CONSULTATION RESPONSE

HM Treasury Mortgage Regulation: a consultation

15 Feb 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 many other housing transactions by allowing home buyers to complete chains.

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

4. **Second-charge mortgages** play a special, and very important role in the new homes sector through "shared equity" schemes. Shared-equity buyers are not credit impaired and are not using second-charge mortgages to consolidate unsecured loans. Shared equity buyers almost always require a first-charge mortgage and so are fully protected by current FSA regulation. Such loans pose no risk to the mortgage market and there is no risk of "gaming".

5. Therefore if second-charge mortgages are to be FSA regulated, we would wish to explore with the Treasury, FSA, CML and lenders how we might allow home builders to offer shared-equity schemes involving second-charge mortgages without needing to become FSA regulated. If home builders did have to become FSA regulated, most would have to abandon offering shared-equity products, thus damaging new home sales and housing production.

6. Investment buyers were an important source of new home demand up to 2007, and could return in significant numbers given the strong demand anticipated for rented homes. We are not convinced regulation of the **buy-to-let mortgage market** is necessary or practical.

7. The home building industry and lenders have worked closely together to reduce the incidence of mortgage fraud in the new homes sector, in particular introducing the Disclosure of Incentives Form (DiF) in 2008.

8. Better risk assessment and risk pricing by lenders should protect against poor lending decisions in this market. It does not seem necessary to protect residential investors against making poor commercial decisions.

HOME BUILDERS FEDERATION (HBF)

9. 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.

10. While HBF member companies are not “lenders” in the conventional sense, they have a major interest in the Treasury’s consultation because their shared equity schemes involve the home builder granting a second-charge loan to the new home buyer, and because investment/buy-to-let demand represented a significant share of new home sales up until 2007, and could again become an important source of demand once the market recovers. We have not attempted to answer the detailed questions in the Treasury’s consultation. Instead we discuss second-charge and buy-to-let lending in the special context of the new homes industry.

11. We note that HBF made a submission to the recent FSA mortgage market review[1] which also put forward our views on regulation of second-charge and buy-to-let mortgages.

THE ECONOMIC 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. 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

[1] Financial Services Authority. Mortgage Market Review. Discussion Paper 09/3. October 2009.

80% is private and 20% public. Therefore new house building makes a significant direct contribution to the UK economy.

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

15. However the industry has a significance for the economy which goes far beyond its direct contribution to GVA and employment within the industry.

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

17. 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.

18. Although new homes represent only about 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.)

19. 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 roughly halved, as has industry employment. This in turn means the Government's housing targets for 2016 and 2020 are now not likely to be achieved, with all the adverse social and economic consequences this will bring.

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

REGULATION OF SECOND-CHARGE MORTGAGES

21. The proposal to regulate second-charge mortgages is of very real concern to the industry. Although we appreciate why the Treasury and FSA are considering such a change, it would have serious, and we suspect unintended consequences for the new homes industry.

22. The suggestion in the consultation is that second-charge borrowing is increasingly used as a form of debt consolidation, in particular by borrowers with impaired credit records and people who are experiencing problems with existing unsecured loans (paragraph 2.8).

23. However in the new homes sector second-charge lending has a particular, and very important role which is quite different from that envisaged in paragraph 2.8.

24. 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 deposit and first mortgage, and the developer will fund the remaining 20-30%, taking a second charge on the property. In today’s market, with lenders’ onerous deposit requirements, this enables buyers to overcome the deposit gap and has been an important measure to help the industry weather the economic storm.

25. House builders offering second charge loans for share-equity sales are covered by the existing consumer credit regulations, including having to hold a consumer credit licence.

26. Under the Government’s HomeBuy Direct (HBD) scheme, run by the Homes and Communities Agency (HCA), the buyer funds 70% of the purchase price with a first mortgage and deposit (this deposit is typically 10% of the 70%), while the HCA and developer each “contributes” 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.

27. The home building industry’s use of second-charge loans is completely different to the situation envisaged in the Treasury’s consultation. Because buyers require 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.

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

29. "Externalities" (paragraph 2.26) are not relevant to second-charge lending by home builders, there is no risk of a home builder's failure damaging the mortgage market (paragraph 2.27), and such schemes do not offer an opportunity for "gaming" (paragraph 2.28).

30. 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 would have to stop offering shared-equity products.

31. It would be of serious concern to the industry, and should be to the Government, if these schemes had to be abandoned because second-charge lending became regulated by the FSA. This would damage the industry's ability to sell new homes and reduce the number of new homes built.

32. **Therefore if second-charge mortgages are to be FSA regulated, we would urge the Treasury and FSA to recognise the very special situation of second-charge lending by home builders, and we would wish to explore with the Treasury, FSA, 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 such borrowers who are almost always subject to the normal first-charge regulation protection. 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.

REGULATION OF BUY-TO-LET MORTGAGES

33. 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 3.21 of the Treasury's consultation. In the downturn these past practices have produced substantial losses for some lenders.

34. Therefore we have fully supported the Council of Mortgage Lenders' (CML) efforts to improve the transparency of new home incentives, most notably by working with the CML and RICS to introduce a Disclosure of Incentives Form (DiF) in 2008. We continue to work with the lenders to rebuild confidence in the new homes sector and in 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 home sales to owner-occupiers with a mortgage.

35. We understand from the Treasury's recent private rented sector paper[2] that buy-to-let accounted for around one fifth of new home sales in 2007. Investor demand has been badly hit by the mortgage famine since Autumn 2007. However, as the Treasury private rented sector paper makes clear, there are good grounds for believing we will see strong demand for private rented homes as the housing market recovers. This should bring about a recovery in investor demand for housing, including new homes.

36. The decision to buy an investment property, whether made by a relatively naive individual or by a sophisticated investor running a private rental business, is a commercial decision, and is therefore quite different from the borrowing decision of an owner occupier.

37. The Treasury consultation highlights the disproportionate increase in arrears and possessions among investment borrowers since the downturn. However we need 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 investors, some of whom were "seeking short-term capital appreciation" (paragraph 3.5), did not anticipate a mortgage famine and misjudged the housing market and economic cycle, as did most people in Government and HM Treasury, the Bank of England, the FSA, the economics profession, business and the population at large. Because businesses thrived in the upturn, we do not argue that those who have suffered in the recession made poor commercial decisions and should therefore be regulated to protect them from themselves. Yet this is in effect what is being proposed for the buy-to-let market.

38. In addition, it is not clear how in practice lenders could adequately discriminate between naïve investors who, it might be argued, need protecting from themselves, and investors making informed commercial decisions which may, in the long-term, turn out to be right or wrong, as with any commercial decision. Buying a home as an investment is ultimately a business decision, whatever the investor's expertise.

[2] HM Treasury. Investment in the UK private rented sector. February 2010. Page 22.

39. **We are not convinced regulation of buy-to-let mortgages is necessary or indeed practical.** In its recent consultation on mortgage regulation[3], the FSA observed 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, not regulation of investment buyers/borrowers.

John Stewart
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[3] Financial Services Authority. Mortgage Market Review. Discussion Paper 09/3. October 2009.