Promoting mortgage access

for affordable housing

A joint good practice note issued by the Chartered Institute of Housing and the Homes and Communities Agency

Overview

Mortgage availability is likely to be restricted, in comparison to recent years, for the medium term. Affordable home ownership options can support those otherwise unable to afford an appropriate home into sustainable home ownership. There are a number of steps that can be taken by local partners to improve opportunities for affordable home ownership in local communities.

This good practice note shares the experience members of the Chartered Institute of Housing working in a variety of different organisations and of the Homes and Communities Agency (HCA) in working with retail mortgage lenders, local authorities and providers in the delivery of affordable housing to customers. It offers advice on how to maximise the mortgageability of all types of affordable home ownership properties planned by local authorities to meet the needs of their local areas.

It does not prescribe an approach which local authorities should take, as it is important that they undertake one which is locally appropriate. It does however highlight issues that can act as a barrier to delivery; ways of dealing with these issues; and offers local authorities that request it, further HCA support.

The note explains the benefits of simplicity and consistency in terms of products, operation and language in clauses irrespective of whether a property is grant funded by the HCA or delivered through planning obligations and providers resources alone. It also explains how to minimise the impact of local occupancy rules on the mortgageability of homes through the appropriate use of clauses ('cascades') which widen eligibility over time, leading to general marketing within a typical period of three months.

Background

1. This note has been produced by the Chartered Institute of Housing (CIH) and the Homes and Communities Agency (HCA) in response to requests from a number of housing professionals, local authorities, retail mortgage lenders and providers of affordable housing. It is intended to raise awareness within local authority housing and planning departments of the issues faced by retail mortgage lenders when providing mortgages for affordable home ownership. The issues raised are equally applicable to conditions that may be applied by local authorities as part of s106 agreements or through planning conditions (e.g. on rural exceptions sites or to achieve other planning policy aims). The note covers both new provision of affordable home ownership and the amendment of previous agreements, to assist in re-sales. It is hoped that the general messages will also be of assistance to housebuilders and providers of affordable housing.

2. In the past greater liquidity in the mortgage market meant that many retail mortgage lenders were prepared to lend on homes that were subject to a wide range of conditions. This is no longer the case. Lenders are now taking

a more cautious view towards properties that are subject to certain conditions or restrictions. From the extensive engagement that the HCA has carried out with retail mortgage lenders it is clear that the predominant business model is one of high volume and low margins that cannot easily accommodate variation. Consideration of current market lending practices needs to therefore form an integral part of the whole planning process in order to maximise mortgage availability for prospective customers.

3. Local authorities may, where affordable housing is scarce, seek to address the needs of the local community by enabling affordable housing for households who are either current residents or have an existing family or employment connection, whilst also ensuring that these areas continue to develop as sustainable, mixed, inclusive communities. The mechanism for the delivery of such aims should be carefully considered to ensure that a mortgage can be secured against the properties once completed. This note is designed to enable local authorities to deliver against these local ambitions.

4. The Council of Mortgage Lenders (CML) issued a briefing note in 2009 (click here) that outlined the issues faced by retail mortgage lenders and offered suggestions of good practice for local authorities to aid mortgageability. This has been promoted by the CIH to its members and by the HCA when working with local authorities to identify local investment priorities. This good practice note complements the CML briefing by highlighting key messages that can be put into practice when delivering affordable home ownership.

Current lender position

5. In order for a property to be mortgageable with high street lenders any conditions placed upon homes will need to be in accordance with their published guidance to conveyancers. Such guidance can usually be found on lenders' websites and three issues in particular are important to consider:

    I. *Retail mortgage lenders require the property to be able to be sold within a reasonable length of time*. - In areas where there is a need to restrict the occupancy of properties this can be achieved through the use of a 'cascade'. Lenders' requirements differ but an optimal cascade will generally operate over three months and no lender will offer mortgages to purchasers on properties involving a cascade that exceeds six months. Limiting this timescale also benefits purchasers of LCHO, particularly those who need to sell their home due to financial difficulties.

