### 1. PURPOSE OF REPORT

1.1 This report seeks approval for a Local Authority Mortgage Scheme in Rochdale

### 2. RECOMMENDATIONS

2.1 To approve the establishment of a Local Authority Mortgage Scheme as per criteria included in paragraphs 3.26 and 3.27 of the report

2.2 To approve the provision of £1 million to fund the scheme; the funding to be provided through prudential borrowing.

2.3 To indemnify the Monitoring Officer in respect of any personal liability he or she may incur by providing an opinion and providing Lloyds TSB with the opinion letter.

### 3. MAIN TEXT INCLUDING ALTERNATIVES CONSIDERED/CONSULTATION CARRIED OUT

#### Background

3.1 The turmoil in the financial and banking market has had a severe impact on both the local economy and on local housing. House prices have continued to fall over the last 12 months, falling by 1.3% nationally, based on Land...
Registry data and the outlook remains uncertain. The lack of buyers, together with the ongoing lack of mortgage availability means house prices are unlikely to increase significantly in the short to medium term.

3.2 There is still considerable concern about some areas of the housing market, particularly the low percentage of first time buyers. According to the Council of Mortgage Lenders (CML), mortgage lending overall increased in 2011, for the first time since 2007, but this was driven by remortgages, with house purchase lending falling by 6%. The CML believes the housing market will remain subdued in 2012 due to uncertainty surrounding the economy and the more prudent approach being taken by lenders. The level of activity in the mortgage market is therefore expected to remain subdued.

3.3 In September 2009, Sector Treasury Services, an independent provider of capital financing, treasury advisory, strategic and consultancy services to UK public service organisations 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. 11 Local Authorities, including Rochdale, initially sponsored the pilot scheme.

3.4 Following the successful completion of the pilot scheme, this report outlines the proposed scheme where the Local Authority can provide targeted help to potential first time home-buyers to enable them to obtain a mortgage. The scheme is a private sector initiative, i.e. not linked to the Right to Buy Mortgage scheme previously provided by Local Authorities.

3.5 All ten Greater Manchester authorities have met with Sector Treasury Services to discuss the scheme. Oldham and Trafford Councils have recently launched schemes in their areas and Manchester is currently in discussions with lenders.

3.6 Cabinet gave an in principle approval in December 2011 for funding totalling £2 million for a Local Authority Mortgage Scheme in the borough.

**Scheme Details**

3.7 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, the Council will be able to specify the maximum loan size, and post codes (in terms of property location) covered by the scheme. Qualifying characteristics for those who qualify for a mortgage under the LAM scheme are at the discretion of the mortgage lender. This means that the Council cannot restrict the scheme to Rochdale residents only, although the property purchased (and the benefits to the local economy that ensue) will have to be in Rochdale.

3.8 If a potential buyer meets the strict credit criteria applied by the lender the Council will provide a top-up indemnity to the value of the difference between the typical Loan to Value (LTV) (i.e. 75%) and a 95% LTV mortgage. The potential buyer will thereby obtain a 95% mortgage on
similar terms as a 75% mortgage, but without the need to provide the substantial deposit usually required.

3.9 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.

3.10 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.

3.11 The indemnity would only be called upon if a loss is crystallised by the lender. By way of example, a property valued at £100,000, with a mortgage of £95,000 and with Council indemnity of £20,000 is sold at £70,000, net of attributable costs. The full value of the £20,000 indemnity would be requested by the lender. If the property is sold at £90,000 net of costs, i.e. an actual loss of £5,000 is incurred by the lender; £5,000 would be requested from the Council. Any loss in excess of the value of the indemnity would be attributable to the lender. The lender would request payment from the Council, who would undertake to make payment within 30 days. This is summarised in the table below:

<table>
<thead>
<tr>
<th>Ref</th>
<th>Action</th>
<th>£000</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
<td>Purchase Price</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>b</td>
<td>Buyer’s Contribution</td>
<td>(5)</td>
<td>5% of Purchase Price</td>
</tr>
<tr>
<td>c</td>
<td>Council Indemnity</td>
<td>(20)</td>
<td>20% of Purchase Price</td>
</tr>
<tr>
<td>d</td>
<td>Mortgage</td>
<td>75</td>
<td>75% of Value</td>
</tr>
<tr>
<td>e</td>
<td>Default – Property Sold</td>
<td>70</td>
<td></td>
</tr>
<tr>
<td>f</td>
<td>Lender Loss</td>
<td>25</td>
<td>100-5 = 95 – 70 = 25</td>
</tr>
<tr>
<td>g</td>
<td>Call on Council Indemnity</td>
<td>20</td>
<td>Limited to Original Value</td>
</tr>
<tr>
<td>h</td>
<td>Default – Property Sold</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td>i</td>
<td>Lender Loss</td>
<td>5</td>
<td>100 – 5 = 95 -90 = 5</td>
</tr>
<tr>
<td>j</td>
<td>Call on Council</td>
<td>5</td>
<td></td>
</tr>
</tbody>
</table>

