Community led housing and retail mortgage lending: guidance for groups

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Aim of this guide

This guide aims to help community led housing (CLH) groups to better understand mortgage lenders. The guide explains briefly how different mortgage lenders operate, how they vary in size and strategy and the impact that this has on the approach they take to your sector. It sets out how lenders can provide mortgages to the community led sector, including where lending can probably be accommodated within current practices. It identifies benefits for community led housing groups in working with lenders to deliver much needed home. It is best used at the outset of any development project; don't wait till the homes are completed and ready for sale before thinking about mortgages!

UK retail mortgage lending: an overview

UK mortgage lending is a diverse sector that is made up of organisations of very different scale and different structures. There are around 200 mortgage lenders. Mortgage lending is big business. The UK mortgage market is worth £1.3 trillion, representing 11.1 million mortgages, and is the largest in Europe in terms of amount lent per year and the total value of outstanding loans. In 2016 lenders lent some £246 billion of mortgage loans.

There are different ways to view the market but it is most commonly split as follows:

The Big six high street banks make up the largest segment of the mortgage market. These are Lloyds Banking Group (including Halifax), Nationwide Building Society, Santander, Barclays, Royal Bank of Scotland (including NatWest) and HSBC. These large lenders may each receive over 1,000 mortgage applications every working day. Some have multiple brands to serve different markets.

Including Nationwide, there are 42 building societies. Unlike Banks which are owned by shareholders, building societies are mutual organisations societies owned by their members – their savers and mortgage borrowers. Building societies have existed for nearly 200 years and they were originally created to allow ordinary people to build and then own their own home.

The so called "challenger banks" are new start-ups or specialist mortgage lenders. These include the banks of large supermarkets. They may serve specific niches such as buy to let or sharia loans.

As well as the above there are those that are "none of the above". Lending is typically low volume but includes local authorities, ethical banks and friendly societies.

Although many lenders have branch offices, most sell their mortgages via brokers and financial advisers (about 70% of mortgages come via brokers and there are probably only 25/30 brokers who specialise in new build homes). Brokers receive a fee from the mortgage lender for providing the lender with mortgage business and may also charge the borrower for their services.

All lenders engage in some form of corporate social responsibility activity –supporting national charities or local hospitals and schools –anything that sustains their profile in their chosen operating area and depending on the size of the lender and the resources available.

Different elements of the mortgage market

Most lenders will provide the following mortgages.

- House purchase mortgage. A mortgage taken out when a property is purchased by an existing homeowner or a first-time buyer. In 2016 there were over 700,000 loans for house purchase involving some £128 billion of funds and of these 48% were for first-time buyers.
- Remortgage and switching. A borrower changes their mortgage without moving home – moving it to a new lender (remortgaging) or a new deal with the existing lender (switching).

- Further borrowing. A borrower may borrow extra money without moving home. This money may be to improve their property or for other purposes.

Different market sectors and risk

Lenders will lend in different sectors of the market. Lending to existing borrowers with small mortgages relative to the value of their property is low risk and high volume, and highly competitive. Typically, the smaller the specific market, the more complex and higher risk it will be. Competition typically reduces while the cost of the mortgage increases.

Lenders are cautious of lending to new borrowers with small deposits and in particular those with a poor history of managing debt. Whilst lenders are keen to find new areas to lend they are often cautious about being the only lender in any market or on any site. Lenders always think about the exit opportunities – if there is a problem and they take possession, is that home going to be marketable and would another lender offer a mortgage on it?

Big lenders are very system driven, using as much automation as possible whereas many smaller lenders rely much more on manual processing and person to person contact. As this might suggest, this means that bigger lenders probably take most standard lending business while smaller lenders focus on lending in smaller more complex niche markets.

Regulation

Mortgage advice and lending is heavily regulated. **Prudential regulation** is focused on ensuring that firms are well run and lend prudently. **Conduct regulation** is focused on ensuring that lenders treat their customers fairly. Lenders are rightly cautious of doing anything that might upset the regulator, and regulators are wary of smaller more specialist mortgage markets.

There are two regulators; the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Mortgage lending is governed by the Mortgage Conduct of Business Rules (MCOB) via the FCA. More rules have arrived via the Bank of England's Financial Policy Committee and the EU. Lenders now have much tighter affordability checks in place and normally must also stress test the borrower's capacity to cope with a 3% interest rate rise within the first 5 years of a loan.

