Manchester City Council
Report for Resolution

Report to: Executive – 14 November 2012

Subject: The Manchester Mortgage Guarantee Scheme

Report of: Director of Housing

Summary

Access to mortgages for first time buyers is severely constrained, with requirements for substantial deposits or the imposition of higher interest rates. The proposed Manchester Mortgage Guarantee Scheme has been developed in response to this alongside representatives from the Manchester Building Society, the Cooperative Bank and Sector Treasury Services. The scheme is aimed at assisting first time buyers to access home ownership, and is targeted at those who can afford mortgage repayments and a 5% deposit.

Recommendations

The Executive is recommended to:

1. Approve the three qualifying criteria required for the Local Authority Mortgage Scheme.

2. Delegate authority to the Director of Housing and the City Treasurer in consultation with the Deputy Leader and Executive member for Finance to participate in the Local Authority Mortgage Scheme (LAMS) with any proposed lenders up to a maximum liability for the Council of £6 million.

3. Delegate authority to the City Solicitor and the City Treasure to finalise and complete all the legal documentation to participate in the scheme.

Wards Affected:

All wards in the City

Community Strategy Spine	Summary of the contribution to the strategy
Performance of the economy of the region and sub region	Delivery of the Local Authority Mortgage Scheme will contribute to the delivery of homes to support the City’s economic growth

Reaching full potential in education and employment	Working families are a key target market for the Scheme which will help to attract and retain economically active households who wish to own their own homes
Individual and collective self esteem – mutual respect	Good quality housing supports improved quality of life and provides an incentive to community contribution
Neighbourhoods of Choice	Access to home ownership increases housing choice and contributes to achieving neighbourhoods of choice

Full details are in the body of the report, along with any implications for:

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

Financial Consequences – Revenue

The council will receive a payment from the approved lender for each mortgage granted; this income will be held in a specific reserve to offset the risk of any mortgage default for 5 years and the Councils 20% indemnity being called upon.

The potential income will be up to £120,000 based on a total of 200 mortgages being offered; this will cover the mortgage default risk, which is currently less than 1% of all current mortgages, (including those granted prior to today's more stringent criteria). If the Council's guarantee is called upon drawdown will be made from the reserve and if the reserve is not sufficient the balance will be met from general reserves.

Financial Consequences – Capital

The proposed Manchester Mortgage guarantee is an unfunded mortgage guarantee scheme and therefore no capital contribution is required.

The Council is agreeing to cover the indemnity risk of up to 20% of the First Time Buyer's mortgage. The maximum liability for the Council will be £6 million and the maximum recommended with any lender will be £3 million, the equivalent of 20% of the total mortgages offered by the lenders, based on each lender offering up to 100 mortgages at the maximum house price of £150k.

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Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy please contact one of the contact officers above.

Report to Executive - Housing Investment and mortgage support in Manchester 18 January 2012

1.0 Introduction

1.1 In the report to the January Executive – Housing Investment and mortgage support in Manchester – the Chief Executive and the City Treasurer outlined a Local Authority backed mortgage guarantee scheme developed by a national consultancy service, Sector Treasury Services. The Executive delegated authority to the Director of Housing and the City Treasurer, in consultation with the Leader and Executive members for Finance and Neighbourhood Services to enter into negotiations with relevant lending organisations on the development of an unfunded mortgage guarantee scheme.

1.2 This report outlines the progress we have made to date in developing the scheme and seeks approval from the Executive to formally enter into a partnership with the Manchester Building Society and the Cooperative Bank to launch the 'Manchester Mortgage Guarantee'.

2.0 Background and Context

2.1 Demand for housing in Manchester and Greater Manchester continues to increase due to household and population growth. Along with the forecast economic and employment growth in the city these factors will continue to generate further need for additional homes, and extended choice of housing type and tenure. Ensuring that the supply of housing meets the demands of a growing, young, mobile workforce and population is a fundamental requirement if the supply side of the economy is to function effectively.

