

Report to Budget Council

Subject: Local Authority Mortgage Scheme 2 (LAMS2)

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1. Purpose

To seek Council's approval for the advance of a further £1million to Lloyds Banking Group to support a second Local Authority Mortgage Scheme (LAMS2).

2. Background

- 2.1 In the light of the recession, and the adverse effects on the local economy and the housing market, a number of local authorities have taken a proactive approach to supporting their local areas, and to increasing the supply of affordable housing. The Local Authority Mortgage Scheme (LAMS) is designed to aid local first-time buyers with the purchase of a home.
- 2.2 By operating a LAMS scheme, the council has an opportunity to provide targeted help to potential first-time home-buyers in obtaining a mortgage. The scheme is a private-sector initiative, not linked to the Right to Buy Mortgage scheme previously provided by local authorities. The scheme is aimed solely at first-time buyers, and the council specifies the qualifying characteristics for those qualifying for a mortgage under the scheme. The criteria of maximum loan-size, the total indemnity available, and the qualifying postcodes within which properties must be located, are driven by the Council's housing needs survey and its housing strategy.
- 2.3 Full Council approved the original LAMS for Gedling at its meeting on 22 February 2012 (minute 76a). An advance of £1million was authorised for the scheme, which was launched on 17 April 2012 and has been well received. Considerable favourable publicity has been generated, the most recent being an inclusion in a significant Sunday newspaper article. At the time of writing, 42 applications for mortgages under the current scheme have been received, of which 31 have already proceeded to completion, representing indemnities of £583,600. Should all the current applications proceed to completion, indemnities will total £798,715, ie. the scheme will be nearly 80% committed.
- 2.4 The current LAMS scheme will end when the last available funds are committed. It is not possible to predict the exact date on which this will happen. The LAMS2 will commence when the current scheme ends to ensure continuity. This will not be before 1 April 2013.
- 2.5 The recession is continuing, and its impact on the local economy and the housing market is unabated. First-time buyers continue to be faced with a requirement for a deposit far in excess of what they can realistically save.
- 2.6 Forty-four authorities have now launched LAMS and a number of these have launched second, third or even fourth schemes. Nottinghamshire County Council is in

the process of launching a county-wide scheme with Lloyds, however there can be only one scheme with any lender in place in a district area at one time, therefore Gedling will not be included in their first tranche due to the operation of its own scheme with Lloyds.

3. Proposal

3.1 Given the success of the current LAMS, and in the light of the above, it is proposed that Council advance a further £1million to support a second scheme, LAMS2.

3.2 Documentation for a Gedling scheme has already been developed with Lloyds and to ensure continuity of the scheme for the public, Cabinet has recommended in its budget proposal to Council (an earlier item on this agenda) a second tranche of the LAMS with a maximum indemnity of £1m. It is proposed that the Council continues with the cash-backed scheme provided by Lloyds Banking Group. This provider has the most experience of the LAMS, having been involved with Sector from the outset in its design, and is currently the only one accepted under the existing terms of the Council's approved counterparty list.

3.3 Full Council approved the original LAMS Policy document for Gedling at its meeting on 22 February 2012. The criteria for the LAMS2 are identical to those set out in the approved Policy document, however some minor amendments have been made to update the Policy document. An updated Policy document for LAMS2 is attached at Appendix 1. Members are to note that the qualifying criteria remain as follows:

- All applicants will be first-time buyers.
- Only applicants wishing to purchase a property situated within the Gedling Borough boundaries will be eligible. (Applicants may currently reside outside the borough boundaries.)
- Only properties having eligible postcodes may be purchased under the scheme. Any postcode straddling a border with a neighbouring authority will be excluded.
- Assistance to an applicant will be limited to a maximum loan-size of £118,750 (calculated as 95% of £125,000).

The Policy has been updated to reflect average house prices during the first 6 months of 2012 and a change in the way Lloyds will recover the indemnity in the event of default. Under the current scheme Lloyds will issue an invoice to the Council, which must be paid within 30 days, however under any future Scheme a deduction will be made from the sum advanced on maturity.

3.4 At the outset of the Council's consideration of the original LAMS, the Council Solicitor and Monitoring Officer considered the legal white paper prepared by Field Fisher Waterhouse for the LAMS pilot authorities, and was satisfied that the Council has the power to offer an indemnity to a mortgage under section 442 of the Housing Act 1985. The Council Solicitor and Monitoring Officer also confirmed at the outset her acceptance of the advice received in relation to the legality of the scheme and the state aid position.

