CONSULTATION RESPONSE

HOME BUILDERS FEDERATION

FSA Mortgage Market Review Discussion Paper 09/3 30 Jan 2010

EXECUTIVE SUMMARY

1. The Home Builders Federation is the principle trade association representing private home builders in England and Wales.

2. Home building, an important UK industry, is heavily dependent on the mortgage market, as is achievement of the Government's housing supply objectives. Although new homes account for only 10-12% of the housing market, they play a key facilitating role for most other housing transactions by allowing home buyers to complete chains.

3. Therefore we would urge the FSA to give particular attention to the implications of any decisions about mortgage regulation for new home delivery and the home building industry.

4. We believe adequately funding the housing market, and ensuring there are adequate numbers of lenders and healthy competition in the mortgage market, should be explicit FSA objectives (DP paragraphs 1.3 and 1.4). Mortgage lending in general, and new home sales in particular, are currently too reliant on a small number of large lenders.

5. We agreed with the FSA that sales of loans above certain LTVs and LTIs should not be prohibited.

6. The home building and lending industries have done a great deal to reduce the incidence of mortgage fraud in the new homes sector, including introducing the Disclosure of Incentives Form.

7. We are working with the CML and lenders to try to ensure lending for new homes is offered on the same terms as lending for second-hand properties, but we would welcome FSA support on this important issue.

8. We are not convinced regulation of buy-to-let mortgages is necessary or practical.

9. Second-charge mortgages play a special, and very important role in the new homes sector through "shared equity" schemes. Shared equity buyers require a first-charge mortgage

and so are fully protected. Therefore if second-charge mortgages are to be FSA regulated, we would like to explore with the FSA, the CML and lenders how we might allow home builders to offer shared equity schemes involving second-charge mortgages without needing to become FSA regulated themselves.

HOME BUILDERS FEDERATION (HBF)

10. The Home Builders Federation is the principle trade association representing the interests of private home builders in England and Wales. Our members, who include companies ranging from major national firms, through regional companies to smaller local companies, are responsible for more than 80% of the new homes built every year.

11. HBF's submission draws the attention of the FSA to the significance of its conclusions for a major UK industry, and therefore for the wider economy. We have not attempted to comment on many of the technical and procedural issues raised in the Discussion Paper (DP). Rather our objective is to highlight key issues relating to the new homes sector.

THE IMPORTANCE OF THE HOME BUILDING INDUSTRY

12. The home building industry has a heavy reliance on the operation of the mortgage market. Approximately three quarters of all UK housing transactions involve a mortgage. While we do not have a comparable estimate for new home sales, the proportion is likely to be similar. Therefore the health of the home building industry, and of housing supply, is dependent on the health of the mortgage market.

13. In normal market conditions, new homes have traditionally accounted for about 10-12% of total housing transactions.

14. The construction industry as a whole accounted for 6.4% of UK Gross Value Added (GVA) in 2007. New home building makes up 17% of total construction industry output, of which 80% is private and 20% public. Therefore new house building makes a significant direct contribution to the UK economy.

15. At the peak of the market in 2007, HBF estimates there were approximately 335,000 people employed in home building.

16. However the industry has a significance for the economy which goes far beyond its direct contribution to GVA.

17. A wide range of other sectors depend on home building, including the building products and materials industry, white goods manufacturers and retailers, solicitors, removal companies and households goods and furniture retailers and producers.

18. In addition to the output and employment contributions of the home building industry to the UK economy, the Government now recognises that housing supply has wide-ranging economic and social implications. Raising housing completions is an important Government policy objective. The long-term undersupply of new homes, which has been severely aggravated by the recession of the last two years, has serious adverse economic and social consequences.

19. Although new homes represent only 10-12% of total housing market transactions, they play a critical facilitating role in the wider housing market: because new homes are not previously occupied, they allow housing chains to close, and therefore many other transactions to take place. (Every chain must have a beginning – a buyer whose purchase is not dependent on a sale – and an end – a property for which availability does not depend on a further purchase.)

20. The collapse in mortgage lending since mid 2007, and the resulting extremely restrictive mortgage terms – especially the withdrawal of affordable higher LTV mortgages – has had a very damaging impact on home building and the industry. House building activity has halved, as has industry employment. This in turn means the Government's housing targets for 2016 and 2020 are no longer achievable, with all the adverse social and economic consequences this will bring.

21. **Because of the new home sector's far-reaching housing market, economic and social significance, we believe the FSA should give particular attention to the implications of any decisions about mortgage regulation for new home delivery and the home building industry.**

THE OBJECTIVES OF MORTGAGE MARKET REGULATION

Funding the Housing Market

22. The home building industry is damaged by the UK's tendency to violent boom and bust cycles in the housing market. While an upswing makes development profitable, heavy losses can be made in the downswing, many jobs and skills are lost, and the capacity of the industry then takes many years to rebuild in the next upswing. These violent cycles make forward planning extremely difficult, and they have an adverse impact on innovation and productivity improvements.

