The National Assembly for Wales - Inquiry into the provision of affordable housing

Submission by the Council of Mortgage Lenders to Communities, Equality and Local Government Committee

Introduction

1. The Council of Mortgage Lenders (CML) welcomes the opportunity to submit written evidence to the Communities, Equality and Local Government Committee. The CML is the representative trade body for the whole of the residential mortgage lending industry. Our 109 members currently hold around 94% of the assets of the UK mortgage market, and include commercial banks, mortgage banks, building societies and non bank specialist lenders.

2. In addition to lending for owner occupation and private renting, CML members have lent over £60 billion to housing associations across the UK for new build, repair and improvement to social housing.

Context and current mortgage market

3. The UK mortgage market remains extremely constrained. Mortgage lending remains subdued albeit generally is holding up at the previous years levels. On an encouraging note the repayment of the government / Bank of England support is now well ahead of plan with only £37BN outstanding under one of the main planks - The Special Liquidity Scheme – originally £185BN which has to be fully repaid by 2013. It now appears that the banking sector will be able to comfortably the meet milestones here. This has been largely possible through the opening up of capital markets ["RMBS" investors] during late 2010 / 2011 albeit the current Eurozone / sovereign debt crisis could temper investor appetite.

4. Accordingly to that extent the UK mortgage funding market has a demonstrable track record of performance through difficult times and the UK could be deemed to be a relatively safe haven for investors – in particular not being in the Euro is an asset right now. That said we can not insulate ourselves from the fall out from the Eurozone crisis.

5. In the meantime there is no let up for the sector in terms of emerging legislation / policy direction – the latest being the Independent Commission on Banking recommending the ring fencing of retail banks from investment banks. Additionally work towards Basel III and other steers to enhance capital / liquidity ratios will inevitably challenge the abilities of the sector to grow lending.

6. Much of the mortgage market is sourced from retail deposits and there is only a finite supply of these – especially with competition from corporate bonds / various government issues e.g. index linked certificates chasing higher returns in what remains a low interest rate environment. Despite capital markets having thawed slightly, for the reasons set out above it does not appear that bond issues from the markets will be in abundance and given the finite supply of savings then the inevitable conclusion is that mortgage funding will remain tight.

7. With respect to activity levels, gross mortgage lending has been pretty flat for some considerable while, although there has been a slightly firmer tone in recent months. Bank of England figures show that gross mortgage lending in September was stronger than expected, at £13.7 billion. This was 4% up on August and 10% higher than a year ago. Our forward estimate is that gross lending dipped to £13.1 billion in October, but 13% higher than a year ago.

8. Remortgaging has underpinned lending levels over the past year, but house purchase activity has been below year-earlier levels until recently. Stronger buy-to-let lending has also been part of the story over the past few quarters, but again this has mainly been remortgaging activity.

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9. While lending volumes remain at broadly 33/40% of where they were during 2006 / 7 what is equally striking is the fact that they are below where they were a decade previously. There continue to be the emergent regulatory requirements / demands for higher capital / liquidity which point to 2012 being another year of subdued lending.

10. The immediate direction of house purchase activity is a little unclear. The latest RICS survey indicates that activity measures were generally a little firmer, but HMRC figures for the last few months point to a slowdown in completed house purchases.

11. The CML has also recently argued that the government should retain the current stamp duty concession for first-time buyers beyond March of next year, in order to help bolster market sentiment.

Arrears, repossessions and negative equity.

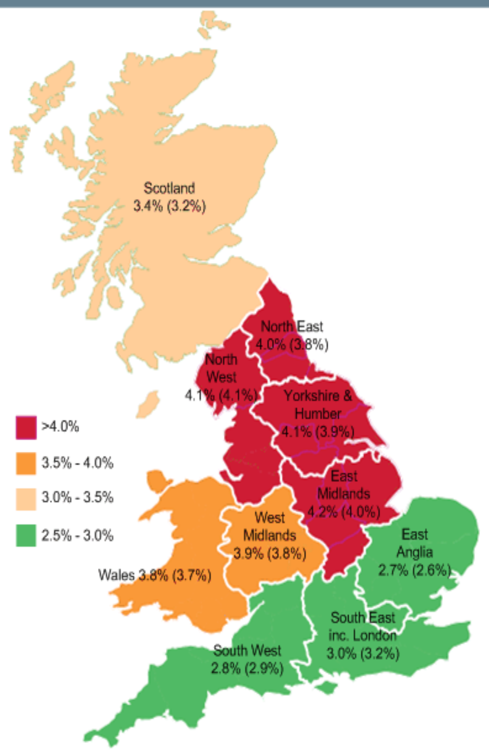
12. It remains the case that underlying credit conditions have been more benign than some analysts were predicting. There have been several factors behind this amongst which are:-

- Unquestionably the low interest rate environment / policy pursued by the Bank of England has played a key part.
- Unemployment figures were not quite as bad as some had envisaged albeit recent announcements on this front presage tougher times ahead.
- The UK housing market has not collapsed in the manner some foresaw.
- Forbearance schemes initiated by the industry and supported by various governments [WG within Wales] have helped avert repossessions.

