding this at present, although it is possible that future LAMS may be able to resolve this issue. Every effort will be made to limit this; however, it is not possible to guarantee this issue will be eliminated.

19. Any post code can only be included within one LAMS, so those included in the Gedling scheme cannot be included in the Nottinghamshire one. Likewise if a single LAMS is launched across the rest of the County the Districts will not be able to launch their own LAMS with the Lloyds Banking Group whilst ours is still active.

20. If a Nottinghamshire County Council LAMS is approved by members it is intended to move ahead as quickly as possible with it. It is understood that other Districts may be interested in setting up their own LAMS. However, although many of them are looking to take part in LAMS, none are sufficiently well advanced in their consideration. If the first tranche of the Nottinghamshire LAMS scheme is successful the hope is that the Districts and the County can work together for future tranches to increase the amount of funding available, potentially pooling funding in each district area.

21. The intention is ultimately to make £15 million available for LAMS. It will be necessary to use this in a number of tranches as no mortgage lender will be willing to agree to borrow such a large amount at quite a high interest rate, whilst having no guarantee that they will actually be able to issue sufficient mortgages within the scheme to make effective use of the funding. There is a requirement to have some flexibility around how much of the available cash is drawn down in each tranche, and how the interaction with future District Council LAMS will work in practice. The intention to begin with is to invest £2 million in the first tranche to support the Nottinghamshire LAMS.

Potential Partners for LAMS

22. There are a number of financial institutions that have signed up to LAMS but there are only currently two that are willing to take part in the cash backed scheme that is the most appropriate for Nottinghamshire. Leeds Building Society has a single branch in Nottinghamshire – in Nottingham City centre. Lloyds Banking Group has a significant branch network across the county and has been the chosen partner for virtually all LAMS that have already been launched and has the experience gained from participating in more than 30 of them.

23. Lloyds are the most appropriate partner for the first tranche of LAMS money in the County. It is expected that other financial institutions will join the scheme in the future and these can be considered for future tranches, but it is recommended that Lloyds are chosen for the first one. Lloyds currently exclude newly built houses from their scheme. The intention will be to work with other financial institutions to potentially increase the number of lenders that could provide a LAMS across Nottinghamshire.

24. If a further appropriate lender joins the scheme before the proposed total indemnity value has been fully utilised it is expected that there will be two Nottinghamshire LAMS running concurrently, via two different lenders. This will help to give potential borrowers choice and assist in getting more mortgages approved more quickly. It is possible that a second lender may have different requirements to Lloyds in terms of relevant County Council approvals and it may, therefore, be necessary to seek them separately. Some of the recommendations of this report are written to satisfy Lloyds' requirements, but this should not be taken to mean that Lloyds will be the only mortgage lender that the authority will consider using.

25. Lloyds Bank ‘brand’ LAMS as the Local Lend-a-Hand Mortgage Scheme. In addition to the Local Lend-a-Hand Mortgage Scheme Indemnity Deed, the Local Authority Monitoring Officer (Corporate Director for Policy, Planning & Corporate Services) must provide Lloyds TSB Bank plc and Lloyds TSB Scotland plc with an Opinion Letter confirming that the Authority has the power to enter into, observe and perform the terms and obligations required of it under the Scheme. The Authority will also be required to indemnify the Monitoring Officer in respect of any personal liability he or she may incur by providing the Opinion Letter.

26. Both the Opinion Letter and the Monitoring Officer's Indemnity Deed will be in a prescribed form and, in addition to the resolution required to enter into the Mortgage Scheme Indemnity Deed, the Local Authority will need to ensure that there is a suitable resolution or other form of authority for the grant of the Monitoring Officer's Indemnity Deed. These requirements are covered within the recommendations of this report.

Financial Implications

27. Expenditure in a LAMS is treated as any other investment to a financial institution and is covered by the Treasury Management Strategy and Policy approved last February. Funds invested with the Lloyds Banking Group would be treated in the same way as any other long-term bank deposit and would not require the Authority to set aside any additional financing from revenue or capital purposes.

28. The Government holds a significant shareholding in the Lloyds Banking Group and consequently Lloyds is already on the County Council’s Approved Lending List and our ability to lend to Lloyds is currently reflected in County Council’s Treasury Management Strategy and Policy.

29. Future loans to other financial institutions, for the purposes of a LAMS, would be assessed against the credit and counterparty criteria set out in the Authority’s Treasury Management Strategy and Policy.

Management of Risk

30. There are two financial risks to the County Council: firstly that the financial institution defaults on the loan and secondly that their lending criteria are insufficiently stringent and that a significant number of defaults occur. The former of these risks can be minimised, but not alleviated completely, by careful choice of the counterparty. The latter risk is more difficult for the County Council to control and it is important to be comfortable that the financial institution has a risk-aware methodology in respect of the granting of mortgages. It is reasonable to expect them not to take risks with the County Council’s money that they would not take with their own, and this has been confirmed.

31. Figures from the Council of Mortgage Lenders show that the incidence of mortgage defaults in 2010 and 2011 was 0.3% of all mortgages. There are no specific figures available for first time buyers and it might be reasonable to assume that the incidence of defaults would be higher, but even if every default was to be for the full amount of the guarantee (i.e. the property was sold for less than 75% of the purchase cost) it would take almost a doubling of this default rate to ‘wipe out’ the interest premium paid by the financial institution. In 2012 LAMS transactions have attracted interest rates (including the premium) of between 2% to

4.5% p.a. and if this interest (or even a part of it) were to be ‘set aside’ in a reserve to cover the risk of default, there is unlikely to be a meaningful financial risk to the authority.