23. Therefore we broadly support the FSA's efforts to improve housing market stability through better regulation of the mortgage market – in the words of the DP, to "generate more stable and sustainable mortgage lending". This can only improve home building industry performance and benefit the UK's overall economic performance.

24. With this in mind, it is of concern that the FSA's list of objectives for mortgage regulation (paragraphs 1.2 and 1.3) does not include ensuring the housing market is adequately mortgage funded.

25. There are two dimensions to this objective.

First, the total volume of mortgage lending needs to be adequate to fund the housing market, although we fully acknowledge that this should be in a manner that is "sustainable".

Second, we are concerned about the number of lenders in the mortgage market and the degree of competition. The market today is disproportionately dependent on a handful of large players. New home sales are especially vulnerable because they rely very heavily on three or four large lenders. It would not serve the interests of borrowers or the home building industry if regulation were unnecessarily to restrict the number of lenders and make it even more difficult for new entrants to come into the mortgage market.

26. **Given the importance of the housing market and the home building industry to the UK economy, we believe adequately funding the housing market, and ensuring there are adequate numbers of lenders and healthy competition in the mortgage market, should be explicit FSA objectives.**

Mortgage Supply and Housing Market Instability

27. The Barker Review (2004) of housing supply concluded that Britain suffered from a long-term under-supply of housing, with land supply the key constraint on housing supply.

28. The FSA has, quite rightly, considered whether mortgage market regulation can contribute towards greater stability of house prices and the housing market. While we support this broad approach, the FSA must recognise that house price rises are not solely a consequence of excessive mortgage lending. The Barker Review concluded that the long-term undersupply of housing had led to underlying real house prices growth well in excess of that in other European countries.

29. The solution to this problem lies with planning and land-use policies, not mortgage regulation. It would be very unfortunate if we ended up at some point in the future with

mortgage regulation trying to dampen down long-term house price growth brought about by England's highly restrictive planning system.

Managing Mortgage Risk

30. We support the DP's focus on irresponsible, high-risk lending. While this may bring short-term benefits to individual lenders and buyers, the longer-term risks to the mortgage market, housing market and wider economy are all too obvious.

31. We do not feel qualified to comment on the technical proposals for prudential supervision of lenders.

32. Question 5

However we do believe that regulation should not attempt to micro-manage mortgage products, and **we fully support the FSA's decision not to prohibit LTVs or LTIs above certain thresholds.**

33. A fundamental reason for today's mortgage market problems was inadequate assessment and pricing of risk in the boom years. This resulted in bad individual lending and borrowing decisions and it helped to fuel the surge in mortgage lending from 2005-2007.

34. Therefore the solution must be primarily to ensure that lenders adequately assess and price risk. Crude product regulation would inevitable block not just risky borrowers, but also buyers/borrowers who were well able to afford an adequately risk-assessed and risk-priced higher LTV or LTI mortgage, thus unnecessarily constraining the housing market. This illustrates why we believe the FSA should make adequate funding of the housing market one of its primary objectives.

MORTGAGE LENDING ON NEW HOMES

35. As well as outlining above our thoughts on the broad health of the housing and mortgage markets, and the critical importance of the mortgage market to the home building industry, we wish to address a number of specific mortgage regulation issues relating to new homes.

Number of Lenders and Competition

36. As noted above, the home building industry is today heavily reliant on three or four large lenders. In the case of the Government's HomeBuy Direct (HBD) scheme, the bulk of lending has been undertaken by just two lenders.

37. Not only is the small number of lenders itself restrictive, but these lenders also limit their lending exposure on any individual housing site, adding to inflexibility and lack of competition.

38. It is therefore extremely important for the home building industry that FSA regulation is undertaken with full understanding of its potential impact on the overall volume of lending, and on the number of players in the mortgage market.

New Home Lending

39. During the boom years, poor practices crept in among some developers, valuers and lenders, and outright fraud became a feature of the market, especially in the case of some inner-city apartment schemes. This is discussed in paragraph 9.20 of the DP. In the downturn these practices have produce substantial losses for lenders.

40. Therefore we have fully supported the CML's efforts to improve the transparency of incentives for new homes, most notably by working with the CML and RICS to introduce a Disclosure of Incentives Form (DiF). We continue to work with the mortgage industry to help rebuild confidence in the new homes sector and new home valuations. Having recognised that the poor practices of some developers have damaged the whole industry, HBF member companies have put in place their own strict internal procedures to ensure incentives are fully disclosed and DiF forms are accurately completed for all new homes sales to owner-occupiers with a mortgage.

41. It is therefore discouraging that, despite HBF's and HBF members' best endeavours, lenders still have discriminatory pricing and lending terms for new homes. For example, higher LTVs are available for second-hand homes than for new homes. Some lenders impose special valuation criteria for new home valuations, criteria which do not conform with RICS Red Book rules and new home valuation guidance.

42. Question 11

We note that the DP discussion of mortgage fraud (page 94ff) does not acknowledge the DiF as an important step to curb mortgage fraud, and it does not recognise the significant efforts the CML, lenders, the HBF and individual home builders have already made to reduce the scope for mortgage fraud.

