

Cabinet – 24 October 2012

Walsall's Local Authority Mortgage Scheme

Portfolio: Councillor Adrian Andrew, Deputy Leader, Regeneration
Related Portfolio: Councillor Christopher Towe, Finance and Personnel

Service: Housing

Wards: All

Key decision: Yes

Forward plan: Yes

1. Summary

- 1.1 Over recent years the economic downturn has severely affected the housing market. The number of house sales in Walsall have fallen 50% between 2007/08 and 2011/12. First time buyers are a critical part of the housing market, and typically generate a number of resultant property transactions i.e. at the foot of the 'property chain'. Whilst some first time buyers are able to afford mortgage payments, they cannot raise the minimum initial 10% deposit typically required.
- 1.2 The Local Authority Mortgage Scheme (LAMS) is a nationally agreed scheme which aims to help first time buyers to purchase a home, where they are able to afford the mortgage payments, but unable to raise the initial deposit. It works by the Council providing an indemnity to lenders to cover 20% of the purchase price, which enables the lender to reduce the deposit required by the first time buyer to 5% of the purchase price. This means they can offer a 95% loan to value (LTV) mortgage on similar terms to a 75% mortgage. This scheme will support Walsall people to access the housing ladder. This in turn will help stimulate the housing market, bringing multiple benefits for the residents of Walsall.
- 1.3 The scheme does not involve the Council lending mortgage finance itself. It is proposed that the Council provide a 'cash backed' indemnity fund of £5m which would be deposited in ring-fenced bank accounts with the relevant lenders for a minimum period of 5 years. It is anticipated that dependant on take up this could assist around 250 first time buyers, and bring the benefit of the resultant additional property sales that would typically occur. It is proposed that the scheme would be open to all areas of the Borough and that the loan value would be no more than £142,500 (based upon 95% of a typical maximum purchase price of £150,000). The Council will earn a return of interest on the balance of monies held in the indemnity fund from lenders. This is likely to be in the range between 3% and 4.5%.

- 1.4 The LAMS scheme is open to first time buyers only, but can assist with the purchase of both newly built and existing homes in Walsall, although some of the larger lenders do not offer the Scheme on newbuild properties (such as Lloyds). It will complement Newbuy, the national indemnity scheme for newbuild homes, which was announced as part of the Government's National Housing Strategy November 2011.

2. Recommendations

- 2.1 Approve the adoption of the Local Authority Mortgage Scheme in Walsall and agree the associated local criteria:
- Available in all post codes across the Borough
 - Limited to a maximum loan value of £142,500 .
 - Approve total funding of £5m, to be released in tranches
- 2.2 That authority be delegated to the Executive Director for Regeneration, in consultation with the Portfolio Holder for Regeneration, to sign or authorise the sealing of any deeds, contracts and other related documents in relation to the Local Authority Mortgage Scheme, and approve any variations and update to the local criteria.
- 2.3 That authority be delegated to the Executive Director for Regeneration, in consultation with the Portfolio Holder for Regeneration, to approve those lenders that meet the Councils Treasury Management Counter Party list (credit ratings) and to sign or authorise the sealing of any deeds, contracts and other related documents in relation to the approval of the Lenders.
- 2.3 That authority be delegated to the Executive Director for Regeneration, in consultation with the Portfolio Holder for Regeneration, to grant and authorise the execution of an indemnity to the Monitoring Officer in respect of any personal liability he may incur by providing any Lender with an Opinion Letter.

3. Report detail

- 3.1 Table 1 shows that since 2007 / 08 there has been a substantial decrease in house sales, as a result of the economic environment, uncertainty in the housing market and the difficulties in obtaining an affordable mortgage. In 2009 Sector (Sector is an independent Treasury Management service to UK public service organisations) developed a pilot Local Authority Mortgage Scheme (LAMS). The pilot proved successful and 72 councils have subsequently adopted LAMS with 26 actively supporting mortgages. LAMS is specifically aimed at first time buyers, as they are the group which have most difficulty in attracting mortgage finance due to higher level of deposit required, and / or that they have no equity from an existing home to use as a deposit. This investment not only helps first time buyers, but is fundamental to stimulating the whole housing market and assisting with ongoing regeneration activity. A purchase by a first time buyer can generate as many as 5 additional purchases within the property chain.

Table 1

Time Period	Number of Sales in Walsall
April 2005 - March 2006	4026
April 2006 - March 2007	4800
April 2007 - March 2008	4273
April 2008 - March 2009	2242
April 2009 - March 2010	2151
April 2010 - March 2011	2189
April 2011 - March 2012	2178

source: Land Registry Accessed June 2012

- 3.2 The LAMS scheme is aimed at first time buyers for the purchase of both new and existing properties, providing help for potential buyers who can afford mortgage payments - but not the initial deposit – to get on to the property ladder.