Lloyds Banking Group will require a further opinion letter from the Monitoring Officer and an indemnity from the Council in respect of any personal liability he or she may

incur by providing the opinion letter. A formal decision by members is required to establish appropriate authority to exercise the power set out in s442, and it is proposed that this again be delegated to the Chief Financial Officer in respect of LAMS2. These two issues will be subject to a separate report to Cabinet for the appropriate approvals to be sought.

4. Financial Implications

- 4.1 The sum of £1m has been included in the Council's capital programme, an item earlier on this agenda. This sum would be advanced to Lloyds and a fixed rate of interest agreed.
- 4.2 The advance to Lloyds attracts a premium rate of interest to reflect the risk of mortgage defaults, however rates in the market have dropped significantly since the first LAMS was established.

5. Recommendations

It is RECOMMENDED that Council:

- 5.1 subject to the approval of the capital programme, approves the advance of £1m to Lloyds Banking Group;
- 5.2 approves the LAMS2 Policy attached at Appendix 1 as the basis for a second LAMS Scheme for Gedling Borough Council, which will continue to be known as the "Lend a Hand Scheme"; and
- 5.3 notes that a further report will be presented to Cabinet to request approval for the necessary indemnity to the Monitoring Officer and delegation to the Chief Financial Officer.

LOCAL AUTHORITY MORTGAGE SCHEME 2 (LAMS2) POLICY

INTRODUCTION

Currently, home mortgage lenders are typically prepared to lend a maximum of 75-80% loan to value (LTV), even if an applicant can afford a 95% mortgage. The applicant therefore requires a substantial deposit, and a first-time buyer purchasing a property valued at £100,000 would have to provide a deposit in the region of £25,000. Many potential first time home-buyers do not have the funds needed for such a deposit.

As a result of the current economic environment, uncertainty in the housing market and the difficulties in obtaining an affordable mortgage, many potential home-buyers remain in social housing, thereby reducing the availability of such housing for those who may have a greater need for it. To address this shortage, and to help the housing market and local economy, some local authorities have considered issuing mortgages. However, authorities have limited financial resources and little expertise in this area, and there are considerable operational risks attached to residential mortgage activity. The possibility of entering into a partnership with residential mortgage lenders has therefore been explored, 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.

In September 2009, Sector Treasury Services set up a pilot scheme to assess the viability of a Local Authority Mortgage Scheme (LAMS), including the legal and accounting issues surrounding a financial indemnity of this nature, and eleven local authorities initially sponsored the pilot scheme. The remit of the pilot scheme included discussions with a range of residential mortgage lenders, with a view to securing options for funding the scheme. Initial discussions with potential funders and partners revealed that due to the high level of set up costs, funders would only be interested in a national scheme, rather than separate arrangements with individual local authorities. Early discussion with the Council of Mortgage Lenders (CML) secured support for such a standard national scheme.

Via the LAMS2 scheme, the council has an opportunity to provide targeted help to potential first-time home-buyers in obtaining a mortgage. The scheme is a private sector initiative, not linked to the Right to Buy Mortgage scheme previously provided by local authorities. The scheme is aimed solely at first-time buyers, and the council will specify the qualifying characteristics for those qualifying for a mortgage under the scheme. The criteria of maximum loan-size, the total indemnity available and the qualifying area within which properties must be located, will be driven by the Council's housing needs survey and its housing strategy.

1. HOW THE COUNCIL'S STRATEGIC AIMS AND OBJECTIVES WILL BE MET BY THE LAMS2

The "Vision 2026" of Gedling Borough in the Sustainable Community Strategy is "Gedling Borough: the part of Nottinghamshire where people want to live, work and do business". Provision of good quality housing is at the heart of achieving the social, economic and environmental objectives that shape a community, and create a sense of place. Good housing improves social, environmental and economic wellbeing and helps to create better communities that can attract investment and skilled workers.

The adoption of the LAMS2 will contribute to the fulfilment of the council's strategic aims and objectives by enabling first-time buyers to enter the housing market within the borough, and subsequently to contribute to its social, environmental and economic well-being. It is a customer and community focused initiative, providing practical assistance to first-time buyers, whilst freeing up social housing for those in greater need. It demonstrates the council's aim to be flexible and forward looking, and to look for innovative answers to challenging problems.

2. HOW THE LAMS2 WILL CONTRIBUTE TO HOUSING AND OTHER CORPORATE STRATEGIES

The council's Housing Strategy sets out the council's approach to housing in the borough, and to how it embraces its role as a strategic place shaper by ensuring that housing and services are shaped by what local people want and need. It draws together all the influences and pressures on the housing situation, all the evidence related to the strategic housing role, and all the action that is planned to move towards the overall council "Vision 2026".

