HM TREASURY

Help to Buy: mortgage guarantee

scheme outline

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1 Introduction

1.1 The Government is committed to supporting people who aspire to become homeowners. In recent years, increased deposit requirements and falling equity values have left many hardworking households unable to get onto the housing ladder or trapped in homes unsuited to their aspirations and needs. In today's Budget the Government has therefore announced the Help to Buy package to support a new generation in realising the dream of homeownership. This package includes the introduction of a new mortgage guarantee to enable more households to access mortgages on both new build and existing homes, without the need for prohibitively large deposits.

1.2 Help to Buy: mortgage guarantee will be designed to increase the appetite of mortgage lenders for high loan-to-value lending to creditworthy customers. It will provide lenders with the option to purchase a Government guarantee that compensates them for a portion of their losses in the event of foreclosure. The Government will charge a commercial fee for the provision of this guarantee.

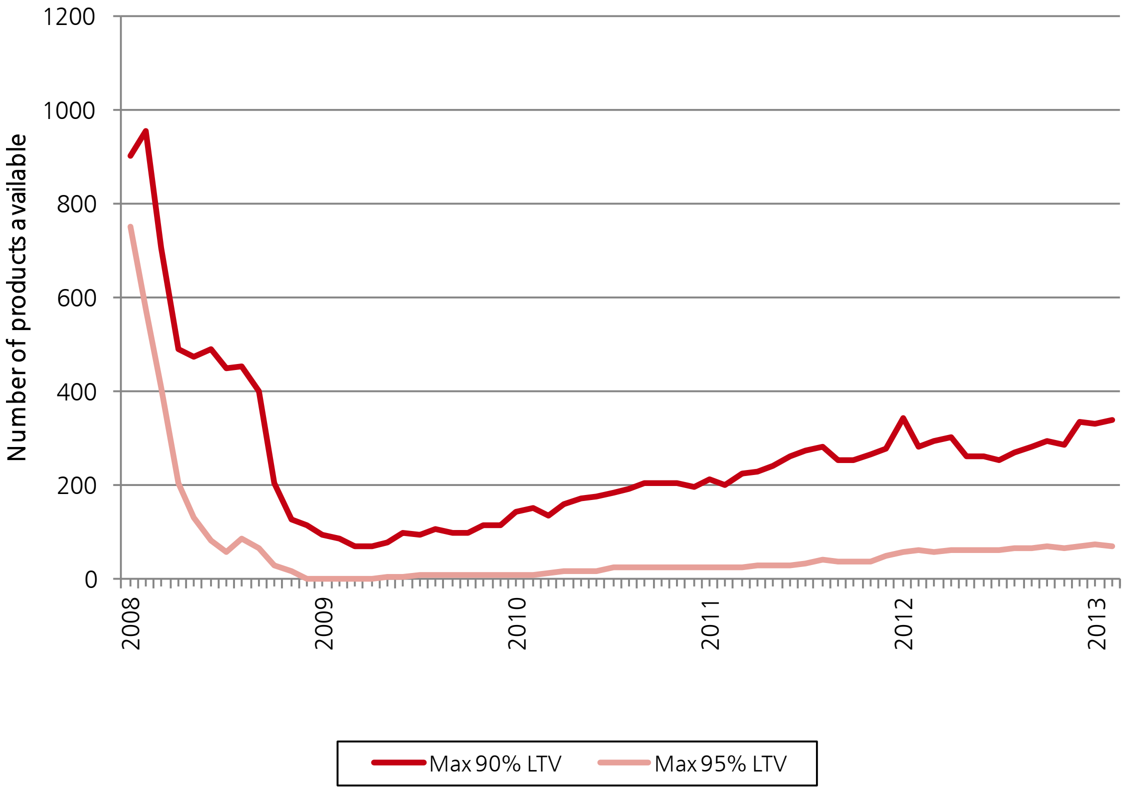
1.3 This technical paper sets out the working assumptions for Help to Buy: mortgage guarantee. These do not represent a final scheme design; this will be developed following further analysis and discussion with industry. The overarching principles of the proposed design are to provide a scheme that:

- is focused on helping borrowers, and is simple for the customer;
- is open to a wide range of lenders;
- is as administratively straightforward for lenders as possible;
- does not incentivise irresponsible lending;
- contains the level of risk being borne by the Government; and
- can be put in place rapidly and effectively.

