East Lothian Council

REVISED REPORT

REPORT TO:	Cabinet
MEETING DATE:	8 March 2011
BY:	Executive Director of Corporate Resources
SUBJECT:	Assistance to first-time home buyers in East Lothian

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1 PURPOSE

To consider participating in a scheme to assist first-time home buyers in East Lothian.

2 RECOMMENDATIONS

Cabinet is recommended to

2.1 Note the substantial progress on creating a scheme in partnership with the banking sector, and to note that a launch date is expected soon.

2.2 Approve the following local criteria that officers should seek to have incorporated in the final agreement.

a) All East Lothian post codes should be included.

b) The initial deposit and indemnity limit should be £1million.

c) Current Council and Registered Social Landlord (RSL) homes should be excluded from the scheme.

2.3 Note that an approach to setting a maximum loan value is under development.

2.4 Delegate the finalisation of the agreement to the Chief Executive, Executive Director of Community Services, Head of Law & Licensing and Head of Finance.

3 BACKGROUND

3.1 On 27 October 2009 I reported to Council on a range of new initiatives designed to provide more affordable homes in East Lothian. At that time I recommended that Council should “note progress on developing a low cost method of supporting first-time buyers.”

3.2 In summer 2009, East Lothian Council in conjunction with 3 other Scottish councils and 7 English councils engaged Sector Treasury Services Ltd to develop an assistance scheme to help first-time home buyers. If it could be done, this was seen as a way to use the extensive powers available to Councils under Housing Acts to help people that have fallen victim to the financial crisis of 2008 and consequent constrained mortgage lending onto the home ownership ladder. This would alleviate some demand pressure on social housing, assist in the recovery of the wider housing market and indirectly assist in the recovery of the construction sector of the economy.

The Assistance Scheme

3.3 Having sought partner banks, Councils were pleased that a major UK high street bank responded positively and we have worked with them in developing a scheme that could soon be available in their branches. Once the scheme is up and running it could become nationwide and open to participation by all mortgage lenders depending on the extent to which other Councils and UK mortgage lenders adopt this or similar schemes.

3.4 The scheme is in the final stages of negotiation and for commercial reasons unfortunately I am unable to disclose the name of the bank at this stage.

3.5 The scheme is simple in design, targeting the difficulty many first time buyers have in funding the deposit of around 25% often required when they try to buy their first home. The Council would agree to provide a guarantee for up to 20% of the purchase price so that the buyer would be able to borrow up to 95% of the value of the property, which is rare in the current market, and the interest rate charged will be more favourable than would normally be available to borrowers with small deposits. The Council would make a cash investment with the bank to back-up the agreed overall value of the guarantee, which in effect places an overall cap on the amount of borrowing made in the county under this scheme and the number of borrowers that will be able to access it.

3.6 By applying their current assessment criteria, the bank would ensure that the buyer/s should be able to pay the normal mortgage payments, which will reduce the risk of default. Should the borrower breach the mortgage agreement, then the bank would call on the guarantee and the Council could lose the funds that back the guarantee for that individual mortgage. However, liability under the guarantee will only arise if the property is sold and the bank suffers a shortfall and beyond this scheme the Council has wider legal responsibility to manage homelessness in their area. Should this situation arise, it is likely the Council would consider avoiding a default situation by seeking to purchase the property on a local mortgage to rent basis, which would avert both a financial loss and homelessness.

3.7 The risk of default is currently estimated at 3%. The bank mitigates the financial risk to the Council by paying an interest rate on the deposit set at a premium to the normal commercial rate. The amount of the premium has been calculated to compensate for the estimated liabilities under the guarantee.

3.8 The Council guarantee would expire 5 years after drawdown, although this could extend to 7 years if the borrower is three monthly payments or more in arrears during the final six months of the five year period.

3.9 The bank has now substantially completed its due diligence and I understand that the bank will be ready to launch the scheme soon.

3.10 As this would be a partnership, the general nature of the assistance provided has already been agreed, and there are three main eligibility criteria

(a) Each borrower in relation to the mortgage is a first time buyer (or in the case of joint Borrowers at least one of them is a first time buyer) in accordance with the bank’s standard criteria for determining eligibility for first time buyers.

(b) The loan is for an amount up to a standard financial limit specified by the Council.

(c) The purchased property is in postcode areas specified by the Council.

3.11 There is scope to include further criteria agreed by the Council and the bank and Cabinet should consider what criteria they wish to apply within the Scheme. In general the scheme has the following characteristics:

a) Initially, it will only be available through the bank although this could expand to include all UK mortgage lenders should they so wish to participate in similar schemes.

b) It will be available to purchase a property in the post code area in East Lothian that the Council determines, which means applications can come from anywhere in the UK.

c) As the Council determine the value of the overall indemnity facility that the bank can access for East Lothian, the bigger the value, the more mortgages they will be able to provide. The Council can top up that facility but cannot withdraw funds for at least 5 years. The facility would be used up on a first come first served basis. When the facility is used up, the bank would stop allocating mortgages in East Lothian.

d) The Council can determine the maximum loan value, and therefore can influence who will be most likely to benefit from the scheme.

e) In some restricted circumstances first time buyers can include people who have owned a property with someone else in the past e.g. after a broken relationship.

f) All applicants will be subject to the bank’s normal affordability limits and credit checks.

g) Right to buy properties can be excluded.

h) The bank will not provide mortgages under this scheme for new build or shared ownership / shared equity properties. Other lenders may be more likely to provide this option, so this could be available in the future once we have more lenders on board

i) It is not available for buy to let mortgages.

