

Local Authority Lending

intelligent financial software

Introduction

From a few murmurs in the summer of 2008, to a significant call to action from the Local Authorities themselves through the New Local Government Network think-tank, the return to Local Authority mortgage lending has gained speed.

Government is strongly encouraging the process, not least by lowering the minimum interest rate available to Authorities, allowing them to be competitive in the market.

What does this mean for the market and how Local Authorities can move ahead?

Phoebus Software considers recent events and likely outcomes.

Arthur Woolard,

Director, Phoebus Software Limited



Background

In the past, Local Authorities traditionally met the need for the less standard mortgages from their residents, enabling the general improvement of privately owned housing in their constituencies. This gave them a direct influence on the renewal of housing in less well regarded locations. However, changes in legislation, expansion of the mortgage lending market with Banks entering the traditional territory of the Building Societies and the later emergence of a raft of specialist lending companies, all contributed to the withdrawal of Local Authorities from the scene.

In the last 18 months, the more liberal mortgage lending niche, once occupied by Local Authorities in the 1960's and 1970's, and subsequently taken on by the mainstream lending community, has become vacant. Today, mainstream lenders are looking to lend only on the 'prime of prime' cases.

There is a real risk that all the years of housing improvement in less advantaged areas, brought about by broader lending policies, will be eroded. A return of the Local Authority as mortgage lender has become most desirable, if not essential.

The momentum behind Local Authority mortgages

In the period leading up to the early 1980s, Local Authorities were a major mortgage provider, typically lending to residents who often borrowed 100% of the value of their property over 25-years. In 1980 there were 600,000 borrowers with local authority mortgages, around 16% of the market. Local Authorities were very focused on lending to residents who were not, for one reason or another, able to get a mortgage from a mainstream lender, and were often lending for purposes that achieved property improvement in housing areas that might otherwise become disadvantaged.

continues...

Background

The value of new UK mortgages completed in December 2008 was £9.8 bn, a fall of 19% from £12.1 bn lent in November (itself a 43% fall from December 2007's total of £17.3 bn), and Government encouragement of the mortgage lending community to recommence lending in any significant volumes has had little immediate impact.

	Number of house purchase loans	Value of house purchase loans (£m)	Number of remortgage loans	Value of remortgage loans (£m)
December 2008	32,000	£4,300	40,000	£5,500
Change from November 2008	-5%	-7%	-26%	-26%
Change from December 2007	-49%	-55%	-33%	-29%

(Source: CML)

In the Summer of 2008, Local Authorities began to talk of a return to the market, and by the end of the Autumn the momentum of these considerations had grown. The New Local Government Network think-tank Director, Chris Leslie, called on councils to take a lead role in protecting communities from the impact of the credit crunch. In a speech to senior local government leaders, he outlined a number of areas where local authorities could intervene, including measures to provide local authority mortgages.

At the start of 2009, the Northern Rock's repayment schedule of Government capital was relaxed, in order that, as the Chancellor, Alistair Darling, told us:

continues...

Background

"It is right for them to maintain their lending in the housing market." He added that the decision was made in a climate when, "You're facing the departure of foreign- based banks and some of the smaller building societies are not going into too much lending".

This was swiftly followed, on the 22nd February, by an announcement that Northern Rock was to revive its mortgage business with up to £14bn in new loans by 2011.

Around the same time, the housing minister, Margaret Beckett, was understood to be considering resurrecting schemes last seen in the mid-1970s, when local authorities played a major role in the mortgage market. Officials were said to be exploring schemes to help buyers shut out of the market by banks and building societies no longer offering loans above 90% of the value of a home.

The government was clearly paving the way for local authorities to offer low-cost mortgages to first-time buyers and others struggling to obtain loans from traditional lenders demanding large deposits.

At the beginning of February, the Housing Act 1985 regulation changed to lower the Standard National Rate - the key rate set by law that controlled the lowest mortgage rate Local Authorities could offer on the market. This rate was dropped to 3.95% from 5.07%.

With Local Authorities able to leverage an Aaa credit rating, allowing them to raise funds at rates better than the recently down-rated traditional lenders (for example Lloyds/HBOS, RBS and Barclays are now rated Aa3), the stage was set for a significant renaissance of the Local Authority as a mortgage lender.

continues...

Background

The momentum behind the move of Local Authorities back into mortgage lending is already considerable and is gathering pace. It has been generated by Government policy, is attracting all-party support and has been championed by the local Authorities themselves.

This represents a 'call to arms' for the Financial Services Sector as a whole and an invitation to suppliers of mortgage know-how, technology and operational capacity, in particular, to participate in the re-birth.

A role for Local Authorities as mortgage lenders

While the Government continues to concentrate on encouraging mainstream retail lenders to resume a mortgage lending service, the door has been clearly opened to let Local Authorities back into the market. The question is, on what basis would Local Authorities feel comfortable as mortgage lenders in their communities?

The general theme emerging is, not surprisingly, one of Local Authorities seeking a community based, ethical lending policy which serves to protect home ownership and occupancy. There would be little appetite for repossession, more likely would be the adoption of shared ownership and buy and rent-back strategies to support borrowers experiencing payment difficulties.

A well-rehearsed theme of Government and the mortgage lending community has been to help first time buyers into a market. In the past they had been hampered by excessively expensive purchase prices, and now, with prices falling, they remain disadvantaged by an insistence on high deposits as lenders rein in high ratio loan-to-value products. First time buyers remain the driving force behind a healthy housing market, their long term exclusion will guarantee the current slump will continue.