3.12 The Council will set a maximum annual limit for indemnities offered, either in total or for the forthcoming year. The indemnity could be either unfunded or “cash-backed”, depending on the requirements of the lender.

3.13 If the indemnity is un-funded, the Council will receive a premium, expected to be in the region of £500 per mortgage.

3.14 If the indemnity is “cash backed”, i.e. supported by a deposit 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) - and may have conditions / structures attached. The deposit will be made on a fixed interest rate for the full term and the interest rate is currently around 4%.
3.15 In accordance with the legislation, the lender will not have a legal charge over the deposit. In the event of an indemnity being called and an amount being payable by the Council to the lender, a request for payment would be made by the lender. The Council will undertake to settle the amount payable within 30 days.

3.16 For both types of indemnity, and assuming no default by the buyer, the indemnity liability would terminate on the earliest of the end of the agreed indemnity period (i.e. 5 years) or an early repayment of the mortgage.

3.17 Sector Treasury Services, together with the pilot local authorities, have prepared advice setting out the legislative framework for the scheme and on State Aid rules. This advice has been reviewed by the Council in developing the scheme for Rochdale.

3.18 There are a number of risks associated with the scheme, and these are addressed in Section 7 of this report.

3.19 A risk assessment, outlining the key risks and potential mitigating controls has been developed by Sector Treasury Services. This assessment has been amended to reflect the proposed scheme in Rochdale and is attached in Appendix 1.

3.20 Once the Council has agreed to participate in the scheme, and set parameters in terms of the maximum amount of indemnity, maximum loan and post codes covered by the scheme, the mortgage lender will manage the operational side of the scheme without any direct input from the Council. The Council will therefore have no involvement in determining who is eligible for a mortgage under the scheme, and there will be no right of appeal to the Council by any applicant who has a mortgage application rejected. Sector Treasury Services will undertake an annual audit of the scheme to ensure both parties are fully compliant with the agreement. Sector receives a fee from the mortgage lender, not from the Council, for their role in administering the scheme.

3.21 Due to the changing environment, further legal and / or accounting advice may be required during the life of the LAMS. To ensure consistency, it is anticipated that Sector Treasury Services Ltd will obtain updated advice on behalf of participating authorities. Any additional fees incurred in this respect will be agreed with all parties in advance.

**Current Position**

3.22 Around 250 local authorities across the UK have expressed an interest in the scheme. Over fifty authorities have signed up to LAMS, of which nineteen have launched. Within Greater Manchester, Oldham and Trafford Councils have recently launched schemes in their respective areas.

3.23 There are currently eight lenders involved in the scheme with other lenders expected to become involved as the scheme expands.
3.24 Lloyds TSB bank is the largest lender involved. They will not lend against new build and will only participate based on the cash back model. The other lenders currently involved have some restrictions in place which limit the geographical area they cover or the types of home buyer to whom they will lend.

3.25 Mortgage applicants for the scheme will only be eligible for standard repayment mortgages. Interest rates will be slightly higher than those available to applicants for who are able to fully fund a 25% deposit themselves. The scheme is only applicable for repayment mortgages, and for First Time Buyers (defined as someone who has never previously owned a property).

Proposed Scheme

3.26 The proposed scheme for Rochdale is as follows:

- A “cash backed” scheme with Lloyds TSB;
- Scheme to apply to all Rochdale post codes;
- A maximum loan size of £142,500 is proposed under the scheme.
- A total indemnity value of £1 Million;
- Provide assistance to approximately 30-40 First Time Buyers.

3.27 In accordance with the criteria set by Lloyds TSB a number of criteria will apply:

- Only those who can meet the lending criteria and can sustain payments would be eligible;
- Right to Buy properties would not be eligible;
- New build homes would not be eligible;
- Apartments would not be eligible
- There will be no residency restrictions (i.e. applicants who live outside Rochdale will not be excluded);
- Full post codes that cross authority boundaries will be excluded.