3.12 Officers have considered what criteria would be both appropriate to East Lothian and likely to be acceptable to the bank, and recommend that we seek the following criteria:

a) All East Lothian post codes should be included

b) The initial deposit and indemnity limit should be £1million, which should be sufficient to support around 40 mortgages.

c) Current Council and Registered Social Landlord (RSL) homes should be excluded from the scheme.

The best way to establish and maintain a maximum loan value for the scheme is being evaluated. The scheme will be of greatest value if targeted at one and two bedroom properties as these have a lower value, which implies a lower guarantee per property and therefore more properties supported from the total indemnity value. However, the value of such properties varies significantly across East Lothian. Whatever approach is adopted, the values will have to be kept under review to ensure that they preserve a link to the housing market that will change over time.

Scottish Government

3.13 The scheme is designed so that it can be used by any UK Council, so this could be an initiative that has national importance. The Scottish Government is aware of the proposed scheme and I have requested their assistance in its development in two respects:

a) Their views on the use of legislative powers have been sought as this provides some assistance to both the Council and the bank in their interpretation of those powers. Independent legal advice has been sought by both parties, and the Council's legal advice is summarised in section 6, but the views of Scottish Ministers remain of significant value, and

b) As explained in section 6, Scottish Ministers can offer significant assistance in helping the Council finance the indemnity.

3.14 Although the scheme design is now well advanced there are some final points to be negotiated and a launch date to be agreed. The timescales for this are unknown and would be best dealt with through delegation to officers. It is recommended that the finalisation of the agreement within the criteria decided by Cabinet should be delegated to the Chief Executive, Executive Director of Community Services, Head of Law & Licensing and Head of Finance.

4 POLICY IMPLICATIONS

4.1 The Scheme provides support for the delivery of housing policy.

5 EQUALITIES IMPACT ASSESSMENT

5.1 This report is not applicable to the well being of equalities groups and an Equalities Impact Assessment is not required.

6 RESOURCE IMPLICATIONS

6.1 Financial – the financial implications of the scheme are unusual and centre on the accounting and financing of the indemnity, and the risk of financial loss arising from borrower default.

6.1.1 In terms of the indemnity, in pure accounting terms this is not expenditure as it is an investment. Revenue income arises from the interest paid on the investment and revenue expenditure would arise should a borrower default and the bank call on the guarantee. However, eventually the invested funds are substantially returned to the Council.

6.1.2 However the accounting framework within which the Council has to work is not as straightforward as this, and there is a risk depending upon the exact nature of the final agreement and operation of the scheme, that the indemnity could be classified as revenue expenditure in the year that it is made, and revenue income in the years that it is returned to the Council. This would mean that the Council would have to make provision to finance the deposit from reserves. As the reserves are already fully committed to support the Council budget over the next three years, this is not the preferred approach.

6.1.3 A better alternative would be to consider whether this could be accounted for under statutory accounting arrangements as capital expenditure financed by borrowing. This is the approach the Council adopted when investing in the provision of housing by East Lothian Housing Association, and a similar approach could apply to this scheme, which is essentially about assisting individuals to acquire suitable housing.

6.1.4 Accounting for the indemnity as capital expenditure is only possible if Scottish Ministers give specific consent to allow that. Therefore I have requested that Scottish Ministers consider providing consent for the Council to account for the indemnity as capital expenditure under legislative provision made in section 1 (2), Schedule 3, Local Government (Scotland) Act 1975. Should consent be received, the Council will have the option of adopting this accounting treatment if that was most appropriate.

6.1.5 As mentioned in section 3, based on the best information I can identify the Council should expect a default rate of around 3%, which suggests that the mortgages supported by a £1million deposit would include 1 or 2 that end in default. The value of each default would depend on the specific circumstances but would probably be in the region of £20-25,000. Of course 3% is an averaged rate and the rate in any one year may be significantly above or below 3%.

6.1.6 In principle, the cost of the default will be met from the premium rate of interest paid on the investment by the bank. However, the Council is not a commercial organisation and would not take such a narrow economics-based view of the scheme. A mortgage default would mean a household losing their home and probably becoming homeless in which case the statutory duties of the Council with regard to homelessness would apply. In managing this scheme, depending on the individual circumstances that apply in each case, it may make more social and economic sense for the Council to buy the property and convert from a mortgage to a rental based occupation of that property. This would both avoid homelessness and the loss of deposit. This is not an arrangement that can be part of the agreement with the bank nor should the Council seek to automatically apply this in all default situations, but it is an option that could be pursued with the homeowners in some circumstances.

6.2 Personnel - none.

6.3 Legal – the Head of Law & Licensing has considered and concluded that Section 71(3) of the Housing (Scotland) Act 2006 provides sufficient statutory power for the Council's participation in the scheme by way of providing an indemnity or guarantee. However, there were a wider range of complicated matters that needed to be considered before such a ground-breaking scheme could proceed. Working closely with the Head of Finance, he sought the views of Senior Counsel, who dealt comprehensively with all the questions Council officers raised, confirmed that the required statutory power was available and was satisfied on all the matters raised in the questions. Therefore, based on Senior Counsel's advice, the Head of Law & Licensing as the Council's

Monitoring Officer is satisfied that the Council's participation is in general terms lawful and intra vires the Council's statutory powers.

7 BACKGROUND PAPERS

7.1 Council 27 October 2009 – "Housing Finance Update"

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