Consultation on Housing and Wellbeing

Response by the Council of Mortgage Lenders to the Shelter Scotland Commission

Introduction

1. The Council of Mortgage Lenders (CML) is the representative trade association for mortgage lenders. Our 125 members comprise banks, building societies, insurance companies and other specialist mortgage lenders who, together, lend around 95% of the residential mortgages in the UK. In addition, the CML's members have lent over £60 billion UK-wide for new-build, repair and improvement to social housing of which just under £4 billion is in Scotland.

2. CML Scotland welcomes the opportunity to respond to the consultation by the Shelter Scotland Commission on Housing and Wellbeing.

General

3. It is our intention to restrict our comments to matters covered in Chapters 2 and 3 of the report.

Chapter 2

4. The statement in the consultation that "We understand that since the 2008 global economic crisis it has been difficult for many housing associations to borrow at affordable interest rates to fund new house building " represents an over simplification of the position and is made against a background of interest rates being at a historical low.

5. Looking at latest available information from the Scottish Housing Regulator (SHR) it would appear that since the start of the credit crunch committed loan facilities have increased from just under £3bn to just over £4bn with loans drawn down almost doubling in that period to just over £3bn. It is not quite the impression that is gained of no lending happening but clearly these figures do not tell the whole picture. There is a need to raise private finance to develop and build the number of new affordable homes required, particularly with reductions in public subsidy. In addition finance is also required to assist with achieving Scottish Housing Quality Standard and potentially the new energy efficiency standard for social housing.

6. What has changed so far as lenders are concerned is the terms on which they are prepared to lend to the RSL sector. Traditionally lenders lent to RSL sector on a long term basis of up to 30 years with rates of 25 to 50 basis points above LIBOR not being uncommon. Today it is likely that lenders will want to lend for a shorter term, typically 5 to 10 years with margins commonly being in the range of 200 to 300 basis points above LIBOR. If they are prepared to lend longer term they will be likely to seek to have an ability to review their pricing say every 5 years.

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7. One of the lessons for Banks of the recent crisis is that they cannot fund long term borrowing by themselves borrowing in the money markets on a short term basis. In addition margins at 25 to 50 basis points over LIBOR are not going to meet the Banks' own funding costs, particularly given the increased requirements on them from Regulators to retain more capital and meet increased liquidity requirements under Basel 3.

8. In looking at the RSL sector it has to be borne in mind that traditionally it had a low risk profile as a result of a high level of public subsidy with that subsidy assisting with both development through Housing Association Grant and rental streams through Housing Benefit. The risk profile of the sector has however been increasing in recent years:

- There are lower levels of new build subsidy—many RSLs in Scotland had strong reserves but if you are going to use reserves towards new build you can only do this on one occasion.
- The reforms to the welfare system have also begun to impact on the sector with higher arrear levels and this is before the introduction of universal credit being paid directly to applicants.
- There are also issues in the sector with regard to liabilities for pension deficits.

As the Scottish Housing Regulator (SHR) has highlighted in their annual financial analysis of the sector these emerging risks may be limiting the appetite of some RSLs to increase indebtedness and gearing.

9. The sector is also not immune from the general economic conditions and the SHR has mentioned that it has taken intervention action in the case of 3 RSLs to prevent insolvency events arising. Overall the risk profile of the sector is increasing but still remains a good risk although there are undoubtedly some RSLs facing increased financial pressures.

10. We believe the sector is likely to see further consolidation in terms of mergers and Group structure arrangements. The latter can be a good way for an RSL to obtain funding from a strong parent to undertake development and improvement works. Protections can be built into the arrangement so that the RSL largely retains its independence. There are a number of good examples of this which can be seen in Scotland.

11. The consultation talks about RSLs coming together to obtain better deals from investors and funders. While this could be possible there can be issues around the governance of such arrangements and there are not always straight forward. In our view RSLs should be looking at a range of options:

- Those RSLs who are of a scale that he they can do so should be looking at the capital markets either by way of bond issuance or private placement. There is clearly investor appetite to invest in social housing and this has been evidenced in Scotland in recent times by the Bond issued by Wheatley Group and the private placement undertaken by Link.
- RSLs who cannot directly access the Bond market may wish to look at the possibility of using an aggregating vehicle such as The Housing Finance Corporation (THFC). THFC itself raises Bond finance in the capital markets and then on lends these monies on similar terms to individual RSLs having carried out a financial assessment of the RSL.
- Some Insurance Companies are providing long term loans to the RSL sector e.g. Legal and General.