The strategy addresses these requirements through four objectives

- quality (improving the standard of housing)
- neighbourhoods (building safe and strong communities)
- inclusion (making sure everyone can access the type of housing they need)
- supply (managing the supply of homes that Gedling needs for the future).

The Housing Strategy is an integral part of the Sustainable Community Strategy, since good housing is key to delivering a number of the council's priorities.

The Local Development Framework (LDF) is a suite of planning documents that guide how and where new development takes place in the Borough. The key strategic LDF document for housing is the Core Strategy, which sets out where housing developments involving more than 500 properties can be made.

The adoption of the LAMS2 will contribute to the fulfilment of the Council's housing and other corporate strategies by meeting an identified need from first-time buyers for assistance with obtaining a mortgage. It will achieve this without involving the council directly in the residential lending market, of which it has little experience.

3. HOW LAMS2 WILL CONTRIBUTE TO THE COUNCIL'S KEY PRIORITIES

The current economic climate has led to continuing uncertainty in the housing market, and to difficulties in obtaining an affordable mortgage, particularly for first-time buyers. Many potential home-buyers remain in social housing, thereby reducing the availability of social housing for those who have a greater need.

To achieve its "Vision 2026" of making Gedling the best place to live and work, and the best council around in the views of its residents and staff, Gedling Borough Council has agreed priorities, and made plans, that it aims to deliver through its own work and that of its partners. These priorities are people, homes, jobs, place, performance and recreation.

The LAMS2 Policy addresses in particular the priorities of "people" and "homes", enabling first-time buyers wishing to purchase a home in the borough to do so without the

requirement to save the significant deposit routinely required. In turn, this potentially allows such buyers to move from social housing and accordingly to increase the supply of such accommodation for those with greater need.

The LAMS2 does NOT promote reckless lending, since all applicants must meet the standard lending criteria set out by Lloyds Banking Group, and must be able to provide evidence to demonstrate that the higher loan-to-value mortgage is affordable.

4. CRITERIA FOR ELIGIBILITY IN THE LAMS2 AND THE CONDITIONS TO BE APPLIED

All potential buyers (applicants) will firstly meet the strict credit criteria applied by Lloyds Banking Group. If this initial test is failed, the application for assistance under the LAMS2 will terminate. If the initial test is passed, the following criteria set by the Council will also be strictly applied:

- All applicants will be first-time buyers.
- Only applicants wishing to purchase a property situated within the Gedling Borough boundaries will be eligible. (Applicants may currently reside outside the borough boundaries.)
- Only properties having eligible postcodes may be purchased under the scheme. Any postcode straddling a border with a neighbouring authority will be excluded.
- Assistance to an applicant will be limited to a maximum loan-size of £118,750 (calculated as 95% of £125,000).

Given that applicants have to meet the strict criteria imposed by the lender and the Council's local criteria, no other conditions will be imposed or enforced by the council. In particular, the council will have no right of first refusal on the sale of a property subject to an indemnity under the scheme, and there will be no second charge made on the borrower's home.

5. AMOUNT OF ASSISTANCE AVAILABLE TO INDIVIDUAL APPLICANTS UNDER THE LAMS2

LBG requires the maximum individual loan-size to be stipulated at the inception of the scheme. The absolute maximum is 95% of the average property valuation locally. The average price of a property in the Gedling Borough area between January and June 2012 was £155,081 therefore the absolute maximum individual loan-size permissible under an LBG cash-backed arrangement would be £147,327. The maximum individual indemnity at 20% of £155,081 would be £31,016.

However, the following local criteria will be applied in respect of the Gedling Borough Council LAMS2 scheme:

- The maximum individual loan-size towards which assistance may be given to a first-time home-buyer is £118,750 (calculated as 95% of £125,000).
- The maximum individual indemnity to be offered to a first-time home-buyer under the scheme is 20%.
- The maximum value of an individual indemnity is therefore £125,000 x 20% ie. £25,000.
- Given that the maximum sum available in respect of the scheme is £1million, the maximum number of first-time home-buyers to be assisted by the scheme is 40.

6. TYPE OF ASSISTANCE AVAILABLE UNDER THE LAMS2

Lloyds Banking Group (LBG) provides funds under a “cash-backed” arrangement. The council is required to make a 5-year advance to LBG at the inception of the scheme, equivalent to the full value of the total indemnities being offered. Interest will be paid annually by LBG at a premium fixed rate.