It should be noted that first time buyers can use LAMS to purchase any home within Walsall, with the exception of:

- new build apartments.
- Right To Buy purchases
- Shared Ownership purchases
- where the first time buyer already owns a property

Whilst the above applies generally it should be noted that one of the larger lenders under the Scheme (Lloyds) currently exclude all new builds (see paragraph 3.9).

- 3.3 LAMS is a standardised national scheme but there are specific criteria that each local authority needs to set, these being maximum loan value, area and total investment. It is proposed that LAMS is:

- Limited to a maximum loan value of £142,500. This is based on a typical maximum £150,000 purchase price, which was chosen as this is the threshold for properties in disadvantaged areas to be stamp duty exempt, and is above the average sale price in Walsall of £109,000 (July 2012)
- Available to all postcodes across the Borough
- Total indemnity of £5m.

- 3.4 If a potential buyer meets the strict credit criteria applied by the lender, and meets the criteria set out by the Council to qualify for a mortgage under the scheme, the Council will provide a 20% loan to value indemnity. The potential buyer will thereby typically obtain a 95% mortgage on similar terms to a 75% mortgage, but without the need to provide the larger deposit. Potential buyers will apply on a first come first served basis.

It should be stressed that the scheme does not promote reckless lending, it is essential that the applicants meet the standard lending criteria as set out by the

lender, and that the higher LTV mortgage is affordable. The scheme does not involve the Council lending mortgage finance itself.

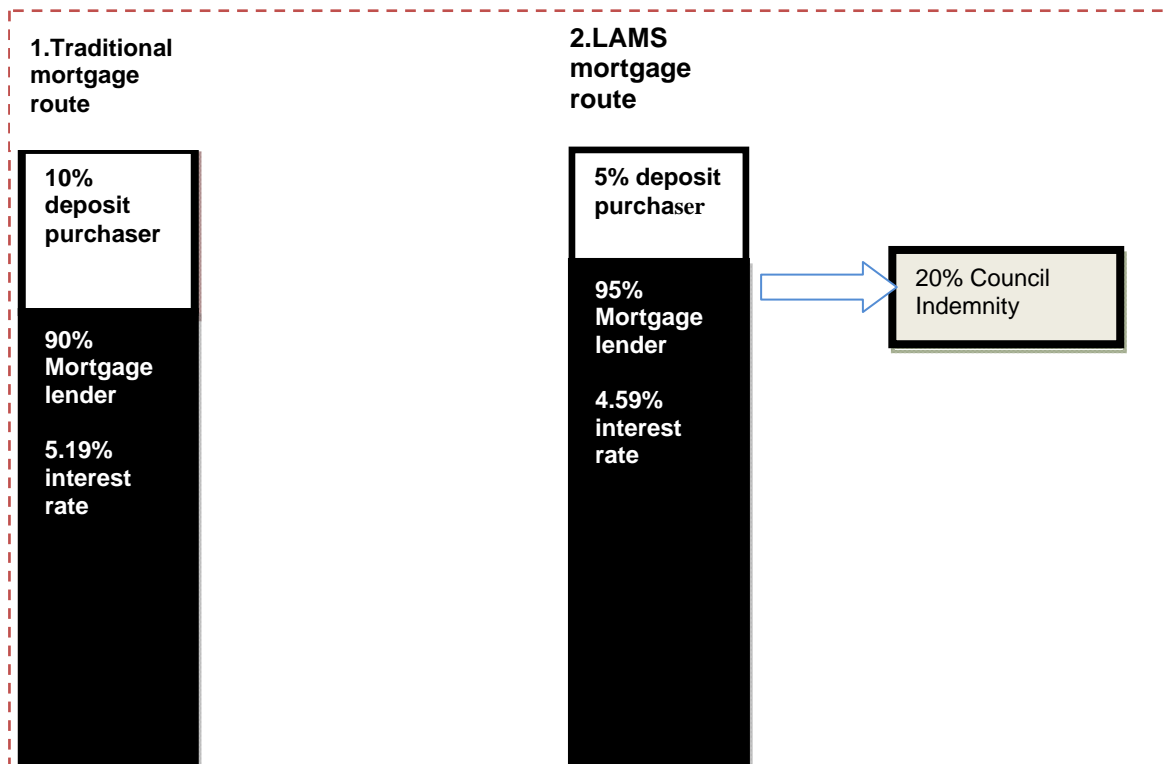
3.5 The scheme assists people who do not have a high personal deposit. For example, a factory worker and sales assistant couple with a joint income of £30k a year, apply for a mortgage for the first time. They apply for a 25 year mortgage re-payment term on a property valued at £100,000, with the lender willing to lend up to 3.5 times their income.