13. Clearly the outlook here will be challenging with potential higher levels of unemployment, and continued pressures on household finances through a combination of an accelerating fiscal squeeze and higher inflation. Moreover with lesser capacity for mortgage rescue initiatives in future together with a decision to cut payments for "support for mortgage interest" then the safety nets for borrowers will be more limited and lenders will need to work collaboratively with clients / other stakeholders to help minimise distress.

14. Standard and Poor's has provided a geographical split of mortgage arrears by region set out below. It clearly sounds some notes of caution but would indicate that Wales was fairing reasonably well as at the end of Q1 2011.

Map 1
Total U.K. Mortgage Arrears By Region In Q1 2011



Note: Figures in parentheses are for the second quarter of 2010.

15. Negative equity is also a potential important area as a combination of unemployment and negative equity are two of the key drivers for mortgage arrears and possessions. This is why the market is delicately poised with low interest rates providing a safety cushion for borrowers. Were rates to rise quickly then many people could potentially receive a mortgage payment shock if they were on tracker / variable rate mortgages.

16. CML estimates that Wales has some 36,000 cases of negative equity. This equates to 4% of the UK total and is broadly in line Wales share of the UK mortgage market. This is no doubt an aspect which will continue to feature on the housing agenda especially if unemployment accelerates and / or should interest rates rise.

17. With regard to RSL lending we would stress the challenging environment for longer term funding with increasingly lenders opting for shorter term facilities – commensurate with their own funding becoming more uncertain / shorter duration. Whilst there have been no situations where LSVTs / RSL lending requirements have not been funded it is clear that longer term requests will be testing and inevitably funding costs will increase.

18. A further aspect being monitored closely by lenders is the potential impact of welfare reform and in particular the potential for a substantial reduction in direct payments. CML has joined with some 16 other organisations in seeking an amendment to the Welfare Reform Bill to allow tenants a rent direct choice

19. There are concerns on the impact of RSL's [which are shared by the RSL community] and there have been recent examples of capital market issues [e.g. Moat Housing] where investors were seeking higher margins by dint of the uncertainty around this matter. This continued period of uncertainty will not help funding conditions and is likely to result in greater pricing variations between housing providers,

The effectiveness of public subsidy in delivering affordable housing, in particular Social Housing Grant

20. Social Housing Grant (SHG) is the primary source of subsidy for the provision of affordable housing in Wales and has been used effectively over recent years. Implementing the Essex review recommendations and establishing a new regulatory structure, has enabled housing associations to lever in substantial private finance to supplement SHG which for rented homes has been set at 58%. Lower levels of grant are available for intermediate rent (25%) and for low cost home ownership schemes (30-50%)

21. The use of SHG has enabled the provision of some 9000 homes in the last four years, a substantial increase over the originally projected total of 6500. The use of grant at the above levels has also enabled rents to be maintained at existing affordable levels.

22. During this, and the next three years there are substantial cuts planned in SHG budgets which will reduce from some £100m pa to £48m in 2013/14. This will have a substantial effect on the provision of affordable homes at a time when demand is most likely to increase. Even the previous level of provision fails to meet the estimated housing need projected in the report 'Housing Need and demand in Wales 2006 to 2026' which estimated that an additional 5100 non market homes per year are required to meet anticipated need.

23. Land value is a key factor in the provision of affordable housing and free or discounted land is another important form of subsidy. While some land stems from Sect 106 planning agreements the use of public sector land is increasingly seen as an important component and the government have a key role to play in facilitating its planned release.

24. Some Welsh RSL's have developed a good track record in delivering low cost home ownership schemes and there is evidence from lenders that this mortgage market is proving relatively resilient. Given hat this form of development consumes less grant it should be possible to extend this form of provision with perhaps some targeting to existing tenants. If such acceleration was to be considered it may also be beneficial to consider a standard form of lease such as the one recently approved by the Homes and Communities Agency and CML.

Whether alternatives to public subsidy are being fully exploited

25. Affordable housing provision requires a degree of public subsidy if rents are to remain at less than market levels. In the UK we have seen examples of higher rents being charged to allow housing providers to borrow a greater share of development costs and thereby reducing the level of grant. This new affordable rent programme allows rents of up to 80% of market value but many question the sustainability of this regime and it remains untested. Higher rents will of course fuel increases in housing benefit costs which can then be a new cause of concern.

26. As previously stated the present system of SHG and private finance has been particularly successful in levering in private finance and it is essential that the structure to support this is retained.

Whether the Welsh Government, local authorities and RSL's are effectively utilising their powers to increase both the supply of, and access to social housing

27. The reductions in SHG budgets pose a difficult challenge to the government. While we believe that the release of more public sector land could form part of the answer much will depend on the land values sought as this is where some form of substitute subsidy could arise.