2 Trends in high loan-to-value lending

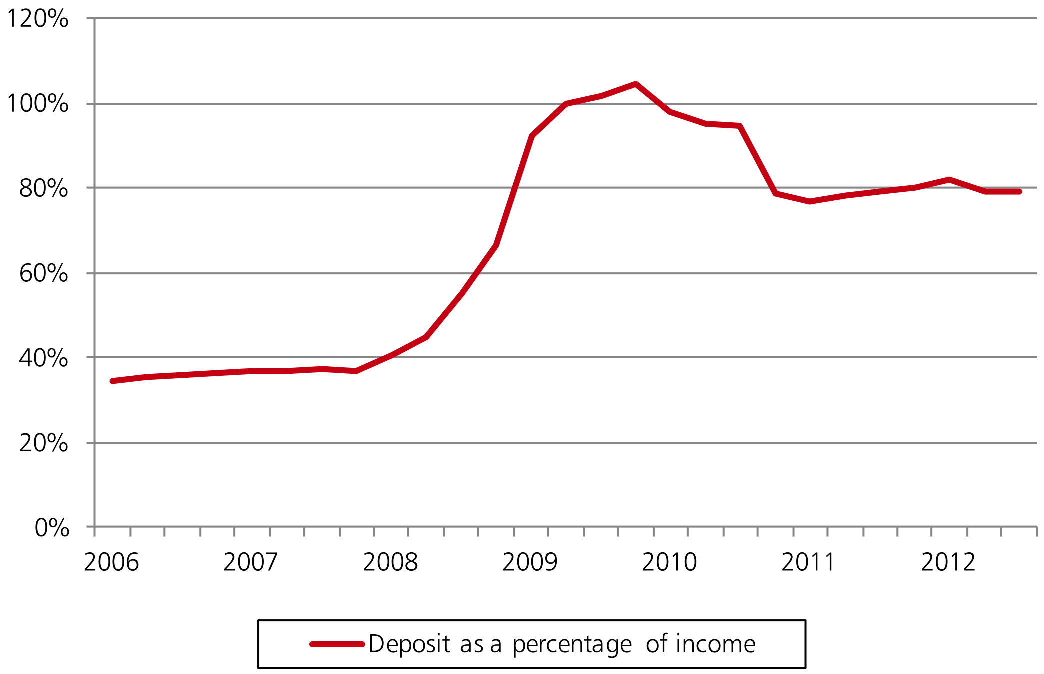
2.1 The availability of high loan-to-value (LTV) lending has seen a sharp reduction in the wake of the financial crisis, as shown in chart 2.A. The reduction in high LTV mortgage availability has been reflected in the increase in the average deposit for a first-time buyer. Chart 2.B illustrates how average deposits for first-time buyers have risen from around 35 per cent of average incomes in 2006 to just under 80 per cent in 2012.

Chart 2.A: Number of high LTV mortgage products available



Source: 'Moneyfacts Treasury Reports UK Mortgage Trends'