32. One of the risks within LAMS is that the financial institution is unable to repay the loan from the Authority at the end of the five year period, due to financial failure. As a bank which is 41% owned by the UK Government, Lloyds is amongst the most secure banks in the world and the risks of lending to them is lower than it is for almost all other financial institutions and they have by far the highest credit rating of any lender participating in the scheme. Consequently, it is felt the risks inherent within lending to Lloyds as part of LAMS are modest. If Lloyds does not exist in five years’ time, it is highly likely that most other financial institutions will also have failed and that the UK Government will also be in a very perilous financial position.

Summary

33. LAMS offers an effective and risk-aware method of using the authority’s reserves to assist in re-invigorating the local housing market by assisting first time buyers to obtain cost-effective mortgages. These reserves should be returned in full in five year’s time and in the interim period an attractive rate of interest will be earned, including a premium to mitigate the possibility of mortgage defaults.

34. LAMS will not promote reckless lending or provide mortgages to those who cannot afford them, but it does reduce the amount of deposit required before a cost-effective mortgage can be obtained.

35. LAMS should assist in providing economic support within the County, and in doing so will help to promote economic prosperity. It is hoped that District Councils other than Gedling (who have already carried out one LAMS) will be encouraged to participate in the scheme in the future, which will be beneficial to them both from an economic prosperity perspective also in their role as housing authorities. If the scheme can assist even a small number of movements out of social housing its advantages will be substantial.

36. If LAMS in Nottinghamshire is successful, a first tranche of £2 million is likely to lead to about 70 first-time buyers entering the property market. Whilst this might seem a low number, consideration needs to be given to the potential impact in assisting over 300 property transactions when taking into account the property chain, together with the wider impact upon the local economy. The follow on tranches, particularly if backed with extra money from the Districts, may have a significant impact on housing and economic activity within the County.

37. The County’s Legal Service has been consulted throughout this project. State Aid has been considered and such risks that exist within LAMS will be minimised and managed to the fullest extent possible to ensure compliance. Furthermore, the County Council will be required to give a Data Protection indemnity to Lloyds Bank up to the limit of £1m and £5m (depending upon the circumstances).

38. Since this is a new and exciting initiative to boost the Nottinghamshire economy it is proposed that a report on the progress of the scheme, six months after the launch, is presented to a future meeting of Finance and Property Committee.

Reasons for Recommendations

39. LAMS is a relatively recent development and consequently this is the first time the matter has been considered by Policy Committee.

40. LAMS provides the County Council a very significant role in promoting economic prosperity within the County. Participation in LAMS, by way of lending to banks in a manner which allows them to make more affordable mortgages available to people who do not currently have the resources to put a significant deposit into a house, will assist in ‘oiling the wheels’ of the property market within the County. This can only be positive for economic growth.

41. There is evidence that there are a large number of individuals, couples and families who are currently in either social housing or private rented accommodation but who have the ability to pay a mortgage and want to buy their first house. The obstacle to them becoming property owners is the need for them to save a significant deposit (sometimes as much as 25% of the property value) before they have access to a mortgage at a reasonable interest rate, or even access to a mortgage at all. LAMS allows these people to buy their first house with a significantly lower deposit than would otherwise be required, and on similar terms to them providing a 25% deposit. The potential for LAMS to assist in ‘freeing up’ social housing is beneficial to housing authorities and there is an expectation that at least some of the district councils within Nottinghamshire will join LAMS at a later stage. Other authorities have already used LAMS and it has proved that there is demand for the scheme if finance is available to back it.

Statutory and Policy Implications

42. This report has been compiled after consideration of implications in respect of finance, equal opportunities, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATIONS

43. That Members approve:

    (a) The County Council’s involvement in the Local Authority Mortgage Scheme (LAMS), in the sum of £15 million which will be drawn down in a number of tranches;

    (b) That Lloyds Bank be appointed the initial financial partner with an initial investment of £2 million;

    (c) That the Corporate Director for Environment & Resources, in consultation with the Corporate Director for Policy, Planning & Corporate Services and the Section 151 Officer, be authorised to appoint further financial institutions who have registered for LAMS, as deemed appropriate, and to arrange for the further deposit of funds as required (including possible further deposits with Lloyds Bank);

(d) That the LAMS be adopted in accordance with the outline provided within this report and that the following arrangements be approved:

   (i) A total indemnity value of £15 million, which will be drawn in a number of tranches;

   (ii) A maximum loan size for the authority of £142,500;

   (iii) The qualifying post codes will be provided to the lender in a schedule to the indemnity deed;

(e) That the Corporate Director for Environment & Resources be authorised to take all action and/or decisions he considers necessary to give effect to any matter relating to the proper functioning of LAMS;

(f) That approval be given to the County Council indemnifying the Monitoring Officer in respect of any personal liability that he or she may incur by providing an opinion and providing the Lender with the Opinion Letter in relation to each and every Scheme that the Council enters in to;

(g) That progress on the scheme is presented to a future meeting of Finance and Property Committee.

Councillor Reg Adair
Chairman of Finance and Property Committee

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Constitutional Comments (JFW 03/12/12)

44. Policy Committee has the authority to agree these recommendations.

Financial Comments (NS 22/11/2012)

45. The risks associated with establishing a Nottinghamshire LAMS are set out in this report and the likelihood of the Authority incurring any material loss is very low. The investment of £2 million in the Lloyds Banking Group would be covered by the Authority's current Treasury Management Strategy and Policy.

46. As indicated in the report, the investment in LAMS would be treated as any other long-term investment and would not require financing from the Authority's revenue budget or capital programme. Interest from the loan to Lloyds would appear as additional interest in the revenue account net of any sum set aside for potential bad debt.

Background Papers

47. None

Electoral Division(s) and Member(s) Affected

All