28. We believe that there is scope for some housing associations to increase rents and thereby make a greater contribution to development funding. We made this point when responding to the WAG consultation on social rents and believe that there may be specific scope for LSVT landlords.

29. Community Housing Cymru has estimated that a £3pw increase on all housing association rents could support the cost of delivering 1000 affordable homes without SHG.

Whether there is sufficient collaborative working between local authorities, RSL's, financial institutions and homebuilders

30. There is a good deal of partnership working between these bodies, supported by some specific examples.

31. The Welsh Housing Partnership, supporting the provision of new intermediate rented homes, is an excellent example. This £16m project is financed through a combination of £3m Welsh government grant, a £12m loan from the Principality Building Society's commercial division and a £1m contribution from the four RSL's directly involved. The scheme has some capacity to expand but would be somewhat dependant of the appetite of other lenders.

32. CML and some of its lender members have been pleased to work with Welsh government officials, WLGA, CHC and local planning authorities to provide guidance around the funding and mortgageability issues that can arise in sect 106 agreements. The task and finish group has now largely completed the draft guidance and we understand it is about to be distributed. While this should enable greater acceptability of sect 106 agreements we would caution that this remains a more difficult lending market.

33. With regard to working with home builders the CML has been pleased to contribute to the following new build mortgage indemnity initiative for England which we believe would be particularly beneficial in extending to Wales, helping both first time buyers and the house building industry.

34. The scheme was announced in the governments new Housing Strategy and has been developed by CML and the Home builders Federation. It should mean that mortgages of up to 95% can become more widely available on new build homes. This will help buyers with only modest deposits and give a welcome boost to housing market confidence, with builders able to respond by pursuing more new build projects.

35. The full details of the scheme are now being developed, but essentially it will work as follows

- The developer will deposit cash funds to indemnify the lender, equivalent to 3.5% of the value of the property, that the lender (or its bank if it is a non-deposit taker) will hold for seven years, and on which interest will be payable. Funds will be returned to the developer at the end of the seven-year period minus a portion of any credit losses on the loans in the scheme. The scheme will have a central administrator who will enable each lender and developer to create "silos" of funds that apply between them, so that all the funds deposited by a builder with a particular lender are available to meet any of this lender's losses on loans on this builder's properties.

- The scheme is open to any lender and any developer, but there is no compulsion to join, and there are no specific volume targets. Both flats and houses will be included in the scheme, but it will not necessarily be available on every property and both lenders and developers will have discretion on which counter-parties they wish to work with. It will be available only on lending to the owner-occupier sector, not buy-to-let, and a cap on the maximum value of the eligible property will apply. The scheme will operate in England, but similar schemes are under consideration in Scotland and Wales.
- The government will be providing an additional guarantee of 5.5% of the value of each property included in the fund that can be called upon in the event of losses exceeding the value of the funds held on deposit.
- Interest is payable on these funds. In the event of shortfall losses, the lender would be able to claim 95% of its loss on any property from the fund.
- All parties have an incentive for the indemnity not to be called upon in practice; lending quality is in no way compromised by its existence and all the usual FSA rules and lender practices would apply to the lending decision and the subsequent management of the mortgage.

36. It is important to note that the borrower's own liability is exactly the same as on any other mortgage. The fund does not indemnify the borrower; it simply enables them to get a mortgage for a higher proportion of the value of the property than would otherwise be available. The borrower will still be required to repay any shortfall incurred on the property if they fail to keep up their mortgage payments and the lender is forced to take possession and sell. The only difference is that, in those cases where the borrower cannot or will not meet their liabilities, the lender will be able to offset 95% of its loss against the indemnity fund.

37. We have had several preliminary discussions with Welsh Government officials on indemnity schemes and remain keen to participate in a scheme for Wales. A variation of this scheme exists in Scotland where the Scottish Government has helped with set up costs.

38. A further initiative worthy of consideration is the Local Authority Mortgage Scheme (LAMS) developed by Sector Treasury Services. Under the scheme local authorities provide financial assistance to first time buyers thereby allowing them to obtain a 95% loan to value mortgage and therefore they can purchase with much lower deposits.

Whether innovative methods of delivering affordable housing such as Community Land Trusts or co-operatives could be promoted more effectively by the Welsh Government

39. With growing pressures on resources it is commendable that the Welsh government is seeking out how other forms of provision may assist in the delivery of affordable homes. We are keen to be involved in such initiatives and believe that it is important to consider the specific funding implications.

40. While we believe that Community Land Trust's (CLT's) and Co-operatives may have a role to play we do not see them as providing a solution to meeting general housing need. We would also caution that the time and resources spend on smaller scale provision options may not be the most effective use of resources. Our experience to date on CLT's has been that any efficiencies gained through the planning process may evaporate in the delivery mechanisms.

Contact

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