3.28 A maximum loan size of £142,500 is proposed under the scheme. This figure has been calculated based on a maximum property value of £150,000 for a person with a 5% deposit. As an example of the maximum indemnity value per property, this would equate to £30,000 for a person with a 5% deposit but both the maximum property value and actual indemnity would vary if a person has a higher personal deposit.

3.29 Each First Time Buyer purchase will also have a wider housing and economic effect. The average length of a housing chain is around 3 to 4, meaning that if forty purchases assisted through the scheme this will lead to another 80 to 120 sales in the wider market.

3.30 Average house prices within the borough are currently around £118,000 however in order to assist economically active first time buyers to purchase homes in the borough the scheme is targeted at a homes up to £150,000.
3.31 Figures from the Council of Mortgage Lenders indicate that 0.3% of mortgages are repossessed each year, although the rate for first time buyers will be slightly higher (between 1 and 2%). If a 4% default rate was used (double the average) this represents a financial risk on the Council’s investment in the scheme of £40,000 over five years on a mortgage portfolio of £1 Million. On a fixed investment rate of approximately 4.1%, the funds deposited with a lender of £1 Million, the Council would make an investment return of circa £205,000 over the 5 year period.

3.32 Subject to Cabinet approval the scheme will formally launch in August 2012. An initial press release will be issued after the Cabinet meeting to confirm the proposed scheme. This will not include reference to an actual launch date as this could still be subject to change whilst the legal agreement with Lloyds TSB is being finalised.

3.33 A communications programme linked to the introduction of the scheme is being developed in line with the guidance provided by Sector. It is likely to include media releases for local print and broadcast channels, information on the Council’s website and some targeted communications including posters and flyers for display in the mortgage lender’s branches and estate agents. The scheme will also be promoted to Council staff via the intranet and staff newsletter.

**New Build Indemnity Scheme**


3.35 The scheme will be open to all house builders and lenders in England who wish to participate, and will enable home buyers to secure mortgages with at least a 5% deposit. The scheme will only cover new build houses and flats, and the first loans are expected to be available in spring 2012.

3.36 The scheme will be complementary to the LA Mortgage scheme as it only covers new build properties, and is dependent on house builders opting to offer properties through the scheme.

**Alternatives considered**

3.37 There are two potential alternatives options which Cabinet should Consider:

*Option 1* - Support the proposed scheme which will deliver significant benefits to the borough by enabling the Council to play a pro-active role in supporting the local economy, pump priming the housing market and providing a means for an affordable entry onto the property ladder for first time buyers. In addition participation in the scheme will also have the added benefit of reducing the pressure on the demand for social housing by potentially removing eligible local first time buyers from the housing waiting lists.
**Option 2** - Do not support the proposal to establish a LAMS.

**Consultation proposed/undertaken**

3.38 Consultation has taken place with GM authorities to assess the level of interest in the scheme across the sub-region. Should approval be granted to proceed with the scheme, it will be promoted across the Council’s media streams and through the local press.

4. **FINANCIAL IMPLICATIONS**

4.1 The total amount of indemnity to be provided under this scheme is £1 million and this will be “cash backed”. In accordance with the terms of this indemnity, the Council will be required to place a deposit with the lender for this amount at the commencement of this scheme and for which it will receive a favourable interest rate currently around 4.1%. Upon completion of the indemnity period, funds would be repaid back to the Council with interest received annually.

4.2 In accordance with the legislation, the amount advanced under this option will be deemed as capital expenditure and will therefore need to be reflected in the Council’s capital investment programme where it will be funded from prudential borrowing. The annual cost of interest payments on this debt will be charged to the scheme. Our Capital Financing Requirement (CFR) will increase by the amount of the total indemnity when the capital expenditure is incurred. The deposit is due to be returned in full at maturity and be treated as a capital receipt reducing CFR accordingly. There should no need to set aside provision to repay the debt liability, so Minimum Revenue Provision is not required.

4.3 In order to keep to a minimum any future potential call on the Council’s resources due to mortgage defaults, it is recommended that the majority of interest earned, net of cash flow impact on the £1 m advanced, is placed into a reserve to be used as a first call on any future liabilities. At the end of the indemnity period all surplus funds held in this reserve would be made available for general purposes.