Lenders, affordable housing and community led organisations

Not all homes developed by community led groups are intended for homeownership. For those sold to buyers who need a mortgage, getting the best possible access to mortgage funding is key. Some features of CLTs and cohousing are quite locally specific in mortgage lending terms. Where lenders do become aware of these details the lender may decline the business.

Lenders have lending policies in place. Information on customer facing websites is often brief and simplified, more detailed policies are often provided to brokers and solicitors. As a survey of lender documentation has shown, most mortgage lending policies fail to reference CLTs or cohousing. It is therefore possible that a lender will not lend where they become aware that these organisations are involved.

Affordable housing: lenders and shared ownership.

Many lenders fund housing associations, including co-operatives, but fewer provide finance for community led groups. Lenders and trade bodies are familiar with affordability and affordable housing.

Nevertheless, only a minority of around 23 lenders support shared ownership, the most common tenure used by the affordable housing sector. although the number of lenders supporting shared ownership has risen over the last decade many still see it as too small a sector to be worth supporting. Shared ownership has built in complexity seen as requiring disproportionate resources for a relatively small market.

Lenders and the community led sector

Even fewer lenders are active in the community led sector resulting in lending being declined due to lack of understanding. Lending for community led development is more complex than mainstream lending and requires specialist knowledge. If the scale of activity is too small – especially at the level of an individual lender's appetite for that business or the market share they can achieve, then it might be declined as it makes no financial sense given all the extra work entailed.

Different homeownership products developed by community led groups

Issues relating to different forms of affordable housing, and to cohousing, are considered separately below.

Community led affordable housing

Community led housing groups are long-term stewards of housing, and many aim to ensure the home remains genuinely affordable for every future occupier.

In recent years, CLTs in particular have sought to maintain affordability in various ways:

- Retaining some equity in their homes so that they can influence their future role and status.
- Restricting the price of a property for both the first sale and subsequent sales of a property.
- Restricting who can live in a property; usually to those who live/ work in a local area.

The issue for CLH groups wishing to ensure that these homes are mortgageable on good terms is that any restriction on who may buy a property, how much equity they can purchase or on the sale price has implications for the loan. Ultimately, what makes the risk of lending for a mortgage acceptable is the ability of the lender to straightforwardly recover their debt if a borrower defaults on their mortgage[1]. This implies being able to sell a property for its full value without any undue restrictions on who can buy, how much they can buy, and how quickly they can buy.

Only one or two lenders make any reference to CLTs in their documentation, and none mention CLH or other CLH approaches, so we start from a position where most lenders will know little or nothing about your sector.

The good news is that a significant minority of lenders including many smaller providers (often local building societies) have concentrated on specialist markets including affordable housing. As a result, this market appears to be adequately, if not plentifully, served with for the most standard affordable housing products; equity loan, shared ownership and the Right to Buy. An established market results in structures and processes which potentially can be "piggybacked" by community led housing groups.

[1] It should be noted that default rates in general are very low. In 2016 there were over 11 million mortgage loans outstanding with 7,700 possessions, 0.07 of the stock of loans. While this is a low point in the cycle possessions peaked at 75,000 and 0.77% in 1991 and 48,900 and 0.43% in 2009. Possession is the last resort and there are tight court and regulatory rules that require lenders to ensure fair treatment of customers

Shared Equity and Equity loans

It is important to distinguish between shared equity and equity loans. In the former the ownership is split between the equity partners in contrast to equity loans where the ownership is 100% with the one owner and with the equity loan as a second charge on the property. The lender has a right to any uplift in the value of the home in proportion to the loan's value against the total original purchase price. The two terms shared equity and equity loan are often confused and the existence of the government's Help to Buy equity loan scheme – in which most bigger lenders participate - means that is what might be assumed in any discussion of equity. So be aware!