Chart 2.B: First-time buyer deposit as a percentage of income



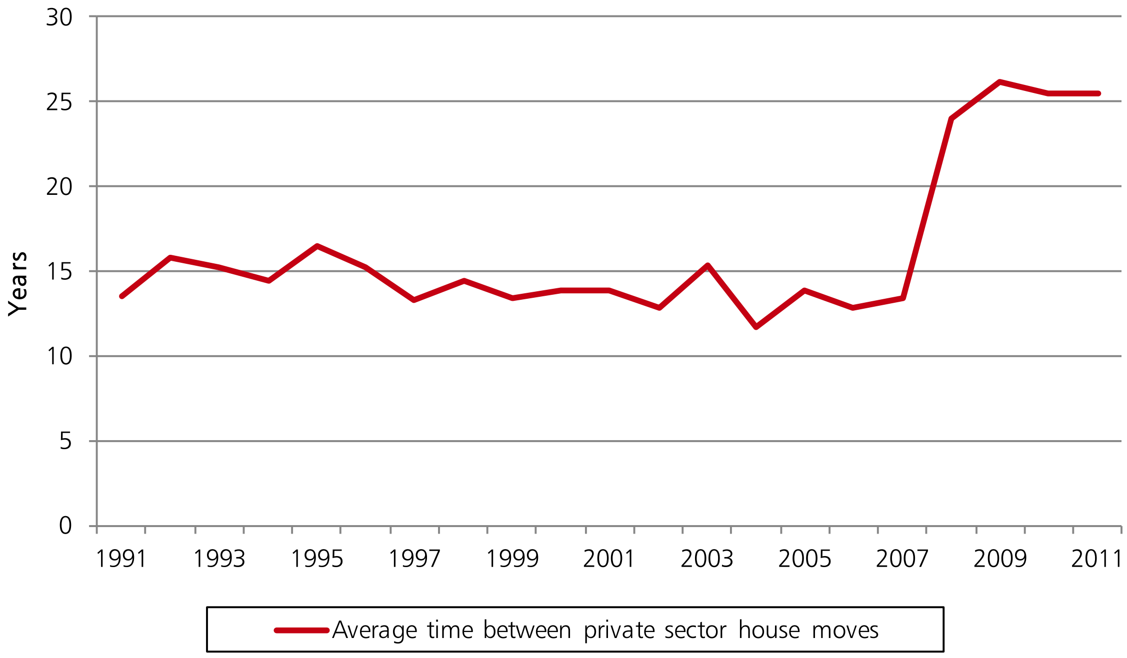
Source: HM Treasury analysis, Council of Mortgage Lenders

2.2 There has been an associated reduction in the number of people buying their first home in the last five years. In 2012 there were 40 per cent fewer first-time buyers than in 2007. Where first-time buyers have been able to get on the housing ladder they are increasingly reliant on support from their parents or relatives. While the median age of a first-time buyer has risen only marginally since 2007, the Council of Mortgage Lenders (CML) have estimated that the median age of an 'unassisted' first-time buyer has risen from 30 to 33.

2.3 It is not just first-time buyers who have been affected by the lack of high LTV lending as the financial system returns to health. Existing homeowners with low levels of equity in their property are also struggling to move or remortgage onto a more competitive offer. In many cases, these frustrated homeowners are looking to climb onto the next rung of the ladder, and their inability to move has limited the number of properties on the market available to first-time buyers.

2.4 These wider trends are reflected in the low number of transactions across the housing market over the last five years. Residential property transactions fell by around 50 per cent after 2007 and have changed little since. Chart 2.C shows that current turnover rates are equivalent to houses selling, on average, once every 25 years, compared to once every 15 years before the crisis. This trend is unlikely to be consistent with a well-functioning housing market.

Chart 2.C: Average time between private sector house moves



Source: HM Treasury analysis, HM Revenue and Customs (HMRC), Department for Communities and Local Government (DCLG)

2.5 Government action is already helping address these problems. The Funding for Lending Scheme (FLS) was announced in June 2012 and allows banks to obtain funding from the Bank of England in order to lend on to non-financial businesses and households. Bank funding costs have dropped markedly since the FLS was announced, reflecting both the impact of the scheme and wider global developments. This has been reflected in the prices and availability of loan products to UK households. Recent statistics from the CML show that January 2013 saw the best start to a year for mortgage lending volumes since 2008.

2.6 The Help to Buy package announced today will build on this momentum, with a particular focus on high LTV lending, and will facilitate the readjustment of the market following the financial crisis.

3 Help to Buy: mortgage guarantee

3.1 The Government has developed an outline of its model for a mortgage guarantee as part of the Help to Buy package. This outline design is set out below and will form the basis of further discussions with industry, regulators, consumer groups, and other interested parties. A final and detailed scheme design will be developed following these discussions.

Scheme mechanics

3.2 The Government will provide lenders with the option to purchase a guarantee on the top-slice of the mortgage. In other words, the Government will compensate the mortgage lender for a portion of the net losses suffered in the event of repossession. The guarantee will apply down to 80 per cent of the purchase value of the guaranteed property.