4.4 The following worked example shows the possible costs, interest income and final return on investment for a given set of assumptions.

- The Council deposits £1m with a lender
- Average mortgage of £100k
- 20% indemnity equates to £20k per mortgage on average
- Potentially 50 loans
- Deposit at 4.1% earns £205k
- Borrowing £1m for five years costs £110k
- Assume 2 defaults – cost £40k

Estimated return on investment:
4.5 It should be noted that using the above example, break-even point would be breached if a further three mortgages defaulted and resulted in a full call on our indemnity (default rate 10%). The table below also shows the effect if 10 loans defaulted in full (20% default rate).

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<thead>
<tr>
<th>Income &amp; (Costs)</th>
<th>£000</th>
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<tbody>
<tr>
<td>Interest Earned</td>
<td>205</td>
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<tr>
<td>2 Loans Default</td>
<td>(40)</td>
</tr>
<tr>
<td>Borrowing Costs</td>
<td>(110)</td>
</tr>
<tr>
<td>Return on Investment</td>
<td>55</td>
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</tbody>
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<table>
<thead>
<tr>
<th>Income &amp; (Costs)</th>
<th>2 Defaults</th>
<th>5 Defaults</th>
<th>10 Defaults</th>
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<tbody>
<tr>
<td></td>
<td>£000</td>
<td>£000</td>
<td>£000</td>
</tr>
<tr>
<td>Interest Earned</td>
<td>205</td>
<td>205</td>
<td>205</td>
</tr>
<tr>
<td>Loans Defaulting</td>
<td>(40)</td>
<td>(100)</td>
<td>(200)</td>
</tr>
<tr>
<td>Borrowing Costs</td>
<td>(110)</td>
<td>(110)</td>
<td>(110)</td>
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<tr>
<td>Return/ (Loss) on</td>
<td>55</td>
<td>(5)</td>
<td>(105)</td>
</tr>
<tr>
<td>Investment</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

5. LEGAL IMPLICATIONS

5.1 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.

5.2 The Scheme has been structured to comply with the state aid requirements of EU State Aid regulations and the public procurement risk is considered low.

5.3 In addition to the Local Lend a Hand Mortgage Scheme Indemnity Deed, the Local Authority Monitoring Officer 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. 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.

6. **PERSONNEL IMPLICATIONS**

6.1 There are no personnel implications.

7. **CORPORATE PRIORITIES**

7.1 The Local Authority Mortgage Scheme contributes to the key priority of improving health, wellbeing and prosperity in the Council's corporate plan, Aiming High, recognising that assisting first time buyers is essential to retaining and attracting economically active individuals with key economic skills and experience.

8. **RISK ASSESSMENT IMPLICATIONS**

8.1 If the mortgagee is in arrears for three months or more at any time in the final six months of the first five years of the mortgage term, the indemnity (or guarantee) will be extended by another two years and therefore the risk to the Council in receiving a claim from the Bank is extended by a further two years. In such circumstances the Council’s maximum indemnity will be 20% of the purchase price.

8.2 If the property is repossessed within the first five years or seven years if extended as in 7.2 and the sale proceeds didn’t repay the mortgage, the scheme lets the Bank claim against the Council.

8.3 It may be unlikely that the Council can recover the amounts paid to the Bank from the Borrower. However it may be possible to include in the documents to be signed by the Borrower an undertaking to repay the Council if a demand is made under the indemnity. This could be supported by a second charge against the property. However the Council would need to accept that the Borrower is unlikely to be able to make such a repayment in a default situation and the indemnity may include a restriction on the Council from seeking to be repaid if the Bank has not been repaid in full or if there are still amounts owed under the loan.

8.4 Negative equity in the owner occupied market can sometimes occur hence the scheme needs to be subject to a property valuation survey to reduce the risk.

9. **EQUALITIES IMPACTS**

9.1 **Workforce Equality Impacts Assessment**

There are no significant workforce equality issues arising from this report.
9.2 **Equality/Community Impact Assessments**

There are no significant equality/community issues arising from this report.

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<tr>
<th>Document</th>
<th>Place of Inspection</th>
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<tr>
<td>Local Authority Mortgage Scheme</td>
<td>Customers and Communities Service, Floor 4, Municipal Offices, Smith Street, Rochdale</td>
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<tr>
<td>Equality Impact Assessment</td>
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