Lenders who lend on shared equity typically do so in shared ownership where the equity is split between the home owner and the housing association. Equity loans are relatively simple for lenders (being widely used through the Help to Buy Equity Loan) and they help reduce the deposit needed on a new build property. Lenders treat the loan as part of the customer's deposit[2]. For example:

Customer deposit	£5k
Equity Loan	£20k
Mortgage	£75k
Open market value	**£100k**
Loan to value for mortgage purposes	75%
Minimum customer deposit new build	5%
Minimum customer deposit existing property	5%

Equity loans typically offer the best deal for the customer and are the preferred option for the lender, with the widest choice of providers. But equity loans do present major challenges for CLTs. The use of a secured charge rather than a lease means the property can be sold into the open market rather than remaining affordable in perpetuity. Furthermore, an equity loan is subject to the same regulations as a standard mortgage making them more complex to administer and offer.

Shared ownership

Shared ownership in CLH schemes is accepted by many lenders. As the name implies the purchaser buys a share of the property, and they are typically charged a rent on the element that they do not own. However, whilst they own only a portion of the property they are responsible for all repairs and maintenance. When the property is sold the owner has the choice of selling the share (and thus retaining the affordability relative to house prices) or buying out the other equity interest in a back to back arrangement selling the home as 100% owned. If this is done then unless there are caps in place as to the amount of equity that can be sold (e.g., 80%) then the home is "lost" into the market.

Shared ownership has flaws. The rent is typically at 3% and can be more than the mortgage rate. There is a legal risk that the lender could lose their security if rent is not paid. Managing arrears of both the mortgage and the rent can be complex. Consequently, lenders are cautious of who they work with and often restrict this to housing associations. Lenders also benefit from a standard lease mortgagee in possession (MIP) clause that allows the option of selling into the open market to recover their outstanding debt (subject to detailed restrictions, and typically with a buy back option).

A lender may charge a higher rate of interest on their loan than for a mainstream mortgage. They may require a higher deposit from the customer if they are buying a new build, especially flats.

[2] The equity loan may have zero interest charged at least initially. This helps the borrower.

Market views are split on your placing a cap on the share that owners can buy. Some lenders feel uncomfortable with every element that potentially limits their ability to recover amounts due in cases of default. Other lenders appear relaxed by the principle in particular if operated in a consistent way and combined with the mortgagee in possession clause. That the number of lenders prepared to support capped staircasing is limited is part of the concern for some.

Whilst the inclusion of the cap does add complexity, it does not appear to diminish a lender's security, in particular if used in areas where demand for property is, and is expected to remain, high. However, lenders did indicate that caps are just one of a number of restrictions that shared ownership providers have sought to implement and therefore it is sometimes easier to say "no" to all applicants than get into potential complexities from many different schemes. Groups looking to use a cap should base your approach on the Homes England lease for Designated Protected Areas and politely press lenders to review policies on the basis that a cap has no discernible impact on lending risk. Some lenders may refuse to support capped staircasing on the basis that shared ownership should be a product leading to full home ownership. In these cases, making the case for affordability in perpetuity in some areas and pointing out that relatively few shared owners staircase to full ownership in any case may be helpful. The existence of a Homes England lease permitting caps would re-enforce such arguments for a change in position.

Discounted Market Value

Discounted Market Value (DMV) is a structure via which a seller (usually a community land trust) sets the initial price of a property and then restricts the price at which it can be resold. Unhelpfully different terms are used including Resale Price Covenant, Restricted Resale Price, Discounted Market Value and Open Market Discount Scheme.

In our view discounted market value (DMV) should be the "standard" term. Despite its inherently simple structure, and the option to use standard wording, few lenders support DMV as they are unfamiliar with the concept and lack understanding of the complexity with regards to the valuation.

As with shared ownership, the customer may need a large deposit when purchasing a new property.

Example: LTV of 50%, OMV of £100k	Resale Price Covenant/DMV **New build**	Resale Price Covenant/DMV **Existing property**
Min Deposit required	£12,500	£2,500
LTV for mortgage	75%	95%
Value for LTV	£50,000	£50,000
Typical mortgage rate*	1.9%	4.5%

*Rates are for a 2 year fixed rate as at Q4 2017.

Typically, the discounted market value is set at a fixed percentage of the open market value of the property, making it straightforward for lenders to calculate.