    II. *Any restrictive covenants need to be flagged at the earliest possible stage* – It is helpful if lenders and purchasers are made aware of any restrictive covenants, including any potential difficulties, early in the sales/nominations process. This could be flagged by the local authority and/or the affordable housing provider. This will reduce problems that could occur with mortgage lenders at a later stage in the sales process, reducing the potential for surprises for both purchasers and vendors.

III. *Retail mortgage lenders require a Mortgagee Protection Clause for shared ownership* – The HCA model lease contains such a clause, recently updated, which must be used in all HCA-funded shared ownership. Lenders will not accept a new lease without this clause in place, even if it is not grant funded. Under the Mortgagee Protection Clause, losses that may reasonably be incurred by the lender through repossession of a shared ownership property are covered by the provider. The Mortgagee Protection Clause is different from a Mortgagee in Possession clause which is covered below.

Specific restrictions affecting mortgage availability

6. Through a number of recent discussions retail mortgage lenders have highlighted further concerns to the HCA, namely:

    a. *Provisions that restrict value with reference to something other than open market value* – These are not currently supported by retail mortgage lenders. Examples given include values that are fixed at a multiple of local wages or that rise fall in relation to certain chosen indices. The lender requires the realisable value of their security to be based upon the specific value of the property they are lending upon. The lender must be able to instruct its surveyor to value the property on the basis of open market value.

    b. *Considerable complexity in drafting clauses* – Is likely to lead to retail mortgage lenders refusing to support schemes. Examples given include cross-referral to other documents including multiple appendices, the use of non-standard agreements and difficulty in identifying which restrictions apply to which properties. The conveyancer will be asked to check as part of their general undertaking that the lender's requirements are being met by the document. Any doubt in this is likely to result in the withdrawal of the mortgage offer. A s106 agreement which is clear as a stand-alone document can help to avoid such difficulties.

    c. *Mortgagee in possession clauses* – These are clauses that allow a (commercial or retail) lender who has repossessed the property to operate free of restrictions which are placed upon individual properties. These are required by commercial lenders and an increasing number of retail lenders. Many local authorities allow these clauses to be activated immediately, recognising that repossessions are an extremely rare event. In order to be accepted by a lender any time limit set will need to be three months or less. Such a clause does not solve all the issues outlined in this note; therefore these issues still need to be considered, even when a Mortgagee in Possession clause is included.

How does this affect your local area?

7. From our experience it appears that these issues are most effectively addressed by local authorities who consider the mortgage market throughout the planning process and address the issues holistically. We believe that there are four key points in time when consideration of the mortgage market in planning for affordable housing will be particularly beneficial.

    I. *Formulating planning policy* – Most local authority planning policies set out the percentage requirements for affordable housing that will be sought, based on viability and need. This provides the framework for the facilitation of developer contributions to affordable housing. If local authorities are seeking to specify policy beyond these requirements (e.g. in relation to local occupancy or incomes) then they are likely to benefit from consideration of issues outlined in this note, particularly those in relation to product type and cascades.

    II. *Pre-application discussion* – Many local authorities have standard requirements for affordable housing which are set out in pre-application check-lists to speed-up the planning process. Where these specify provision of affordable home ownership brief coverage and/or explanation of the issues in this note is likely to be of benefit. Pre-application discussions may also be an appropriate point to ensure that the applicant/provider fully understands how the mortgage market can impact on the provision of affordable home ownership.

    III. *Determining a planning application* – Agreement of heads of terms at an early stage, giving consideration to the issues highlighted in this note, in relation to the provision of the affordable housing will help to avoid subsequent problems with the availability of mortgages.

    IV. *Drafting the s106/planning conditions* – The prior agreement of the heads of terms should render this task a relatively simple one. To further assist local authorities in this we have included some examples of clauses that retail mortgage lenders have highlighted to us which would prevent them from lending on a home at annex one of this note.

