

DERBYSHIRE COUNTY COUNCIL

CABINET

27 November 2012

Report of the Director of Finance

**LOCAL AUTHORITY MORTGAGE SCHEME
(FINANCE AND MANAGEMENT)**

1 Purpose of the Report

To gain approval in principle for the County Council to participate in the Local Authority Mortgage Scheme (LAMS).

2 Information and Analysis

LAMS has developed as a result of a number of local authorities wanting to take a proactive approach to support their local area, increase the supply of affordable housing and assist first time buyers, who can afford mortgage repayments, to purchase a property.

It is a national scheme, operated by Sector Treasury Services Limited, available to all local authorities and mortgage lenders.

The significant difficulties experienced in the financial and banking markets in recent years have impacted on both the national and local economy and on local housing. 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 - banks have to hold capital reserves that are 8 times higher for a 95% loan to value (LTV) mortgage than they do for one which has a 75% LTV. They are typically now only able to lend a maximum of 75% - 80% LTV at attractive mortgage rates – mortgages are available for some borrowers with a lower deposit, but these tend to be at high interest rates.

Individuals are likely to need to save for a 20% - 25% deposit, whilst at the same time as paying rent for either social or private housing. This is having a significant impact 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 due to individuals saving towards a 25% deposit rather than spending within the wider economy.

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 new builds are specifically excluded from some LAMS. A separate Government backed scheme exists for newly built properties.

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. Some LAMS providers offer the facility for part-ownership schemes and this will be considered as part of a further report to Cabinet.

There are two types of LAMS: a non-funded and a funded scheme:

- Non-funded

The County Council will agree with a financial institution the amount it is prepared to indemnify, eg £1million. This funding remains with the County Council and is only called upon in the event of a default leading to repossession. However, the County Council will agree to this funding being available to indemnify against default for a five year period. For each completed mortgage application the County Council will receive a single cash payment.

After this five year period the lender assumes full responsibility for the mortgage and any subsequent defaults and the money is no longer earmarked for the purpose of indemnifying against default.

The risk to the County Council is that the individual defaults and the financial institute claim the indemnity as agreed.

- Funded

The County Council will lend an amount of money (initially expected to be about £1m) 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 default by mortgage holders.

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.

There are two financial risks to the County Council: firstly that the financial institution defaults on the loan and secondly that the mortgagee defaults requiring the lender to claim the indemnity as agreed.

The first risk can be minimised by ensuring that only an institution with a creditworthiness rating that would be acceptable to the Council in terms of its routine Treasury Management activities is selected. This will require a change to the Treasury Management policy when it is next approved in February 2013.

The common risk in both schemes is the default of the mortgagee. This risk can only be mitigated by the financial institution ensuring their lending criteria are sufficiently stringent. This 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.

Figures from the Council of Mortgage Lenders show that the incidence of mortgage defaults in 2010 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. Should a mortgagee default and the property subsequently sold the proceeds will be used to cover the 75% of loan liability remaining with the bank/building society. Any remaining proceeds will be used to repay the Council's 20% indemnity. The premium paid to the Council for investing in a LAMS scheme, based on a £1m overall investment, will be sufficient to cover around one loan defaulting to the full 20% liability, or, for example, four loans where the average sale proceeds only cover 90% of the original house value. For four mortgagees to default in this way would be the equivalent of a failure rate of around 12%, significantly higher than is generally the case.

In both scheme types, 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.

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. This scheme is specifically aimed at first time buyers and is intended to benefit those who will find it difficult to enter the housing market. Other authorities have selected amounts relevant to their own area, for example Northumberland County Council has a maximum mortgage value of £95,000, whereas Tunbridge Wells District Council has a maximum purchase value of £350,000. Consideration will be given to ensure that an appropriate maximum purchase price be set that maximises the potential investment made and reaches as widely across Derbyshire as possible. The higher the maximum loan allowed by LAMS the fewer individuals who can be helped.

For example, assuming a 5% deposit on a £120,000 property, £6,000 is put down by the mortgagee, the mortgage would be for £114,000. As a result the maximum indemnity per property that the Council will be liable for is £24,000. If a total amount of £3 million is invested this would potentially assist a minimum of 125 first time buyers. If the value was set at £200,000 then the minimum would reduce to 75 first time buyers. A final decision regarding the property value will be recommended in the next report to Cabinet after further research has been undertaken.