With house prices rising faster than incomes, some CLTs have linked the cost of property to average wages in the area. This works best where the discount is large, local employment robust, and demand strong (London being the obvious example). This approach reduces the move-on options for the buyer and may dis-incentivise further investment in the property. While it effectively eliminates the need for a valuation it is more complex than a normal purchase and creates challenges for

lenders' processes and systems both pre and post house purchase. It is accepted by a very few lenders.

Although the numbers of lenders prepared to support DMV are limited – and we are unable to find a strong lender rationale for this reticence – they do include the two largest; Halifax and Nationwide. However, these two will only lend as a matter of course when price is linked to open market value as a fixed percentage. There are some operational challenges with DMV, for example the valuer would need to be aware of the price restriction. The absence of a standard structure through which the restriction is enforced is unhelpful. Terms contained only within deeds can be identified late in the buying and selling process or even missed (although this would be primarily a legal issue). Given that the same effect can be delivered with a Shared Ownership lease with a staircasing cap the sector may wish to consider alignment to that option. Smaller lenders may be willing to take a flexible approach, particularly on local projects. It is however best to have a mortgagee in possession clause included, allowing sale into the open market in the event of default by the borrower. Other lenders may be persuaded to exercise some flexibility in relation to DMV when it is pointed out that Halifax and Nationwide are willing to lend on this product.

It is a harder task to get lenders to support house prices linked to average earnings. Managing these mortgages can be complex and not just at the start. Whilst this scheme is seen by many CLTs as the answer to long term affordability challenges, lenders remain much more cautious, and compared to the other options appear to have stronger operational and lending risk grounds against providing their support. All lenders point to risks to the customer from the long-term link to wages (notably in locations outside London). Groups may wonder at this, given that the product is designed to be low risk by ensuring prices are linked to incomes. But lenders see it from a different point of view – that the consumer is unable to benefit from any capital gain, may therefore not be able to buy another home in the open market, and may also struggle to find a buyer when they come to sell. Whatever you might think of this view, it is ingrained in the lending industry and backed by a regulator that seeks to protect what it sees as consumers' interests.

The arrangement also results in undoubted complexities once the mortgage is in place. Where lenders have lent then it has been important to get named individuals at all parts of the chain prepared to deal with and manage the nuances of the scheme. This typically involves the CLH group working with the customer and the lender. Before accepting business, CLH groups should agree with the lender how individuals can apply for mortgages and may also provide specific details for the CLH group to give to the customer to help them approach the lender through the right channels and help the lender then process the case correctly. For example, London CLT and Nationwide produced a certificate for residents to present in their local branch. Once the mortgage is in place, lenders' systems will probably be unable to keep track of the underlying value linked to earnings and this poses risks of for example further borrowing in excess of the value of the property.

If you plan this approach, then ensure you get enough lender support before seeking to sell homes on this basis. Expect a hard road with lenders and focus on smaller lenders that are local to you, in addition to those known to support such schemes. If considering a scheme, you are likely to be more successful when the discount to open market value is higher and the local economy is strong and enduring. Work with the lender to ensure named individuals in your group and in the lender are in place for key stages of the mortgage process.

New build lending restrictions

Lender new build policies can limit loan to value to 75% or flats and 85% on houses. However, this position is improving in that several lenders are now offering 85% to 95% LTVs). Lenders may also operate site exposure limits - no more than 20% of the loans on any site, although most show some flexibility with smaller sites.

As shown above, a customer buying a home using shared ownership or discounted market value may need to put down a deposit of 25% of their share or the discounted value if the property is new but only 5% if it is an existing dwelling.

This need for a larger deposit reflects problems lenders have experienced with assessing the real market value of properties in the new build sector (but not CLH groups). You have a strong case for asking lenders not to apply new build limits.

Cohousing

There is even less lender awareness of the cohousing market. This is unsurprising given the sector generates a very limited demand for mortgages and even then, largely by use of mortgages on existing properties to provide working capital to part fund the cohousing build. The key constraints for lenders relate to the leasehold restrictions on the home buyer and the treatment of the capital and ongoing costs of the communal house.

Common house costs

The common house model has the general effect of making cohousing more expensive than a standard property (although by reducing the number of rooms required by any household it may still be a cost-efficient option). Those moving into the community clearly value this arrangement, but it is less likely that a mortgage valuer will. The valuer is likely to value only the property itself even though the ongoing costs of operating and maintaining the common house will need to be factored into a borrower's affordability calculation.