Typically the couple would need to provide a £10,000 (10%) deposit and require a £90,000 mortgage. The monthly payment would be a minimum of £540.00 on a 5.19% interest rate for example

Through a LAMS style scheme for the same example, only a £5,000 (5%) deposit would be required by the couple. A £95,000 mortgage would be required, however a lower interest rate would be offered at 4.59% for example, keeping the monthly outgoing the same as on a £90,000 mortgage, ie still giving a monthly payment of £540.00. The interest rate will be subject to variation in the same way that any other non fixed term interest rate is.

The advantage of the scheme is that this first time buyer couple are able to purchase a property with only a £5,000 deposit (rather than £10,000) and receives a better interest rate, which assists them to keep their monthly outgoings affordable. If the LAMS scheme was not available, the 1st time buyers would need to provide an additional £5,000 deposit. It would take the couple an additional 4 years to save this extra deposit if they saved £100 per month, or 2 years if they were able to save £200 per month.

Figure 1 illustrates this example, highlighting the Council's (non lending) role:



3.6 Table 2 below shows the projected minimum number of first time buyers the scheme may assist based on £5m investment, assuming a typical maximum purchase price of £150,000.

Table 2

Total Council Indemnity	£5,000,000
Maximum Loan Size	£142,500
5% Deposit	£7,500
Council Indemnity	£30,000
Potential number of mortgages	166

A ‘cashbacked’ £5m indemnity fund is anticipated to help a minimum of 166 first time buyers, based on a maximum indemnity provided per applicant being £30,000. However it is unlikely that a £150,000 purchase price will occur for every single application. Therefore it is estimated this fund could help approximately 250 first time buyers, based on an average purchase price across the Borough of approximately £100,000, requiring a maximum £20,000 indemnity per property. The £5m invested into the Scheme as an indemnity fund by the Council, could unlock up to £25m mortgage finance from the banks to enable first time buyers to purchase their home with a lower deposit and at an affordable interest rate.

3.7 The indemnity will be in place for a fixed 5 year period for each mortgage granted under the scheme, which may be extended for a further 2 years if a mortgage were in arrears in the last 6 months of the initial 5 year period. The indemnity will only be called upon if the lender incurs a loss in the 5 to 7 year period. For example if the property is sold in this period for less than the purchase price, the Council will be liable for any shortfall up to the full value of the indemnity. Any loss in excess of the value of the indemnity would be attributable to the lender.

3.8 The indemnity can be either unfunded or “cash-backed”, depending on the requirements of the lender. If the indemnity is un-funded, the Council does not provide a deposit (and thus receives no annual return) and will receive a premium of 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 council will receive a 5-year commercial deposit rate + a premium of 0.70%; in the last 6 months this has been between 3% and 4.5%. The return will be ringfenced to fund any potential lender claims from indemnity shortfall. The advantages of the cash backed scheme include the ability to attract a larger mortgage provider such as Lloyds TSB and possible generation of sufficient funds to finance the risk the Authority will be carrying. After financing costs, any surplus would be placed in a reserve to finance any defaults.

For both types of indemnity, and assuming no default by the buyer or mortgage arrears, the indemnity liability would terminate on the earliest of the end of the agreed indemnity period (i.e. 5 years) or on early repayment of the mortgage. In the case of a cash-backed indemnity, the fixed-term deposit would be repaid to the Council at the date of maturity, plus interest due.

- 3.9 The Council can have more than 1 lender providing LAMS within the Borough, provided the lenders meet our Treasury Management Counter Party list (credit ratings).

Current lenders on our Counter Party List are:

- Lloyds TSB
- Leek BS
- Leeds BS
- Principality BS

Each lender will have their own focus on the operation of the scheme. For example Lloyds do not use the scheme to support new buys. They have taken the view that there are alternative routes for new build support and that new build only helps one transaction. Research shows FTB purchase of 2nd hand properties acts as a 'chain-breaker'; releasing a further 4 - 5 transactions in a housing chain. It is however important to note that some of the smaller housing developers are not able to access the national schemes that assist newbuild purchasers - and they are keen for Walsall's LAMS to include newbuild.