3.3 The guarantee will compensate lenders for the same losses and reasonable costs that the lender is entitled to recover from the borrower, in the event of foreclosure. The definition of 'reasonable costs' is set out in the FSA's Mortgage Conduct of Business (MCOB) rules. The MCOB rules explain that lenders are entitled to recover a reasonable estimate of the cost of the additional administration required as a result of the customer being in arrears or having their home repossessed. It precludes lenders from imposing charges in order to increase profits or offset costs from other parts of the business, however.

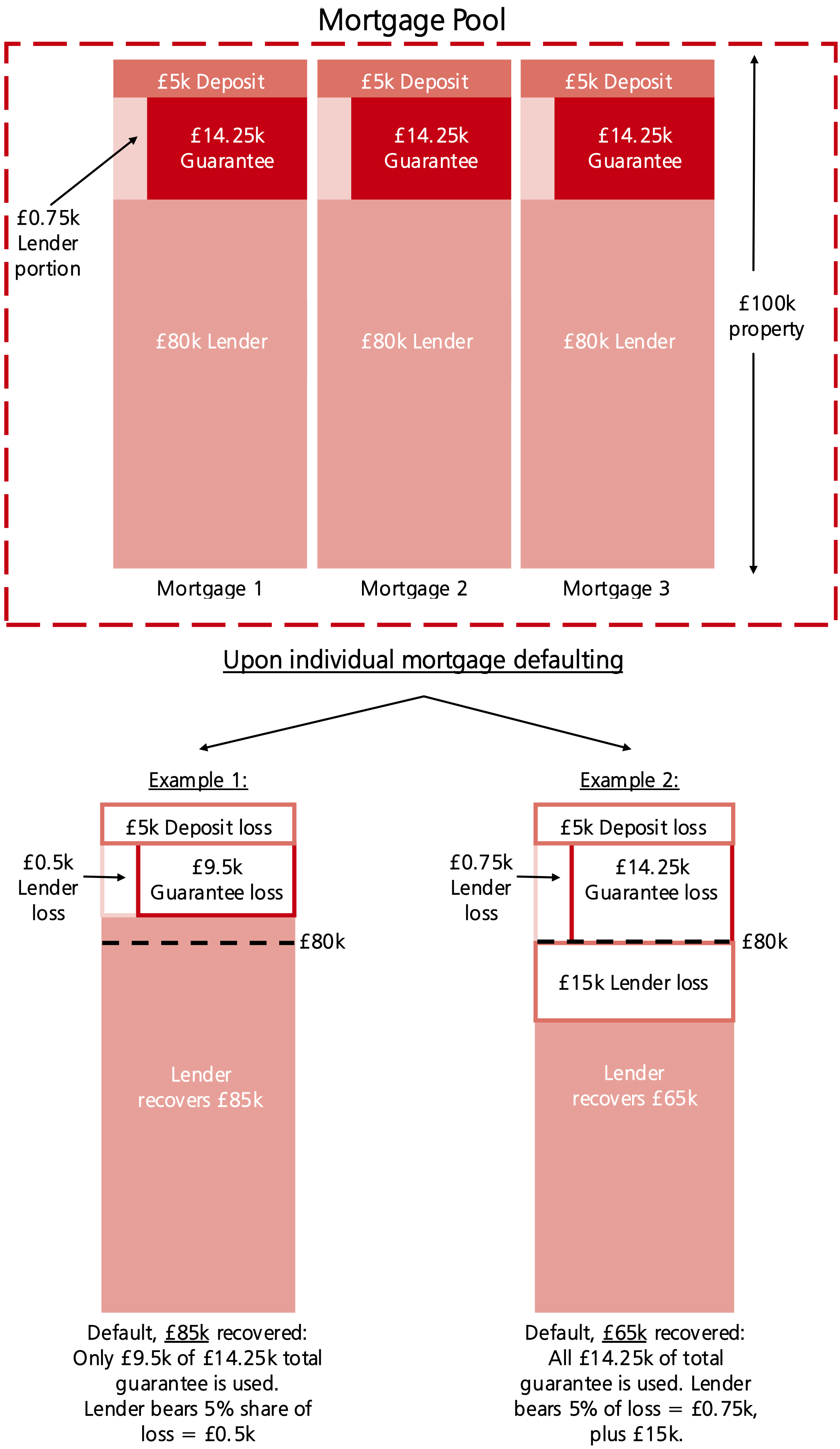
3.4 Lenders will also take a five per cent share of net losses above this 80 per cent threshold. This will help to ensure that lenders are not incentivised to originate poor quality loans.