43. At the root of the problem of more onerous lending terms for new homes seems to be lenders' inability to discriminate between companies with robust procedures and those without, and between higher and lower risk new dwellings. In effect, because of poor past practice by some developers, usually involving particular types new home products, the whole new home sector, and all new homes, are being regarded as equally high risk.

44. **We are working with the CML and lenders to try to ensure lending for new homes is offered on the same terms as lending for second-hand properties, but we would welcome FSA support on this important issue for the new homes industry.**

Regulation of Buy-to-Let Lending

45. While we do not have an accurate estimate of the investor share of total new home sales, in the boom years investors clearly accounted for a significant proportion of new home sales, particularly in town-centre and inner-city apartment schemes.

46. The investor market has contracted sharply since 2007, but we believe investors will remain an important source of demand for new homes in the future.

47. The DP highlights the disproportionate increase in arrears and possessions among investment borrowers since the downturn. However we would urge the FSA to be mindful of the real reason for this. It was not that all the individual investors who are now in trouble made bad decisions about the particular property they bought. Rather, they misjudged the housing market and economic cycle, as did most people in Government and the Treasury, the Bank of England, the FSA, the economics profession, business and the population at large. Because businesses expanded in the upturn, we do not now say that those who have suffered in the recession made poor decisions and should therefore be regulated to protect them from themselves. Yet this is, in effect, what is being proposed for the investor market.

48. In addition, we cannot see how in practice lenders could adequately discriminate between naïve investors who, we might argue, need protecting from themselves, and investors who are making informed commercial decisions which may, in the long-term, turn out to be right or wrong, as with any commercial decision.

49. **While we understand the FSA's desire to bring BTL mortgages into the regulatory framework, we are not convinced this is a practical proposal.** We note in particular the DP's observation that BTL mortgages often involved poor lending decisions and low margins. This would seem to suggest the solution, as with so many other problems in the mortgage market, lies with better risk assessment and risk pricing by lenders.

Regulation of Second-charge Mortgages

50. The proposal to regulate second-charge mortgages is of very real concern to the industry, although we appreciate why the FSA favours such a change, as does the lending industry.

51. The suggestion in paragraph 9.11 is that second-charge lending often acts as a substitute for first-charge lending when potential borrowers are unable to access a first-charge mortgage. In other words, second-charge loans are a poor and unregulated way for risky borrowers to get around regulated first-charge restrictions. There is also the statement that "Not all second charge consumers will be credit-impaired, but a substantial number will be" (paragraph 9.6).

52. However in the new homes sector second-charge lending has a particular, and important role which is quite different from that envisaged in the DP.

53. In a difficult market, many home builders will offer buyers "shared equity". The buyer will typically fund 70-80% of the purchase price, made up of a small deposit and first mortgage, and the developer will fund the remaining 20-25%, taking a second charge on the property. In today's market, with onerous deposit requirements by lenders, this enables buyers to overcome the deposit gap and has been an important measure to help the industry weather the economic storm.

54. Under the Government's HomeBuy Direct scheme, run by the Homes and Communities Agency (HCA), the buyer funds 70% of the purchase price with a mortgage and small deposit (typically 10% of the 70%), while the HCA and developer each "contribute" 15% via a second charge mortgage. The Government's target is for some 10,000 HBD purchases (the scheme ends in September 2010), with a further 3,000 HBD purchases expected through the Kickstart scheme, also operated by the HCA. In the context of total new home sales of less than 100,000 per year at present, these schemes are clearly making a very significant contribution. We have also held discussions with the Government and HCA about making HBD a permanent feature of the Government's low-cost home ownership programme.

55. As will be obvious, this is a completely different situation to that envisaged in the DP. Because the buyer requires a first-charge mortgage, they will be vetted first by the home builder's sales staff, then by an IFA, and finally by the lender. In the case of HBD, the buyer is also vetted by a HomeBuy Agent to assess their suitability for this product and their ability to undertake such an arrangement. In other words, share-equity buyers almost always have a first-charge mortgage and all the protection this brings. The first-charge lender is fully aware the borrower is buying under a shared equity scheme, a factor that will be taken into account in assessing their eligibility for the first-charge mortgage.

56. We understand housing associations operating schemes that involve second charges, and the HCA, are exempt from FSA regulation.

57. If second-charge mortgages were to become regulated, one option for home builders would be to become regulated lenders. However this would be very onerous and expensive, so that few if any companies would wish to take this route. It is more likely firms have to stop offering shared-equity products.

58. It would be of serious concern to the industry, and to the Government, if these schemes had to be abandoned if second-charge lending became fully regulated by the FSA as this would damage the industry's ability to sell new homes, and so reduce the number of new homes built. **Therefore if second-charge mortgages are to be FSA regulated, we would like to explore with the FSA, the CML and lenders how we might allow home builders to offer shared equity schemes involving second-charges without needing to become FSA regulated.** There is no additional risk to borrowers who are subject to the normal first-charge regulations. Indeed in the case of HBD, with the additional role of the HomeBuy Agent, buyers/borrowers are even more carefully vetted than normal open-market buyers/borrowers.

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