2.2 Despite all the economic and financial difficulties we are experiencing, 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. However 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 of those who hope to be home-owners in two years time actually expect it to happen.

2.3 Current constraints are a particular problem for first-time buyers, especially those unable to provide a substantial deposit. Most mortgage lenders are typically prepared to lend a maximum of 75% - 80% loan to value (LTV), even if the applicant can afford a 95% mortgage. This means the applicant requires a substantial deposit, e.g. a first time buyer purchasing a property valued at £150,000 would have to provide a deposit in the region of £30,000. Many potential first time home-buyers do not have the funds needed for the deposit. This preference for low loan to value mortgages is expected to continue to restrict first time buyers especially following the recently announced rules on lending published by the Financial Services Authority (FSA) as part of the Mortgage Market Review.

2.4 Rather than entering into the residential mortgage market themselves, Local Authorities have explored the possibility of entering into a partnership with residential mortgage lenders, with the remit of minimising the financial impact on the Local Authority, and at the same time taking advantage of the expertise already available from existing mortgage providers.

2.5 In September 2009, Sector Treasury Services set up a pilot scheme to assess the viability of a new Local Authority Mortgage Scheme (LAMS), including the legal and accounting issues surrounding a financial indemnity of this nature. Following the successful pilot and the development of all associated documentation and operational processes, the Scheme was launched in March 2011. The Scheme is a national Scheme which operates in a uniform and consistent manner and is open to all local authorities and all mortgage lenders. 33 Local Authorities have launched the scheme including Oldham, Rochdale and Trafford in Greater Manchester. The scheme has generated over 800 mortgages in total and lending of around £90m so far.

2.6 Under the scheme, if a potential purchaser meets a lender’s strict lending requirements, a participating lender will offer a 95% loan to value mortgage on the basis of a 5% deposit from the purchaser, with the difference between the more usual 75% loan to value being indemnified by a local authority for five years in the event of a mortgage default (when there is most risk of repossession). The five years is extendable by an additional two years. The mortgage rates for the scheme are priced similar to those of a 75 % loan to value therefore the purchaser benefits from both a lower deposit requirement and a lower interest rate.

2.7 A participating local authority can specify:

1. The maximum loan size that will be considered for this product.
2. The postcode areas within its boundaries within which property can be considered
3. The maximum indemnity, which determines the number of mortgages under the scheme.

2.8 It should be stressed that the scheme does not promote reckless lending, it is essential that the applicant meets the standard lending criteria as set out by the lender, and that the higher LTV mortgage is affordable.

2.9 Two versions of the scheme are available. Under the funded option a local authority deposits the indemnified sum with a participating lender, who will pay interest while they hold the deposit. The scheme proposed for Manchester is an unfunded guarantee, under which the local authority receives a premium payment, added to the cost of the loan, and the lender accepts the strength of the Council’s guarantee without the need for a cash deposit.

3.0 The Manchester Mortgage Guarantee

3.1 Following the report to Executive in January officers from the City Council have been developing a scheme for Manchester with Sector Treasury

Services. As we have opted for the unfunded guarantee the choice of lenders currently signed up to the national scheme has been limited as the majority of participating banks and building societies only offer the funded option. The Manchester scheme, subject to approval from the Executive, will be one of the first to use the non-cash backed option on scale across the country.

3.2 Manchester Building Society and the Cooperative Bank have played a key role in shaping the scheme recognising the strength of the Manchester brand which has resulted in the proposed 'Manchester Mortgage Guarantee scheme. Manchester Building Society gained approval to proceed from their Board in October, the Cooperative expect to follow in early 2013 and there will be the opportunity for other lenders to participate in the scheme.