Good practice for the future

8. *Nominations agreements* – Some local authorities prefer to use nominations agreements with the provider of affordable housing rather than placing restrictions on specific properties to ensure appropriate occupancy. The HCA model shared ownership lease contains a clause that before selling any owner must first offer the property back to the provider. If such a process is tied in with a local authority nominations agreement then it can ensure appropriate occupancy without imposing a condition which would affect a retail lender.

9. *Variations to existing planning obligations* – Local authorities may also wish to carry out variations to historic schemes whose restrictions render the properties subject to them unmortgageable. Local authorities may be alerted to such problems upon first-sale or upon a subsequent resale. In both cases variation to bring the restrictions into line with current good practice will be beneficial to individual purchasers and their communities. Where such revisions take place it will be helpful to, as far as possible, cover all of the affected homes in one exercise. Difficulties in relation to understanding multiple revisions are often reported as an issue in this area for lenders.

10. *Product type* - To maximise the chances of obtaining mortgages secured on affordable home ownership properties, local authorities will benefit from specifying tenures that are clear and simple or, as some local authorities do, simply specifying the tenure as 'Intermediate affordable housing' (or similar) to give flexibility for future provision. Where products are specified these could be in line with the standard HCA products, noting that the HCA has recently produced a simple standard shared ownership lease (mentioned above). HCA standard products are well understood and supported by lenders but their use does not mean that every property has to be funded by the HCA. Many local authorities are able to deliver affordable home ownership that meets the needs of their local areas through planning obligations and provider resources alone, without the need for additional government subsidy. The HCA is keen to support such provision and consideration of the issues within this note will help enable delivery.

11. *Cascades* – Where there is a need to place restrictions on the future occupancy of affordable homes, this can be achieved through a clear and time-limited cascade of typically three months. A cascade initially restricts marketing of a property to qualifying purchasers within a very small local market and gradually widens the net. At the end of the cascade period, if an appropriate offer has not been made, the property can be sold to any purchaser on the open market, or the local authority or provider can agree to buy the property back. In order to be effective the cascade should be time-limited, commencing at the start of the sales process, and clearly allow that if no qualifying purchaser can be found the lender is able to realise their security within a maximum of six months. It is important to note that a number of retail mortgage lenders require a maximum of three months making this an optimum time-limit which will result in a wider choice of mortgage providers, delivering greater choice for local people. Such a mechanism protects the property to ensure that, where there is demand, it will remain as affordable in perpetuity but also ensures that the lender has access to an asset whose value can be realised.

12. *Nominations agreements* – Some local authorities prefer to use nominations agreements with the provider of LCHO rather than placing restrictions on specific properties to ensure appropriate occupancy of affordable homes. The standard HCA shared ownership lease contains a clause that before selling

any owner must first offer the property back to the provider. If such a process is tied in with a local authority nominations agreement then it can ensure appropriate occupancy without imposing a condition which would affect a retail lender.

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Further support

14. In addition to the strong and ongoing relationships built by HCA local teams with local authorities and the support offered by the CIH to its members, the HCA intends to carry out further work with a wide range of stakeholders, to improve awareness and understanding of the mortgageability of affordable home ownership properties. If there is sufficient local appetite this could include working towards the creation of standard clauses that work for local areas and retail mortgage lenders. It will also involve consideration of the wider intermediate market, not simply those properties which the HCA has funded.

15. Some independent mortgage advisors have extensive experience and knowledge of the mortgage market and may be able to provide interested local authorities with valuable insight. Local authorities interested in accessing this advice can contact the HomeBuy Agent for their area who will have a panel of experienced independent mortgage advisors.

