

COMMUNITY AND SOCIAL AFFAIRS COMMITTEE

19TH SEPTEMBER 2012

REPORT OF HEAD OF COMMUNITIES & NEIGHBOURHOODS

LOCAL AUTHORITY MORTGAGE SCHEME (LAMS)

1.0 PURPOSE OF REPORT

- 1.1 To consult members of the proposal to participate in Leicestershire County Councils (LCC) Local Authority Mortgage Scheme (LAMS).
- 1.2 To inform members that participation in the LCC LAMS Scheme requires a capital investment of £1,000,000 from the authority.

2.0 RECOMMENDATIONS

- 2.1 **Members approve the recommendation to participate in LCC's LAMS Scheme and approve the attached project mandate and business case for inclusion in the capital programme for 2012-13.**
- 2.2 **Members recommend that the Policy, Finance & Administration Committee (PFA) be asked to approve £1,000,000 in 2012-13 as a capital investment in the LAMS Scheme funded by capital receipts.**
- 2.3 **Members approve the investment of the capital in the LAMS scheme via the Cash-Backed Indemnity option (para. 5.6 refers).**
- 2.4 **Members recommend to PFA that the annual interest be set-aside in a specific reserve for the period of the indemnity (para. 5.7 refers).**
- 2.5 **Members recommend to Full Council that the Annual Investment Strategy be amended in accordance with paragraph 5.10.**
- 2.6 **Subject to approval of recommendations 2.1 to 2.3 ; Members delegate to the Head of Communities & Neighbourhoods in consultation with the Chair of Community & Social Affairs Committee, Head of Central Services and the Solicitor to the Council to agree the Service Level Agreement between LCC, Melton Borough Council and the chosen financial institution.**

3.0 KEY ISSUES

- 3.1 The principle behind the Local Authority Mortgage Scheme is to make home ownership more accessible to first time buyers and to help the local housing market and thereby the local economy. The scheme will also meet the housing needs of households who would otherwise be in need of affordable housing.

- 3.2 The scheme has been designed to minimise the financial impact on the Local Authority, and to work in partnership and utilise the expertise of residential mortgage lenders. The model is supported by the Council of Mortgage Lenders.
- 3.3 The scheme requires the Local Authority to provide a financial indemnity of up to 20% of a mortgage for potential home-buyers who qualify for local authority support and, who meet the strict lending criteria set by the lender. The potential buyer will hereby obtain a 95% mortgage on similar terms as a 75% mortgage, but without the need to provide the substantial deposit usually required.
- 3.4 In the event of a default an invoice would be issued to the Council to cover the amount of the indemnity provided against the mortgage, less any monies recovered as part of the repossession and sale of the property.
- 3.5 Figures from the Council of Mortgage Lender 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, however the strict lending criteria followed by the financial institution would ensure this was not reckless, but even if every default was to be for the full amount of the guarantee (i.e. the property was sold for less than 75% of the purchase cost) it would take a doubling of this default rate to 'wipe out' the interest premium paid by the financial institution. Recent LAMS transactions have attracted interest rates (including the premium) of about 4.5% p.a. and if this interest (or even part of it) were to be set aside in a reserve to cover the risk of default, there is unlikely to be a meaningful financial risk to the authority.
- 3.6 The scheme does not promote reckless lending, successful applicants must meet the standard lending criteria as set out by the lender, and the higher loan to value mortgage must be affordable. It simply reduces the value of deposit required.
- 3.7 LAMS is a national scheme, launched in March 2011, and is standardised as much as possible. Under the scheme, each Local Authority can only specify three qualifying criteria:
- The maximum limit for the indemnity
 - The maximum property valuation
 - The qualifying post codes*

*Please note, the recommendation is to partner with LCC, therefore qualifying post-codes must be within the County boundary. Had a district level scheme been pursued, any properties sitting across district boundaries would have to be excluded. The County partnership, effectively means that more properties can be included, but it also means that few can be excluded, because say, for example, members would like to exclude all post-codes in a specific area of the borough, because the County scheme exists LAMS is applicable to all post-codes in the County and the exclusion would have no effect, except that prospective home-buyers could be limited to a purely LCC scheme and not a Melton LCC scheme.

- 3.8 Once the parameters have been set, the mortgage lender will manage the operational side of the scheme without any direct input from the Local Authority.

4.0 **POLICY AND CORPORATE IMPLICATIONS**

4.1 The scheme has the following links to the council's corporate priorities:

- Improving the well-being of vulnerable people
- Improve quality of life for people living in the most disadvantaged neighbourhoods
- Help provide a stock of housing accommodation that meets the needs of the community
- To provide high performing services that are efficient and meet customers' needs

4.2 LAMS has the following project objectives;

- To assist first time buyers who are unable to provide substantial deposits to access mortgages
- To meet the needs of households who would be otherwise in need of affordable housing
- Reduce need for affordable housing and make best use of affordable housing stock
- Assist the local housing market and the wider local economy

4.3 Our current housing need model estimates that approximately half of new forming households, under 35 years, who could afford to buy market housing are unable to do so because they are unable to get a mortgage in the current economic conditions. This equates to approximately 60 households each year, because such households are unable to access market housing without assistance, they form part of the overall need for affordable housing, accounting for just over 20% of total need.

4.4 Evidence shows that around 130 additional affordable homes are needed each year; this level of supply cannot realistically be met through new housing development alone, so the LAMS scheme offers an additional avenue to meeting this need.

5.0 **FINANCIAL AND OTHER RESOURCE IMPLICATIONS**

5.1 The table below shows potential number of first time buyers the scheme may initially assist based on £1m advance, assuming a purchase price of £150,000.