Initially the council is in discussions with Lloyds TSB as one of the Lenders with a local presence. The Council also intends to approach other lenders who offer the scheme to newbuild purchasers, for example a £2m tranche will be set aside for Leeds BS and other applicable lenders.

- 3.10 Some Lenders require as a pre condition of being an approved Lender for the Scheme, 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. This letter has to come from the Councils Monitoring Officer. In order for that Opinion letter to be done 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.

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.

As such a further recommendation is contained in the recommendation section of this report delegating authority to the Executive Director to grant an indemnity to the Monitoring Officer in respect of any personal liability he may incur by providing an opinion and providing the Lender with an Opinion Letter.

- 3.11 The Scheme complements the Government's Newbuy scheme which was first announced in the National Housing Strategy November 2011. Whilst both

schemes include first time buyers, there are differences that mean that adoption of LAMS provides a more comprehensive assistance package to first time buyers, and stimulation of the overall housing market as described in Table 3 below

Table 3

FEATURE	NEWBUY	LAMS
Who	First and second time buyers with income below £60 000	Any first time buyer
Property	Designated plots from participating house builders – NEW BUILD PROPERTIES ONLY	ANY residential property in the LA area i.e. both existing and new properties (subject to exemptions in para 3.2)

- 3.12 The Scheme also complements the national FirstBuy scheme. This scheme is aimed at first time buyers on specific sites, and operates on an equity share basis. The developer and HCA retain 20% equity acting as a deposit, and the purchaser only has to raise the remaining 80% finance.
- 3.13 It is anticipated that stimulating the housing market through increasing the number of first time buyers able to purchase a home, will help new development take place on stalled housing sites, giving a much needed boost to the construction industry and improving the appearance of local areas. This market stimulation can be through the purchase of new properties (if the chosen lender operates a newbuild scheme), and / or through the purchase of existing properties releasing second time buyers to 'trade up' to a new property.

An informal survey of 6 housing developers with sites (all with full planning permission) across Walsall, has suggested there is significant interest in the Scheme from the residential construction industry. The development sites in question gave a good cross representation of sites across the Borough, including sites in Moxley, Darlaston, Leamore, Bloxwich, Town Centre, Willenhall and Aldridge. All of the developers indicated that this product would be useful, as all of the sites would include properties aimed at first time buyers. In some instances the developers were not confident to commence construction as they felt that whilst there was a demand from first time buyers for their product, these buyers were unable to access mortgages due to higher level of deposit / unaffordable interest rate. For example, one developer has built the first phase of starter homes on site, but is unable to complete the second phase until the first phase homes have been sold. Another developer is simply not willing to commence construction until they feel there will be 'able' buyers for their properties. A developer of a site primarily aimed at 'second time' buyers of larger homes said the fact this product was also available to purchase existing homes would help, as it would free up those existing owners who want / need to 'trade up' to a larger home.

Some of the developers also confirmed that it would be helpful if the Scheme was available to newbuild properties as they were unable to sign up for the national NewBuy scheme to help first time buyers (primarily aimed at major national developers). The developers surveyed confirmed that adoption of LAMS

may encourage them to start on site and / or recommence work on part completed sites. The adoption of Walsall LAMS would be one of a suite of activity that is aimed at kickstarting the residential construction industry in Walsall, including the successful Walsall New Homes Bonus programme, and national programmes such as the Get Britain Building Fund, NewBuy and FirstBuy.

4. Council priorities

- 4.1 As expressed in the Corporate Plan 2011/12 – 2014/15, part of the Council's shared vision for the Borough is that Walsall will be a great place to live, work and invest, where “everyone has the chance to live in a home fit for their purpose and fit for their future”. This Scheme could contribute to the Economy priority through boosting the housing market, and thus creating opportunity in the building and supply chain.
- 4.2 The LAMS scheme reflects a key objective of the Marmott Review – Fair Society, Healthy Lives (2010), by helping to create and develop healthy and sustainable communities. The scheme helps increase access to home ownership for first time buyers, which contributes to a mix of tenure and age of residents within communities.

5. Risk management

5.1 Risk 1 – Financial risk to the Council

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, which is 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). If the property is sold within this period for less than its original purchase price, the Council will ‘lose’ its indemnity monies up to a maximum of the full value of the indemnity. The lender will then bear any further losses. As the scheme has only recently been adopted by most participating authorities, there is little or no evidence of ‘default’ rates to assess the level of risk. The worst case scenario is that there is a default on every single mortgage, and the Council would lose its £5m investment, and potential interest. The best case scenario is that there are no mortgage defaults and the Council is paid back its £5m investment plus annual return. The Sector LAMS Annual Report 2011/12 states “Based on data from the Council of Mortgage Lenders the percentage of repossessions by first charge mortgage lenders is 0.3% for both 2010 and 2011. For 95% LTV mortgages to first time buyers this may be higher, perhaps 1 to 2%”. It is proposed that the investment return will be ringfenced to cover any potential claims from lenders for indemnity shortfall.