16. The HCA is also keen to work with local authorities to see what further support could be beneficial. We are already engaged in pilot partnership discussions with a number of local authorities to assist the provision of mortgages in their area and are ready to work with others who invite us to do so. Local authorities, or other partners, who would like to invite the HCA to work with them or would like to provide any feedback on this note can e-mail HomeBuy@hca.gsx.gov.uk

Conclusion

17. Local authorities, developers and affordable housing providers are encouraged to carefully consider this note before entering into a Section 106 agreement that places a restriction upon affordable homes for sale. At all times an approach that ensures simplicity and consistency will be beneficial.

18. The support of retail mortgage lenders is necessary to ensure that affordable home ownership is available to those who need it. Local authorities who have developed an understanding of the mortgage market and have been willing to be flexible in the pursuit of their aims have found success in planning for affordable homes for their residents and communities.

Annex One – Clauses rejected by retail mortgage lenders

The following clauses give examples of drafting that has been rejected by retail mortgage lenders, along with some explanation.

'Low Cost Home Ownership Units – 5% of the total Residential Units which shall be sold to Qualifying Purchasers at a price which shall be no more than two times the Average Local Income' – This clause does not use open market value to determine the value of the property and would therefore be rejected by a retail mortgage lender.

'Low Cost Home Ownership Units – 5% of the total Residential Units which shall be sold at a discount of 20% of Open Market Value'– This clause utilises a non-standard affordable home ownership product in that it fixes a discount to the property. Only two retail mortgage lenders will lend where such a restriction is in place and the presence of additional conditions as outlined in this note will usually prevent them from lending. Recasting the unit as shared ownership would allow a much greater choice of lenders.

'Qualifying Purchaser – A person who has lived in xxxxxx Parish continuously for at least ten years prior to time of purchase' – This clause presents a very narrow restriction on who the properties can be sold to and would therefore be rejected by a retail mortgage lender. If the local authority wishes to target such a group then they could utilise a cascade which would also allow marketing to a wider group if insufficient purchasers could be found in initially identified group.

'Cascade – Providing that the vendor can provide evidence that every Qualifying Purchaser is not willing to purchase the Low Cost Home Ownership Unit and a period of six months has elapsed then the Registered Provider may market the Low Cost Home Ownership Unit to any purchaser who meets the eligibility criteria of the Homes and Communities Agency' – This is an example of a cascade, which would itself normally address problems of a narrow restriction on occupancy. Unfortunately in this example the process is involved and would be difficult to complete within the time-period. It would therefore be rejected by the lender. In order to be effective, rather than specifying a process, a cascade should use a time period as the reference point. An optimal time period, as it is accepted by all lenders, is three months rather than the six months shown in this example.

'The mortgagee shall prior to seeking to dispose of the Affordable Housing Units pursuant to any default under the terms of its mortgage or charge shall give not less than nine months' prior notice to the Council of its intention to dispose' – This is an example of a mortgagee in possession clause which releases the mortgagee from the restrictions placed on the affordable housing units. The time-period after possession is too long and therefore would be rejected by a retail mortgage lender. Many local authorities allow these clauses to be activated immediately, recognising that repossessions are an extremely rare event. In order to be accepted by a lender any time limit will need to be set to three months or less.

The Chartered Institute of Housing (CIH) is the professional body for people involved in housing and communities. We are a registered charity and not-for-profit organisation. We have a diverse and growing membership of over 22,000 people – both in the public and private sectors – living and working in over 20 countries on five continents across the world. We exist to maximise the contribution that housing professionals make to the wellbeing of communities.

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For further information, please contact:

Customer Services: customer.services@cih.org, or 024 7685 1700

The Homes and Communities Agency (HCA) is the single, national housing and regeneration delivery agency for England. Our vision is to create opportunity for people to live in homes they can afford in places they want to live, by enabling local authorities and communities to deliver the ambition they have for their own areas.

For more information visit homesandcommunities.co.uk

The CIH and HCA welcome any feedback or comment on the contents of this note.

Any feedback, queries or questions in relation to this note should be directed to:

HomeBuy@hca.gsx.gov.uk