If a potential buyer meets all the criteria at paragraph 5 (above), the council will provide a “top-up” indemnity to the value of the difference between a 75% loan-to-value, and a 95% loan-to-value mortgage. The prospective home-buyer will thereby obtain a 95% mortgage on similar terms to a 75% mortgage, but without the need to provide the usual deposit.

Individual indemnities will be in place for a fixed 5 year period for each mortgage granted by LBG under the scheme. This period may be extended by a further 2 years only if a mortgage granted under the scheme is in arrears during the last 6 months of the initial 5 year period.

Assuming no default by the home-buyer, the council's indemnity liability will terminate on the earliest of the end of the agreed indemnity period, ie. at the end of the 5-year period, or on the date of the early repayment of the mortgage.

Note: an “unfunded indemnity” is not backed by an advance, however a premium equivalent to a percentage of the value of the indemnity provided is payable by the borrower (for example 2% of a £25,000 indemnity represents a premium of £500). This arrangement is not however available from Lloyds Banking Group.

7. CAPITAL RESOURCES AVAILABLE UNDER THE LAMS2 CASH-BACKED SCHEME

The council will advance funds to Lloyds Banking Group equivalent to the maximum indemnities to be offered, on which LBG will pay an enhanced rate of interest.

The sum to be made available by the council under the LAMS2 is £1million.

The emphasis of a cash-backed arrangement, and the overall substance of the transaction, is that the council is providing financial assistance to facilitate a lender making available a greater amount to the borrower than would otherwise be their practice. In England one of the routes by which the expenditure of a local authority can qualify as capital expenditure is set out in regulation 25 of The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Section (1)(c) of the regulation defines that “the giving of a loan, grant or other financial assistance to any person, whether for use by that person or by a third party, towards expenditure which would, if incurred by the authority, be capital expenditure”, shall be treated as being capital expenditure.

8. APPLICATION PROCESS FOR THE LAMS2 AND THE FEES PAYABLE

At the inception of the scheme, a promotional article will be published on the council's website, together with a link to the full LAMS2 policy document. Copies of these documents will also be made available via the Citizen's Advice Bureau and local libraries.

Whilst the council will be an “enabler” in that its cash advance to LBG makes the scheme possible, the scheme will be administered solely by LBG, to whom all enquiries applications,

comments and complaints should be directed. Under no circumstances will any council officer offer specific advice to a prospective home-buyer on the suitability of the LAMS2 for their individual needs. This is the role of LBG as the mortgage lender. Accordingly, no specific training is required by the council's own staff in respect of the scheme.

The steps to be followed by a prospective first-time home-buyer interested in the scheme are as follows:

- The home-buyer will visit a branch of LBG to make an appointment to discuss their requirements.
- LBG will assess the home-buyer as a prospective borrower, in accordance with its usual strict affordability criteria.
- LBG will then assess whether the LAMS2 scheme is suitable for the prospective borrower, ie. whether the council's own criteria set out at paragraph 5 are met.

No fees in excess of those normally levied by LBG in the course of their mortgage business will be payable by the prospective home-buyer.

9. COMMERCIAL ISSUES IN RESPECT OF THE LAMS2

In accordance with legislation, LBG will not have a legal charge over the council's deposit under the LAMS2. Should a borrower default on a mortgage, a deduction will be made from the sum advanced to LBG upon maturity.

An individual indemnity will only be called upon if a loss is actually incurred by LBG. For example, if a property valued at £125,000, with a 95% LAMS mortgage of £118,750 and a council indemnity of £25,000 is sold upon repossession for £95,000, net of all attributable costs, (ie. a total loss of £35,000) the full value of the £25,000 council indemnity will be met by the council. The loss in excess of the value of the council indemnity will be met by LBG, ie. £10,000 in this example. However, if the same property is sold for £115,000 net of all attributable costs, (ie. a total loss of £10,000), the sum of £10,000 will be met by the Council.

Given that an indemnity will only be called when all normal mortgage business processes have been explored by LBG, (ie. a borrower finally defaults on a mortgage and the property is repossessed), it is extremely unlikely that the council will be able to recover any part of the value of the indemnity from the individual. The Council will not ask for an undertaking from the borrower, or seek a second charge over the property. Should an indemnity be called, appropriate provision will need to be made in the revenue accounts.

Whilst the advance required by a cash-backed scheme will count as capital expenditure rather than a simple investment within the meaning of the investment strategy, it will still expose the council to the creditworthiness of Lloyds Banking Group. At present the credit rating of LBG is within the range allowed by the council's Treasury Management Strategy Statement.