Add to first time buyers the key workers in a community, often similarly disadvantaged, rarely the highest paid and frequently in Local Authority employment. This group too struggles to buy homes, and offers the opportunity of community based lending which not only supports and protects the community, but also sits squarely behind the national effort to reinvigorate the housing market.

Local authorities have a role to play in the reinvigoration of our national housing market, whilst lending on a highly ethical basis for the benefit of their own communities.

Solutions to be sought

There is a growing enthusiasm from Local Authorities to re-enter the UK mortgage markets in their respective regions, however, they have no real infrastructure, either physical or human, to sell, hold and administer mortgages. For this, in summary, they require:

- A business plan, business model, and lending model to meet the specific needs of the Local Authority. This will define the terms under which lending will be conducted and the scope and disposition of operation needed to support it.
- A corporate entity to hold the balance sheet upon which the mortgage assets would reside.
- Registration of this corporate entity with the FSA for the purposes of compliance with its MCOB (Mortgage Conduct of Business) regulations.
- An operation with supporting technology to manage:
 - Mortgage selling.
 - Mortgage underwriting.
 - Mortgage lifetime servicing.
 - Enterprise command and control (including such key functions as Risk Management and Treasury Services).

At the high-level this is a straightforward list and there are four general routes to securing the items it contains.

These routes each require an FSA registered corporate entity to be set up by the Local Authority: in summary they are:

- The in-house build of a lending operation (human, physical and technological).

continues...

Solutions to be sought

- A drains-up exercise with all the associated entry, ownership (and exit) costs.
- The Local Authority as a direct employer of a full complement of specialist staff but leveraging some common services from within their existing organisation.
- An out-sourced solution using one of a number of third-party mortgage service providers available in the UK
 - A contractually driven service level agreement, delivering a solution that removes a large part of the logistical burden of mortgage origination and servicing from the shoulders of the Local Authority.
 - The Local Authority would still own and run significant command and control functions not contracted away to the third party servicer.
- A similar solution to the out-sourcing solution, but with a Local Authority providing the service provision specifically designed to support other Local Authority mortgage lenders: delivering a powerful solution with significant economies of scale.
- A mixture of in and out-sourced elements. For example, the Local Authority retaining sales and underwriting, but out-sourcing the lifetime management of the mortgage book.

Propositions must be modular to allow Local Authorities to adopt complete, turn-key solutions or retain operational control as they see fit, but must also provide enveloping consultancy to help them to arrive at the solution that is right for each individual Authority.

The challenge of delivery

We can clearly see that Local Authorities becoming mortgage lenders will require solutions that involve complex interweaving of corporate, regulatory, operational and technological elements. Their effective delivery will require networks of consultancy, suppliers and operational partnerships: to identify suitable parties and bring these together is a major challenge. It is important to realise that a solution for one Local Authority may not suit its peers. And, it is even more pertinent to bear in mind that any LA embarking on such a project, needs to be confident in the successful delivery of its objectives. With the negative press surrounding banks, LA's must ensure they chose their lending partners wisely.

We see spaces in these networks for:

- Consultancies with specialist knowledge of both the Mortgage market and lending operational arenas, offering overall management services for the formation of lending businesses to suit the needs of Local Authorities.
- FSA regulation specialists.
- Technology suppliers and software houses, with a proven track record in the mortgage market, to supply and tailor systems.
- Mortgage Consultancy experts, able to determine and implement the required business processes in Local Authorities.
- Providers of processing solutions (Third Party Outsourcers) who can wrap technology and operational solutions into a single proposition.

What next?

As the encouragement to Local Authorities to enter the mortgage market from Government grows, and as Government controlled lenders such as Northern Rock are propelled back into lending, the expectation for rapid action also grows.

In the immediate future we should expect a number of established third party service providers to be very active in opening conversations with Local Authorities.

It is also highly likely that new entrants into service provision will appear, looking to provide highly Local Authority-specific solutions. There is potential to use spare operational capacity in the specialist lender sector, so badly hit by the current downturn, with technology partners available to supply systems to order.

One distinct possibility is a single Local Authority, or a small group of like-minded Authorities, forming a lending organisation which can be made available to all Authorities. Such a new venture would seek strategic partnerships with a range of consultancy and technology suppliers.

Conversations are opening, now, between numbers of the interested parties to this new enterprise: suppliers of mortgage know-how, technology and operational capacity; Government, local politicians and local authority departments.

The next three months will be crucial to the success of the rebirth of Local Authority mortgage lending and success will come to the best partnerships being initiated now.

About Phoebus Software

Phoebus Software is a lending and deposit software provider supporting a range of clients from Top Ten Lenders to start-up enterprises. Phoebus Software, its partners and associates offer a full mortgage business consultancy service based around industry recognised subject matter experts who collectively offer many years senior experience in mortgage lending businesses.

For over 20 years, Phoebus Software has enjoyed a powerful track record of success, demonstrating a culture of innovation and responsiveness. Success that has seen us maintain an annual compound growth in excess of 35% throughout the last decade, with recognition of this in the rankings of the Sunday Times Microsoft Tech Track 100, and Deloitte Technology Fast 50 (UK) and Fast 500 (Europe). Today, Phoebus Software continues to be self-funding, consistently making profits to allow significant reinvestment in research and development.

Phoebus Software has a genuine, deep understanding of the savings, loan and mortgage markets, based both on direct past experience and current, leading edge involvement. We understand the pressures and demands of the industry and thrive on its varied challenges.

To find out more about Phoebus Software or the content of this White Paper, you can visit our website:

www.phoebussoftware.com

Email Arthur Woolard at:

Arthur.Woolard@phoebussoftware.com

Or call us on:

+44 (0)845 618 7070