The Manchester scheme is outlined below:

- The Manchester Mortgage Guarantee will follow the national scheme run by Sector Treasury Services aimed at first time buyers with a minimum deposit of 5%.
- MBS and the Cooperative Bank will both offer an unfunded mortgage guarantee -
- Lenders will initially offer a maximum of 100 mortgages each as part of this scheme.
- MCC receives a minimum payment of £500 from the lenders on each mortgage granted.
- The guarantee is in place for 5 years with an option to extend for a further 2 years if needed.
- The MBS scheme will be primarily aimed at the second hand market but the Cooperative Bank will offer loans on new build houses in addition.
- Lenders will offer mortgages subject to their standard criteria for lending; the scheme does not provide mortgages for households who could not afford repayments; it merely overcomes the need for a large deposit.
- All of the administration is carried out by the lenders.
- The City Council will assist in publicity and promotion for the scheme but will simply refer enquiries to participating lenders.

3.3 As described in section 2 of this report a Local Authority can only specify 3 criteria for the scheme due to State Aid rules.

1. **Maximum loan size** - This is the maximum property value that would be eligible for this scheme. The recommended value for the Manchester Mortgage Guarantee is **£ 142,500**.
2. **Area to be covered –** This will be the area in which the Manchester Mortgage Guarantee will be available. It is recommended that this will be a available in all wards in Manchester
3. **Maximum level of indemnity** - This is the total amount of our liability with any lender i.e. 20% of the total mortgages offered. A maximum of **£3 million** is recommended with each which will be the equivalent of 100 mortgages at the maximum house prices (£150k)

4.0 Conclusion

4.1 This is a real opportunity to build upon the equity products we have pioneered across the City. The scheme will provide incentives to residents who may not otherwise have the option for home ownership in the immediate future. The scheme will also contribute to the recovery of the housing market in the City, support the delivery of new homes and retain and create employment opportunities with the construction industry and associated supply chains.

5.0 Contributing to the Community Strategy

(a) Performance of the economy of the region and sub region

5.1 Delivery of the Local Authority Mortgage Scheme will contribute to the delivery of homes to support the City's economic growth

(b) Reaching full potential in education and employment

5.2 Working families are a key target market for the Scheme which will help to attract and retain economically active households who wish to own their own homes

(c) Individual and collective self esteem – mutual respect

5.3 Good quality housing supports improved quality of life and provides an incentive to community contribution.

(d) Neighbourhoods of Choice

5.4 Access to home ownership increases housing choice and contributes to achieving neighbourhoods of choice

6.0 Key Policies and Considerations

(a) Equal Opportunities

6.1 Not only will the Scheme support access to home ownership for any working household currently excluded from the market, but stimulation of the housing market will create and retain a number of employment, skills and training opportunities for the City's residents.

(b) Risk Management

6.2 The mortgage default rate is currently less than 1% of all current mortgages, (including those granted prior to today's more stringent criteria). Lenders will not be offering mortgages under the scheme to purchasers who have unsatisfactory credit ratings or who cannot afford repayments. The financial risk to the City Council is therefore considered to be manageable. The City Council will receive monitoring information on a monthly basis and will be made aware of any breaches of the mortgage covenants. Lenders have confirmed that repossession proceedings are always a last resort.

(c) Legal Considerations

6.3 The City Solicitor's department have received full details of the Sector LAMS pilot scheme, including the legal analysis of the scheme and the Council has power to enter into such a scheme under Section 442 of The Housing Act 1985. The scheme is aimed at first time buyers to address the "deposit gap" they have in entering into the property market. It is worth noting that the first time buyers must meet the initial criteria to be able to afford the mortgage payments. In this respect there has been a recent announcement to ensure stringent checks are made in relation to first time buyers finances and debts before a mortgage is offered and this further adds weight to the fact that this scheme is to those buyers who can afford the mortgage payments.

The scheme is aimed at individual borrowers, who are not commercial undertakings; state aid does not apply to individuals, provided there are no restrictions on the types of properties.

The indemnity to be given by the Council to the lenders will require a number of legal documents to implement the scheme dependent upon the chosen option. The MCC scheme would look to include lenders other than the existing lender, Lloyds, for example the Cooperative and the Manchester building Society, which will not only assist Manchester residents but also support the national scheme plus the national housing market.