Total Local Authority Indemnity	£1,000,000
Maximum Property value	£150,000
5% Purchaser Deposit	£7,500
95% Mortgage	£142,500
Local Authority Indemnity	£30,000
Potential number of mortgages	33

5.2 The Local Authority 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 was in arrears in the last 6 months of the initial 5 year period.

- 5.3 The Local Authority indemnity would be called upon if a loss is crystallised by the lender. The lender would request payment from the Local Authority, who would be required to undertake payment within 30 days.
- 5.4 There are two models of indemnity that a local authority can provide, “unfunded” or “cash-backed”, this will depend on the requirement of the lender.
- 5.5 Unfunded: If the indemnity is un-funded, the Local Authority will receive a premium, a fixed amount of the value of the indemnity actually provided, typically in the region of £500 per mortgage approved through the scheme.
- 5.6 Cash-Backed being the recommended option: This is when the indemnity is supported by a deposit; 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 – i.e. 5 years (with the possibility of a further 2 years if the mortgage is in arrears at the end of the 5 years.) The Local Authority will receive a 5-year commercial deposit rate + a premium of 0.70%. The most recent cash backed indemnity deposits have attracted returns in the region of 4.1 - 4.3%. This is a higher return than the Council currently receives on its investments but reflects the higher risks involved in the investment as outlined in the risks section below.
- 5.7 To mitigate against any potential loss it is recommended that the annual interest is set-aside in a specific reserve to be only realised at the end of the term of the indemnity and Members are recommended to seek approval from PFA to do this.
- 5.8 Regulation 25 of The Local Authorities (Capital Finance and Accounting) (England) Regulations, within Section (1) (c), 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.
- 5.9 It is therefore proposed that a capital investment be made in the sum of £1,000,000 funded from capital receipts and that the Policy, Finance & Administration Committee be asked to add this scheme to this year’s capital programme..
- 5.10 The loan made to the financial institution is considered to be a service investment rather than part of the treasury management activities of the Council. In order to avoid any doubt about this issue it is considered sensible to amend the Annual Investment Strategy to provide absolute clarity. If the scheme is approved it is recommended to Full Council that this amendment be implemented. This was endorsed at a meeting of the Budget & Strategic Planning Working Group held on 13 September 2012.
- 6.0 **LEGAL IMPLICATIONS/POWERS**
- 6.1 The Solicitor to the Council will need to ensure appropriate legal implications are considered and addressed, in regards to recommendations 2.1, 2.2 and 2.3.
- 6.2 The Solicitor to the Council will need to ensure appropriate legal implications are considered and addressed in relation to the Service Level Agreement between Melton Borough Council, Leicestershire County Council and the financial institution.

7.0 COMMUNITY SAFETY

7.1 There are no community safety issues with regard to this project or the recommendations in this report.

8.0 EQUALITIES

8.1 An Equalities Impact Assessment has been completed for this project and is attached as Appendix C.

9.0 RISKS

9.1 The risks associated with this project are outlined below.

Probability

Very High A				
High B				
Significant C				
Low D	3		1, 2	
Very Low E			4	
Almost Impossible F				
	IV Negligible	III Marginal	II Critical	I Catastrophic

↓
↑
Impact →

Risk No.	Description
1	Mortgage Default, impacting on the Authorities indemnity not covered by interest set aside
2	The investment is extended beyond the 5 year period following arrears in the final 6 months
3	Uptake of the scheme is limited
4	Financial institution is unable to repay loan at end of 5 year period

9.2 One of the risks within LAMS is that the financial institution, currently proposed to be Lloyds, is unable to repay the loan from the Council at the end of the five year period, due to financial failure. As a bank which is 41% owned by the UK Government, Lloyds is amongst the most secure banks in the world and the risks of lending to them is lower than it is for almost all other financial institutions and they have by far the highest credit rating of any lender participating in the scheme. Although the Council's treasury management policies would not allow a loan of above 1 year to Lloyds (and no loans of over 5 years are permissible to any counterparty), the risks inherent within lending to Lloyds as part of LAMS are modest. If Lloyds does not exist in five years time, it is highly likely that most other financial institutions will also have failed and that the UK Government will also be in a very perilous financial position.

9.3 It is recommended that in order to minimise the risk of loss of capital that Members delegate to the Head of Communities & Neighbourhoods in consultation with the Chair of Community & Social Affairs Committee, Head of Central Services and the Solicitor to the Council to agree the Service Level Agreement between Leicestershire County Council, Melton Borough Council and the chosen financial institution.

9.4 As discussed in paragraph 5.6 part of the risk will be mitigated by setting aside the annual interest received in a specific reserve until the end of the period of indemnity.

10.0 **CLIMATE CHANGE**

10.1 There are no climate change issues with regard to the project and the recommendations in this report.

11.0 **CONSULTATION**

11.1 Consultation on the scheme has taken place with the Council's Management Team.

11.2 The Budget and Strategic Planning Working Group have been consulted on amendments to the treasury management arrangements prior to Full Council being requested to approve as the responsible scrutiny body for this function.

12.0 **WARDS AFFECTED**

12.1 All wards may be affected

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Date: 31st August 2012

Appendices: Appendix A - Project Mandate
 Appendix B - Business Case
 Appendix C - Equalities Impact Assessment

Background Papers: Sector Local Authority Mortgage Scheme Notes
 County Council Cabinet Report: LAMS 23rd July 2012

Reference: X:C'tees, Council & Sub-C'tees/CSA/2012-13/19-9-12/Local Authority
 Mortgage Scheme