A full list of post codes to be included within the scheme will be provided to the financial institution. It is the intention that all post codes that are wholly within the county area (but excluding Derby City) will be included within the Derbyshire LAMS.

Any post code can only be included within one LAMS, so those included in the Derby City scheme cannot be included in the Derbyshire one.

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 (eg 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 Derbyshire's perspective it is post codes which are shared between Derbyshire and Derby 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.

If a Derbyshire County Council LAMS is approved by members it is intended to move ahead as quickly as possible with it. Discussions with district/borough councils have suggested that many of them are looking to take part in LAMS but are not sufficiently well advanced in their consideration or do not have the finance required to participate quickly. The Council will liaise with all district councils to ensure that the Council scheme does not lead to unnecessary duplication of LAMS. If the first tranche of the Derbyshire 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.

Potential Partners for LAMS

There are a number of financial institutions that have signed up to LAMS, listed below are the current ones that provide coverage within Derbyshire:

Lender	Type of scheme	Minimum Indemnity
Leeds Building Society	Funded	£0.5m
Leek United Building Society	Un-funded	£0.5m
Lloyds TSB	Funded	£1.0m
Teachers' Building Society	Un-funded	£0.5m

Currently, the Derbyshire Building Society, in the form of its parent company Nationwide, is not signed up to LAMS, however it is likely that in the near future the Nationwide will join the scheme. Similarly, the Co-operative Bank, who act as the Council's own banker, along with its subsidiary, the Britannia Building Society, is in discussions with Sector to join the scheme, however it is unlikely that the Co-operative scheme will be available to the Council within the next six months.

The Council can choose to use different providers for future tranches of investment.

If a further appropriate lender joins the scheme before the proposed total indemnity value has been fully utilised it is feasible that there will be two Derbyshire LAMS running concurrently, via two different lenders. This will help to give potential borrowers choice and assist in getting more mortgages approved more quickly. A further report would be brought to Cabinet to approve the selection of an additional lender if appropriate.

Additional requirements and next steps

The LAMS is administered nationally by Sector, who provides the procurement framework for financial institutions to be selected from and support the Council throughout the lifecycle of its LAMS. In order to procure this service a fee of £3,000 is payable to Sector. Any further LAMS the Council may wish to enter will also be supported by Sector without further cost. As no other providers are available it is necessary to waive Standing Order SO2 to enable the Council to purchase access to the Sector scheme.

It is not anticipated that there will be any further significant administrative costs.

Once the Council has access to the Sector scheme a selection process will commence to choose the most appropriate provider. A further report will follow in due course to recommend the selected provider and launch date and the Council's Treasury Management policy will need amending accordingly.

Once selected the provider would require the Monitoring Officer or Head of Paid Service to sign an Indemnity Deed. The 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 Indemnity Deed.

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 assist in 'oiling the wheels' of the property market within the County. This can only be positive for economic growth.

3 Financial Considerations

The £3,000 joining fee will be funded from the General Reserve.

4 Legal Considerations

The Council has the power, under section 442 of the Housing Act 1985, to enter into an agreement to indemnify a mortgagee making a loan on the security of a house. Details in relation to the Indemnity Deed required are referred to in the main body of the report.

5 Considerations

In preparing this report the relevance of the following factors has been considered: prevention of crime and disorder, equality and diversity, human resources, environmental, health, property and transport considerations.

6 Key Decision

No

7 Call-in

Is it required that call-in be waived in respect of the decisions proposed in the report? No

8 Background Papers

Papers held in Technical Section, Corporate Finance.

9 OFFICER'S RECOMMENDATIONS

That Cabinet approves:

- (a) The County Council participating in the Local Authority Mortgage Scheme (LAMS)
- (b) The waiving of Standing Orders relating to contracts to allow the County Council's to join the Sector procurement framework at a cost of £3,000.
- (c) That a further report be brought back to Cabinet to approve the financial institute selected and specify full terms and conditions of a LAMS.

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