3.5 The guarantee will be valid for up to seven years after the mortgage is originated, as is the case with the existing NewBuy scheme. Evidence shows that loans are unlikely to default after such a period has elapsed. Furthermore, a mortgage taken out on a repayment basis would normally have paid down sufficient capital after this time so that the borrower's equity stake would be greater than 20 per cent, meaning that the guarantee would effectively no longer offer any protection.

3.6 Each lender will pool the loans that they wish to place in the scheme and the Government guarantee will be applied to that pool. A cap, expressed as a proportion of the overall pool size, will apply on the total level of guarantees provided to each pool. This principle is also in line with the NewBuy scheme.

3.7 Chart 3.A below provides an illustration of this mechanism.

Chart 3.A: Illustration of scheme mechanism



Mortgage eligibility

3.8 The scheme is designed to help creditworthy households struggling to save for the high mortgage deposits required by lenders in the current environment. For this reason, a mortgage eligible for a guarantee under the scheme will need to:

- be a residential mortgage, and not buy-to-let;
- be taken out by an individual or individuals rather than an incorporated company;
- be on a property in the UK with purchase value of £600,000 or less;
- have a loan-to-value of between 80 per cent and 95 per cent;
- be originated between the dates specified by the scheme;
- be a repayment mortgage, and not interest-only; and
- meet certain minimum requirements in terms of the assessment of the borrower's ability to pay the mortgage, for example a loan-to-income and credit score test.

3.9 The scheme will also be designed to ensure that lenders cannot use the Government guarantee to restructure the riskiest part of their existing loan book, and that borrowers remain the beneficiaries of the intervention. For that reason there will be some types of remortgage transactions that will not be eligible for the scheme. In particular, a lender will not be able to access the scheme when a borrower is remortgaging a loan which is already part of the lender's existing loan book. A borrower remortgaging with a new lending institution would, however, still be able to benefit from the scheme.

Lender eligibility

3.10 The scheme will be open to any lender that has a permission under the Financial Services and Markets Act to enter into regulated mortgage contracts in the UK.

3.11 There will also be lender-level limits to scheme take-up. These are likely to be linked to lender size.

Scheme duration

3.12 The scheme is intended as a temporary measure. It will be open from January 2014 and will run for three years. This is in line with the Government's view that the current scarcity of high loan-to-value lending is primarily a cyclical issue rather than a symptom of a longer-term structural change in the mortgage market.

Commercial fee

3.13 Lenders will need to pay the Government a commercial fee for each mortgage in the scheme. This fee will be set so that the scheme is self-financing, and lenders will therefore need to compensate the Government for:

- expected losses under the scheme;
- the cost of capital of providing the guarantee; and
- the administrative costs of the scheme.

3.14 The fee will be subject to regular review, so that it can reflect any changes to the components above. There is likely to be differentiated pricing for the fee at different loan-to-value brackets, to reflect the varying levels of risk mitigation offered by the scheme according to the mortgage loan-to-value.

3.15 The timing of the fee, and in particular whether it will be charged up-front or on an annual basis, will be determined following more detailed discussions.

Scheme administration

3.16 The scheme will require an administrator to manage the regular calls on the Government guarantee. The administrator will play a key role in designing and establishing the systems and processes for implementing the scheme. In due course the administrator will also be responsible for managing both applications from lenders and the fee collection and claims processes. There will also be appropriate due diligence and monitoring processes.

State aid

3.17 The Government believes that this scheme will fall outside the State aid framework.

Scale of scheme

3.18 There will be a cap on the size of the Government's contingent liability under the scheme. However, it is not envisaged that this cap will be set so as to constrain the ability of lenders to access the scheme. The Government's initial analysis suggests that a cap of £12 billion would be appropriate, although this is highly dependent on final scheme design and take-up. The size of the Government's contingent liability will therefore be kept under review as the scheme detail is finalised.

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This document can be found in full on our website: http://www.hm-treasury.gov.uk

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