In addition, the bank have first call on any equity in the house, and the council do not have a charge secured on the property. The likelihood of recovery of the sum called upon by the bank in the event of default on the mortgage is low to very unlikely. The effect of this risk is mitigated by the fact that the Council get a relatively reasonable rate of interest on the deposited monies

5.2 Risk 2 – Insufficient customer demand for the Scheme

An Estate Agent survey carried out in May and June 2012 by Housing Services identified a significant demand from first buyers who wanted to get on the property ladder but were unable to raise the necessary deposit. Housing Services will receive monthly reports from the lender/s to monitor progress.

6. Financial:

6.1 The Council will provide an indemnity fund of £5m, in tranches, funded from existing investments. The Council 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). The Council will receive an estimated return of between 3% and 4.5% on any monies deposited with lenders that are committed to indemnify any shortfall that the lender suffers under the scheme. This is above the current average rate of return of 2.20% as at 31 May 2012.

6.2 There will be a £3,000 cost to formally join the scheme and this includes operational costs, such as the use of relevant legal template paperwork relating to agreements between the lender and the Council, an annual audit and year end statements and monthly management information. This will be met from the investment return.

6.3 The table below shows the estimated cashflows, the interest earned will be ring fenced and used to fund any defaults.

Cash Outflows	£
Max indemnity (Year 1-5)	-5,000,000
Legal papers (Year 1)	-3,000
Cash Inflow	
Interest @ 3.5% (Year 1-5)	875,000

It is estimated that the £875,000 interest earned can support 44 defaults (indemnity £20,000) out of the potential 250 mortgages provided from the £5m indemnity. This is within the default ratio of 2% as discussed in section 5.1 Risk

6.4 The proposal to invest £5m in the LAMS scheme would equate to 10% of the Council's investments and it would be classed as a service investment.

7. Legal:

7.1 The Council does not need to go through a formal procurement procedure regarding lender selection for LAMS as the Council is not procuring any goods, works or services. Sector has already invited lenders to participate in the scheme. The first time buyer is selecting the lender and the Council will only participate in the scheme if that lender meets the Council's credit rating.

- 7.2 The Council will need to enter into agreements with the relevant lenders to govern the circumstances in which the lender can call on the indemnity given by the Council. The standard forms of these agreements will be provided by Sector at a cost of £3,000 and the Council will not have much opportunity to agree a different position from the standard forms, as these will have been pre-approved by lenders.
- 7.3 The lenders will not have a legal charge over the monies deposited with them and the Council will not have a legal charge on any of the properties that the mortgage indemnity relates to
- 7.4 There may be State aid implications that would need further legal advice to be taken prior to undertaking any scheme with lenders.
- 7.5 The Council has the necessary statutory legal powers to participate in the Scheme by virtue of sections 435 and 442 of the Housing Act 1985 as amended (the Act), whereby under section 435 of the Act a local authority is permitted to advance money to a person for the purpose of acquiring a house and under Section 442 of the Act whereby a local authority is permitted to grant an indemnity to a lender to give a potential buyer a mortgage. In particular, sub-section (1) states that a local authority may enter into an agreement with a person or body making an advance on the security of a house, whereby in the event of default by the mortgagor the authority binds itself to indemnify the mortgagee in respect of the mortgagors outstanding indebtedness. In addition, sub-section (1A) of section 442 of the Act requires that the advance has to be for a purpose specified in sub-section (1) or (1A) of section 435 of the Act which includes acquiring a house.

8. Property

There are no implications for the Council's Property Assets.

9. Staffing:

Individual applications to the Scheme are administered by the Lender/s. The Council will work with the lenders to ensure the Scheme is marketed effectively to ensure maximum take up – this can be provided from within existing resources in the Regeneration Directorate, and Communications Team. Legal Services will be required to check and process the legal documentation, however as indicated it is proposed to purchase the standard documentation from Sector.

10. Equality implications

Credit criteria of the lender providing the mortgage must be met in order to benefit from the scheme. The Equality Impact Assessment demonstrated monitoring data is required to be collated.

11. Consultation

Consultation has taken place with the Council's Legal and Treasury Management teams. A local Estate Agent survey was also conducted in May and June 2012 highlighting the need for LAMS.

Background papers

- LAMS 2011/12 Annual Report

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