

## The Highland Council

9 May 2013

Agenda Item	
Report No	

### Local Authority Mortgage (Guarantee) Scheme - LAMS

#### Joint Report by Director of Finance and the Depute Chief Executive/Director of Housing & Property

##### Summary

This report seeks agreement to launch a mortgage guarantee scheme for first time buyers within the Highland Council area, using the LAMS (Local Authority Mortgage Scheme) model which has already been successfully launched by a number of English Councils.

#### 1. Introduction

- 1.1 Sector, who provide Treasury information and guidance to the Council, have since 2009 been developing LAMS. The Council was one of an initial 11 Authorities who sponsored the development of a pilot scheme.
- 1.2 LAMS is targeted at first time buyers. To support borrowers in accessing bank mortgages, the Council provides a financial indemnity of up to 20% of a mortgage. The borrower would be required to provide a 5% deposit towards the mortgage. This arrangement allows borrowers to access mortgages, and interest rates based upon similar terms to 75% LTV (loan to value) mortgages, but with only a 5% deposit themselves. The borrower would still have to meet the strict lending criteria set by the lender.
- 1.3 LAMS was formally launched in March 2011 across the UK, and as at October 2012 the following facts are drawn from the LAMS 2012/13 half-year report:
  - 76 Councils signed up with 33 launched
  - 9 fully utilised and now closed off
  - £43m of indemnities agreed (majority £1m per Council)
  - 806 mortgage applications of which 549 have completed
  - £62m of mortgage lending has taken place
  - c250 Councils considering the scheme
- 1.4 To date no Scottish Council has gone live, as some aspects of the Scottish scheme have taken longer to develop. Development of the legal agreements and supporting guidance has now reached a stage where Scottish schemes can now proceed. Draft legal documentation has been reviewed, though there may be further minor changes prior to any scheme launch.
- 1.5 The March 2013 UK Government Budget announced new measures to support homebuyers through a 'help to buy' scheme. One aspect of that scheme is a

mortgage guarantee scheme, which it is expected will offer homebuyers similar benefits to LAMS. However, that UK Government guarantee is not expected to be available until January 2014, with limited details available at this time. For that reason it is proposed that the Council considers implementation of LAMS at this time.

## **2. LAMS scheme**

2.1 Under the scheme, each Local Authority will be able to specify three qualifying criteria;

- the maximum level of indemnity,
- the maximum loan size (for each individual mortgage, based on 95% of maximum property valuation) and
- the qualifying post codes.

Only first time buyers would be eligible. The scheme is standardised as much as possible. Once these 3 parameters have been set, the mortgage lender would manage the operational side of the scheme. It has been confirmed by the lender, Lloyds, that self-build mortgages would be excluded from the scheme.

2.2 For Highland, it is proposed the criteria to be applied would be as follows:

- the maximum level of indemnity would be capped at £1m,
- the maximum loan size for each individual mortgage application would be £142,500, based on 95% of £150,000 (this representing the typical purchase price for a first time buyer within Highland)
- the qualifying postcodes would be those covering the entire Highland Council area (this criteria is used only to define the Council's geography and assist the lender with defining applications related to the Council's guarantee. It is not possible to limit the scheme to particular geographies within Highland).

2.3 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. Other than the criteria set out above, the Council would have no other role within the mortgage application process.

2.4 The indemnity would only be called upon if a loss is crystallised by the lender. Any loss in excess of the value of the indemnity would be attributable to the lender. The lender would offset the loss against the sum on deposit. For 95% LTV mortgages to first time buyers potential default levels are estimated as 1 to 2%.

2.5 The table over the page 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
	0
Assumed Property value	£150,000
5% Deposit	£7,500
95% Mortgage	£142,500
20% Local Authority Indemnity	£30,000
Potential number of mortgages	33

2.6 Lloyds TSB Bank plc is the only lender operating LAMS in Scotland. It will be the Lloyds bank brand, rather than its Bank of Scotland subsidiary, which will operate the scheme. In practice, this means mortgage applications would be handled via Lloyds telephone mortgage centre, they would not be available within the Bank of Scotland branch network.

2.7 Lloyds has stipulated that the indemnity is 'cash backed', i.e. supported by a cash deposit. 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). The Local Authority will receive a 5-year fixed commercial deposit rate + a premium. At the date of writing this report, the expected level of interest plus premium would be 2%. The actual rate to be received may vary through market conditions until the point at which the Council makes its deposit. From that point on, the rate would be fixed.

### 3. Implications

3.1 Sector have produced a detailed risk assessment relating to the scheme and this is set out at **Appendix 1**.

3.2 The main implications relate to the financial aspects (the provision of the deposit and the risks and investment rules and regulations that apply) and risks arising from mortgage default (which would be charged against the deposit).