This will have a limited impact where the buyer has significant equity, but it may impact a buyer with a limited deposit or a limited income. For example: If a cohousing community of 15 properties with the common house adding 10% of cost onto each individual then a property with a stand-alone cost of £200k this would cost an extra £20k. A buyer of a stand-alone existing property priced at £200k would be able to purchase it with a deposit of £10k (5%) and a mortgage of £190k but a cohousing buyer who could not borrow more would require a higher deposit of £30k.

Leasehold terms and resale restrictions

Restrictions on sale within the lease may also impact a lender's willingness to lend. It is possible the restrictions are such that there is no active market of suitable size for a valuer to be confident a buyer can be found. In the absence of such a market a valuer will not return a value and a lender will not lend.

It is sometimes possible to reduce the risk to the lender by offering a guaranteed buy back option or the opportunity for the lender to sell into the open market after a certain time has elapsed. Such clauses may be of limited value to a lender if the Cohousing group does not have the resources to buy back. In addition, it is inherently difficult to separate the house from the wider housing group to sell it.

Cohousing groups also need care in constructing their charging arrangements for the common house. Use of ground rent clauses are under scrutiny due to poor practice by builders, although service charges that are supported by costings and with appropriate scrutiny are accepted.

The clear conclusion is that if the Cohousing network identifies issues with access to mortgage finance (and to date this does not seem to be a pressing matter) then it needs to do much more to raise awareness of its sector. This will become ever more so if the sector wishes to achieve its ambition to grow and be more affordable to those on low incomes.

However, it is also fair to say that the time and effort to do this may not be well spent. The advantages and disadvantages must be weighed against each other – in the short term, greater lender awareness could also lead to increased lender concerns with more restrictive policies being introduced rather than lenders relaxing their current approach.

If the cohousing sector is to target first time buyers with limited deposits, then a concerted drive to obtain better access to mortgage finance will be necessary. Otherwise, it may be appropriate to continue "below the radar" for now.

Engaging in partnership: getting the best out of lenders

Lenders want to lend, and a timely, well- structured proposal delivered to the right person will help to secure funding. The approach should always be to the head office and if relevant, to the person who leads on shared ownership. Bigger lenders may have a person specifically responsible for lending policy though it might also be linked to new development or sales. If in doubt a letter to the Chief Executive will ensure it gets to the right person/department.

Given the lack of knowledge of community led housing, it is important to give an outline of what the organisation is and what it is trying to do followed by more detail setting out what your borrowing requirements might be in terms of the type of product being sought and the scale of borrowing. Don't forget to indicate the opportunities that exist for the lender. Given the requirement might be small in lending terms it would be helpful to set out what the on-going requirement might be in terms of mortgages and how this support would promote access to home ownership

Remember that lenders have choices. They will be weighing up the business opportunities you outline alongside their strategic priorities and the costs and benefits to the organisation. They will then decide whether this is a good opportunity or not. Important factors will include the time and costs involved, staff time, IT, legal complexities and support implications, likely future business, corporate benefits in terms of PR and image and of course what the alternative lending opportunities might be. Some lenders would probably decline your business quite quickly. It is often easier to say no than yes.

Your strategy must be to get an opportunity to make your case in person so that you can explore with the lender what you are looking for. It would be sensible to start your search by looking for lenders that lend on shared ownership – their website should help or you can enquire in a local branch. Other lenders worth a close look are those that have a strong local presence and are active in supporting the community. There are also new lenders coming to market and it may be one of those would see this as an opportunity to operate in a market where there is less competition.

What you have to be clear about throughout is the quality of the security being offered –the home and the ability of the owners/borrowers to service mortgage payments. Lenders may think that your requirements imply higher-risk borrowers. You need to make it clear that is not the case and you may be able to show what good borrowers you can attract by referring to the track record for the organisation in terms of arrears and defaults.

Given the current scale of the community led sector, we would suggest the following ranking why lenders offer mortgages:

1. The philosophy and values of the lender are aligned to community led housing.
2. Association with community led housing enhances the brand of the lender.
3. Community led housing represents a valued business opportunity.

It is important to keep this ranking in mind when planning your approach.