10. LEGAL ISSUES

The following legal documents must be submitted to LBG before the Council can establish the LAMS2:

- Indemnity deed for the LAMS2

- Monitoring Officer's indemnity - an opinion letter, confirming that the council has the power to enter into, observe and perform the terms and obligations required of it under the LAMS2 This is personal to the Monitoring Officer.
- A Council indemnity for the Monitoring Officer's opinion – to ensure that, should the Monitoring Officer act negligently, any liability will lie with the Council and not with the Monitoring Officer.

11. OTHER ISSUES

Due to the changing environment in which the council operates, further legal and accounting advice may be required during the life of the LAMS2. To ensure consistency, Sector will obtain updated advice on behalf of participating authorities, including Gedling. Any additional fees incurred in this respect will be agreed with all parties in advance.

12. RISKS

There are a number of risks associated with the LAMS2. A risk assessment, outlining all the key risks identified, together with the mitigating controls, is shown below.

	Strategic Risk	Key Risk	Risk Rating	Likelihood	Impact	Preventative Measures	Notes
F1	Financial	Local authority affordability	Moderate	Low	Moderate/ High	Make adequate budget provision	For cash backed guarantees it may be prudent that interest earned on the deposit is set aside in a ring fenced reserve to be used to fund future liabilities in the event of failure or default, and the guarantee being called upon.
F2	Financial	Lending to sub-prime applicants	Low	Low	Moderate	Use lender's existing credit criteria	
F3	Financial	Applicant affordability	Low	Low	Moderate	Lender will ensure the mortgage is affordable	
F4	Financial	Costs incurred in the event of a guarantee being called	Low	Low	Low	The number of repossessions by first charge mortgage lenders in 2010 was 0.3% of all mortgages (source-CML website). For each £1m, there is a potential for loss of £3k if each default leads to a 100% loss of the value of the guarantee. For 95% LTV mortgages this may be higher, perhaps 1-2%. The cash-backed guarantee will attract a	No specific statistics available for first time buyers only. Figures could be refined further to cover local or regional areas. For this purpose, it is assumed that the full value of the guarantee will be lost in the event of default.

	Strategic Risk	Key Risk	Risk Rating	Likelihood	Impact	Preventative Measures	Notes
						premium investment return in the region of 4.1%, ie. each £1m allocated to the scheme will earn £41k.	
F5	Financial	Counterparty risk	Low	Low	High	Partnership with highly reputable financial institutions for deposits. Ensure compliance with the TMSS.	The cash-backed mortgage support should not be seen as a straightforward deposit with a financial institution. Participating local authorities may be required to provide a "financial advance" to the participating mortgage lender (to support mortgages in the local economy), so the requirements of the scheme would be slightly different to the usual investment principles. This should be identified in the TMSS.
R1	Reputation	Poor publicity or bad press about the use of public money	Moderate	Low	Low	Press officer to liaise closely with the local press. Promotion of benefits of the scheme, ie. supporting the local housing market and local economy. Good promotional material. Joint working with partners and estate agents. Press releases & photo opportunities.	Sector and the participating lenders will support the promotional process.
R2	Reputation	Repossession in the hands of the lender, therefore outside the local authority's area of responsibility	Moderate	Moderate	Low	Lender to inform local authority if and when an applicant is facing repossession. LA may be able to support people to prevent repossession.	
R3	Reputation	Poor publicity or bad press	Moderate	Moderate	High	Is the local authority support an issue?	

	Strategic Risk	Key Risk	Risk Rating	Likelihood	Impact	Preventative Measures	Notes
		about possible repossession				Early notice from lender to the local authority if action is due to be taken. Local authority to assess the alternative options.	
P1	Political	Lack of political support	Low	Low	High	Ensure political support from the outset. Continued member briefing of progress on the scheme, and on the value of the guarantees offered.	Sector will support this process.
P2	Political	Change of political priorities	Low	Moderate	Low	Future support for the scheme may be withdrawn, but existing support would remain until expiry.	
O1	Operational	Adverse impact on existing staffing levels	Low	Low	Low	The local authority will have no input in the assessment or processing of mortgage applications.	
O2	Operational	Housing market fully recovers and the scheme no longer required	Moderate	Moderate	Low	The scheme will cease to exist. Guarantees already granted (5 years + a further 2 years if the account is 90+ days in arrears) would remain in place.	Further analysis of local and regional housing issues to be added, ie. local housing need, house prices, mortgage approvals etc. This information will determine the anticipated life of the scheme.