3.3 The deposit would not directly score against capital or revenue budgets, the deposit would be funded from existing cash held by the Council and treated as an investment. The regulatory requirements relating to the LAMS scheme are such that the indemnity, provided by way of the deposit with Lloyds, would have to be considered in the context of investment accounting rules and regulations. The Council would have to agree to the cash deposit being a 'permitted investment' and the Council's Treasury Management Strategy Statement and Investment Statement amended accordingly. The following factors have to be considered by members in considering any new 'permitted investment':-

- Totality of Investments – in considering permitted investments, the investment regulations require the Council to give consideration to the totality of its investments i.e. consider risk and exposures of the entire portfolio. Listed below are current and potential investments, all of which are relevant in this context. These include 'pure' investments such as shareholdings, as well as loans to 3<sup>rd</sup> parties which are treated as investments per the regulations. While the Council has not currently set an overall limit on such non-treasury investments, the increasing incidence of proposals coming forward may

require such a limit to be considered in future.

Current loans and investment holdings covered by investment regulations:-

Description	£m
1. Currently approved Loans/investments (excluding Police and Fire):-	
Investments with other parties:-	
- Loans for affordable housing – landbanking fund*	10.003
- Other long-term loans – Caledonia Comm Leisure*	0.048
- Other long-term loans – Ft William Golf Club*	0.087
- Shares in Companies - Inv Airport Bus Park Ltd*	0.946
- House loans*	0.169
- Car loans*	0.039
- Hubco sub-ordinated debt (but not yet invested)	0.094
Total currently approved	11.386

\*At 31/3/12

In addition there are other potential loans/investments which have not yet been formally considered by Council, which could add to the existing financial exposure shown above e.g. further Hubco 'backstop' funding, possible Highland Opportunity Ltd loan.

- In agreeing to any new permitted investment, the report to members must set out; the objective, limits, and the associated risks and controls (including credit or security risk, liquidity risk, counter-party risk and market risk). The strategy or policy statement should describe the controls in place for limiting those risks.
  - a) Objective - to support new home-buyers onto the property market.
  - b) Limits – capped limit of £1m of mortgage indemnity.
  - c) Credit or security risk – the risk of default is referred to earlier in this report, with potential default for this type of mortgage running at 1%-2%. To mitigate these risks the Council would earmark the interest earned on the deposit (estimated as 2% p.a.) to make provision for default.
  - d) Liquidity risk – the Council must ensure it has an adequate liquid (available) cash position to meet its daily operational requirements. By placing the LAMS indemnity on fixed term deposit, the Council is tying up cash balances and reducing its available liquid cash resources. There may therefore be a knock on impact and cost, with the Council having to borrow, or retain other cash balances, to replace the cash now tied up in the LAMS deposit. The 5 year term is longer than the Council would consider appropriate for a typical treasury deposit. This risk can be mitigated by limiting the value of the LAMS indemnity, and by ensuring the Council monitors its overall investment position, and where appropriate considers a cap on non-treasury investments in future.
  - e) Counter-party risk – this represents the risk of the counter-party failing (in

this case Lloyds) and the Council's deposit being lost. The 2008 banking crisis highlighted that there can be no absolute guarantee applying to any counter-party. This risk can be mitigated insofar as Lloyds at present benefits from the UK Government's backing. On an ongoing basis, as Lloyds remains an important counter-party for the Council's treasury operations, its credit rating will be kept under regular review as part of routine treasury management.

f) Market risk – this represents the risk to the value of the investment. As the nature of the investment is a deposit, rather than shareholding or other type, this risk is covered in the credit/security risks above.

- Revenue budget implications – an assessment of the implications for the revenue budget is required, so any loss of value of investment (including in this case mortgage defaults), is considered and provision made. Assuming default is limited to the 1%-2% range, the interest earned on the deposit should exceed the potential levels of default. Were higher levels of default to be experienced, there would potentially be a charge against the revenue budget.
- The deposit placed with Lloyds for the LAMS scheme, being a 'non-treasury investment', would not score against existing treasury counter-party limits.

3.4 While the scheme launch and provision of mortgages would be expected to take place within a relatively short timescale following consideration by the Council, members should be aware of the long-term financial commitment the Council would be entering into, with the indemnity being in place for a minimum of 5 years.

3.5 The lender, Lloyds, has also stipulated a number of requirements in relation to independent legal advice and side letters from the monitoring officer (Assistant Chief Executive) to ensure the Council's decision on LAMS was made in line with its powers and internal procedures. These requirements will be actioned following the decision by the Council.

#### **4. Process/Timetable**

4.1 If members agree to proceed with the LAMS scheme, following the Council meeting a conference call with Lloyds would take place to discuss implementation, and agree actions necessary to conclude all relevant legal agreements and paperwork. Following that, information from Sector suggests launch within a period of 4 weeks should be feasible. The Council could therefore expect a launch July/August.

4.2 The Council and Lloyds would work together in terms of communications, and joint press releases to promote the scheme launch within the area.

#### **5. Conclusions**

5.1 The LAMS scheme has now reached a stage where the launch in Scotland is feasible, and all relevant documentation and supporting guidance is in place.

5.2 The requirement for a cash deposit, relevant investment rules and regulations, and

risk implications are set out within this report for consideration.