- Banks are still lending to the RSL sector albeit the loans are likely to be more short term in nature and on terms which we outlined previously. Some Banks have also been playing a key part in the arrangement and management of issuances in the capital markets.

Like the SHR we believe that the uncertainties and financial pressures impacting on the sector are currently impacting on the willingness of a number of RSLS to increase indebtedness and gearing.

12. The consultation also suggests there may be a need to look at the way in which the SHR operates to facilitate RSLs coming together to raise finance. We are not certain what the issues in this regard are but would emphasise that the strength and robustness of regulation is a key to securing private finance. The SHR has a key role to play in assessing financial viability and good governance and if any proposal was put forward which would weaken this it is likely to impact adversely on the availability of private finance.

Chapter 3

13. We do not agree with the comments in the consultation regarding the UK mortgage market but we do support your call to make the housing and mortgage markets more sustainable.

14. The consultation makes no mention of the fundamental restructuring of financial regulation in the UK with the role of the former Financial Services Authority now being divided between conduct and prudential regulation with the establishment of the Financial Conduct Authority and Prudential Regulatory Authority respectively

15. The call to introduce controls of the nature outlined in the paper seems rather out dated. The ones mentioned are extremely blunt instruments and could have unintended consequences of excluding many people from the mortgage market. They also do not reflect the work which has gone with the support of Government, regulators and the industry itself to regulate better the mortgage market following upon the banking crisis.

16. No mention is made of the Mortgage Market Review (MMR), a comprehensive review of the mortgage market undertaken by the former Financial Services Authority (FSA), which started with a discussion paper in December 2009 and culminated in a policy statement and final rules being published in October 2012. The MMR set out the case for reforming the mortgage market to ensure that it is sustainable and works better for consumers. The MMR changes came into effect on 26 April 2014.

17. The key areas impacted by the MMR changes are:

- responsible lending requirements;
- changes to requirements for the sale of interest-only mortgages;
- transitional arrangements for existing loans;
- advised sales and execution-only sales;
- high net worth individuals.

18. The responsible lending rules under the MMR makes it clear that it is the responsibility of the lender to assess the affordability of the mortgage. Where the mortgage is introduced by an

intermediary, the intermediary is required to ensure that the customer meets the lender's known eligibility criteria, but there is no requirement on the intermediary to assess affordability. In assessing affordability, the lender is required to verify income in every case, and must take into account the committed expenditure of the customer together with their basic essential expenditure and living costs. The lender is also required to stress affordability for the impact of future rises in interest rates. As part of the affordability assessment, the MMR rules also require lenders to take into account future changes to income and expenditure about which they are, or should reasonably be aware.

19. No mention is made of the role of the Prudential Regulatory Authority (PRA) and how the PRA will undertake banking supervision. The PRA will identify the risks to the stability of the financial system, safeguard the safety of the system including and finally will interact with regulated entities to achieve its objectives. The primary objective for the PRA is to ensure the safety and stability of firms to provide a stable secure financial system. This does not, however, preclude firms from failing but if they do the PRA will seek to ensure they do so without significant impact to the stability of the financial system.

20. Tools which the PRA could use include adjusting the amount of capital which lenders require to set aside for particular types of mortgage lending. If more capital was required this could both dampen the demand for mortgages by increasing their cost and restricting the amounts which lenders have to lend.

21. The PRA will seek to ensure financial stability by working with the Financial Conduct Authority (FCA) and the Financial Policy Committee (FPC) of the Bank of England so that firms do not undertake activities either directly or indirectly, that threaten the stability of the financial system.

22. The FPC has also a range of powers available to it and others which it can seek permission from the Treasury to use. We have seen the FPC use these powers in the last few months. It has required lenders in using the new affordability stress test under the MMR for it to be based on an assumed Bank rate 3% higher than at origination.

23. In addition it has required lenders to limit the level of a lender's new lending to no more than 15% of mortgages at 4.5 times income or above (and none at all for Help to Buy guaranteed loans). This is likely to impact the London market more than elsewhere. Nationally, 9% of new loans are at 4.5 times income or more, but the figure is 19% in London.

24. These measures are designed to ensure financial and economic stability, and should not be confused with wider housing policy, for which the FPC is not responsible. Additional housing supply to help correct the imbalance between supply and demand is the main way of relieving affordability pressure and household indebtedness attributable to mortgage borrowing over the long term.

25. In our view there are a range of measures available to lenders, regulators and policy makers to create a sustainable mortgage market without seeking others outlined in the consultation, particularly when no research has been undertaken into their consequences.

Further Contact

26. This response has been prepared by CML in conjunction with its members. Any comments or enquiries should in the first place be directed to:

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