## Recommendation

Members are asked to consider this report and

- (a) Agree the Council adopts the Local Authority Mortgage Scheme (the Scheme) in accordance with the outline provided in this report;
- (b) Agree the Council provides a financial guarantee to the relevant lender (the Lender) in respect of the Scheme (the Guarantee);
- (c) Agree the Council will provide a deposit to the Lender in respect of the Guarantee and that deposit will be made for the full term of the Scheme;
- (d) Agree the maximum limit for the total Guarantee to be offered under the scheme is £1m;
- (e) Agree the maximum loan size is £142,500;
- (f) Agree the qualifying post codes will include all post codes within the Council boundary area and will exclude any that cross the boundary into a neighbouring authority. The qualifying post codes will be provided to the lender(s) in a schedule to the Guarantee;
- (g) Agree the local authority will authorise its Monitoring Officer to provide the opinion letter in the required form confirming that the correct internal procedures have been followed by the local authority in coming to the decision to enter in to the Scheme (the Monitoring Officer's Opinion Letter);
- (h) Agree the local authority will issue a side letter in the required form to confirm that its Monitoring Officer has been appointed in line with the local authority's constitution, is authorised to opine on the matters within the Monitoring Officer's Opinion Letter and that the local authority assumes responsibility for the content of and shall be liable to Lloyds TSB Bank plc. and/or its assignees and successors for any costs etc. incurred by Lloyds TSB Bank plc. as a consequence of reliance upon the Monitoring Officer's Opinion Letter (the Side Letter); and
- (i) Agree to delegate authority to the Head of Legal and Democratic Services to finalise the legal agreement, taking into account any minor changes that may be required before the scheme launch;
- (j) Agree to revise the Council's Treasury Management Strategy Statement and Investment Statement to incorporate LAMS as a permitted investment, based on the information set out within this report.

Designation: Director of Finance and the Depute Chief Executive/Director of Housing & Property

Date: 30 April 2013

Author: Brian Porter, Finance Manager

Background Papers: None

## LAMS Risk Assessment

	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 the cash backed scheme it may be prudent for the interest earned on the deposit to be set aside in a ring-fenced reserve to be used to fund future potential liabilities in the event of a default and the indemnity being called upon. For the non cash backed scheme the same point applies to the premium paid by lender to the Local Authority.
F2		Lending to sub prime applicants	Low	Low	Moderate	Use lender's existing credit criteria.	
F3		Applicant affordability	Low	Low	Moderate	Lenders will ensure the mortgage is affordable.	
F4		Costs incurred in the event of the indemnity / guarantee being called	Low	Low	Low	The number of repossessions by first charge mortgage lenders in 2011 was 0.32% of all mortgages (Source – CML website). So one in 300 mortgages may end up in repossession. For 95% LTV mortgages this may be higher, perhaps 1-2%. The cash backed scheme will attract a premium investment return in the region of 2.7% – 4.6% ie each £1m allocated to the scheme will earn £27,000 - £46,000.	No specific statistics are available for first time buyers only. Figures could be refined further to cover local / regional areas. For this purpose, it is assumed the full value of the indemnity / guarantee will be lost in the event of default.  Interest rates can vary and between January and August 2012 have been in the range from 2.7% to 4.6%.
F5		Counterparty Risk	Low	Low	High	Partnership with highly reputable financial institutions for deposits. Ensure compliance with the TMSS.	The deposit made for the cash backed indemnity should not be seen as an investment. Participating Local Authorities may be required to provide a 'financial advance' to the participating mortgage lender (to support mortgages in the local economy) so a decision to participate in the scheme will always be made on a different basis to the usual investment principles. This could be identified in the TMSS.



	Strategic Risk	Key Risk	Risk Rating	Likelihood	Impact	Preventative Measures	Notes
R1	Reputation	Poor publicity / bad press re use of public monies	Moderate	Low	Low	Press Officer to liaise closely with local press. Promotion of benefits of the scheme, i.e. supporting the local housing market and local economy. Good promotional material. Joint working with partners and Estate Agents. Press release / photo opportunity.	Sector / participating mortgage lenders will support the promotional process.
R2		Repossession in the hands of the lender, therefore outside the Local Authorities area of responsibility	Moderate	Moderate	Low	Lender to inform Local Authority if and when an applicant is facing repossession. Local Authority may be able to support individuals to prevent repossession.	Further work is being undertaken to prevent repossessions
R3		Poor publicity / bad press re possible repossession	Moderate	Moderate	High	Is the Local Authority support an issue? Early notice from lender to the Local Authority if action is due to be taken. Local Authority to assess 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 the value of indemnities / guarantees offered.	Sector will support this process and provide monthly management information.
P2		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 / processing of mortgage applications. All management information provided by Sector.	
O2		Housing market fully recovers and the scheme is no longer required	Moderate	Moderate	Low	The scheme will cease to exist. Indemnities / guarantees already granted – for 5 years + a further 2 years if the account is 90+ days in arrears - would remain in place.	Further analysis of local / regional housing issues to be added, i.e. local housing need, house prices, mortgage approvals etc. this information will determine the anticipated life of the scheme.