

# Cherwell District Council

## Executive

8 January 2018

### Bespoke / Custom Build Mortgage Pilot Scheme

## Report of Executive Director: Finance and Governance

This report is public

### Purpose of report

To consider joining a version of the existing Local Authority Mortgage Schemes (LAMS) which was developed by Arlingclose to promote access to self/custom build home ownership within the district. It sets out the Bespoke/Custom Build (BCB) scheme which offers support to local people to access self/custom build houses by reducing the risk of self-build and provides a return to the council which could be reinvested in housing related activities.

## 1.0 Recommendations

The meeting is recommended to:

- 1.1 Agree to join the Bespoke/Custom Build (BCB) scheme, but limited to an initial pilot scheme of 10 BCB mortgages, for launch in early 2018.
- 1.2 Delegate authority to the Executive Director: Finance and Governance, in consultation with the Lead Member for Financial Management, to extend the scheme to new applications once the success of the pilot has been assessed and further capital funding is in place for additional bridging loans.
- 1.3 Delegate authority to the Executive Director: Finance and Governance, in consultation with the Monitoring Officer and Lead Member for Financial Management, to enter into legal agreements required for the BCB scheme where land is owned by third parties.
- 1.4 Delegate authority to the Executive Director: Wellbeing, in consultation with the Executive Director: Place & Growth and the Lead Member for Housing and the Lead Member for Estates & Economy to set the criteria for prioritising access to the scheme for applicants with a local connection.

## 2.0 Introduction

- 2.1 At the end of October 2017, the Commercial Development Panel gave its support to a business case recommending that CDC join the BCB mortgage scheme. This

report presents the case for joining the scheme which could provide increased access to a wider range of bespoke / self and custom build housing options for local people.

- 2.2 The product would support the council's long term priorities around increasing access to housing in what is an expensive market. It is aimed at sections of the population who would not be eligible for social housing, but who may struggle to access housing (particularly self or custom build) due to affordability issues in the area. Examples of the target beneficiaries of the products could include, but need not be limited to, key workers or young families with a local connection.
- 2.3 Supporting the housing market and the provision of additional housing is a key target for both the government and most local authorities. In addition to a growing population, people live longer, divorce more often and a quarter of adults under the age of 35 are still living with their parents. As such the challenges of accessing housing are likely to remain a high priority for local people.
- 2.4 Nationally, we need to build in the region of 250,000 new homes every year to keep up with demand. This remains an extremely challenging target. Mainstream developers are likely to continue to focus on building 3 and 4 bedroom properties as these offer a better financial return for them, and across local government councils are looking at a range of tools to meet the gap between supply and demand in terms of local housing needs.
- 2.5 Self-build is already a priority for the council given its investment in Graven Hill and the council has strong commitment to innovative approaches to housing and commercial opportunities. There is an increasing demand for 1 and 2 bedroom properties for single occupancy, as well as increasing demand for low cost good quality housing, including shared ownership units and housing for people with special needs. These trends add to the increasing pressures on the housing market, and it is unlikely that this growing demand will be met through traditional construction channels alone.

## **3.0 Report Details**

### **National Policy Framework**

- 3.1 To address the national housing need, the government introduced the 'Right to Build' policy in 2014. This initiative has gathered some further momentum in the Self-build and Custom Housebuilding Act 2015. From 1st April 2016, all local planning authorities are required to maintain and promote a register of interest of aspiring custom and self-builders, and the next step will be to match available land to demand on the register.
- 3.2 The Planning and Housing Act 2016 requires planning authorities to give suitable planning permissions in respect of enough serviced plots of land to meet the demand for self-build and custom housebuilding in the authority's area arising from the register. The available land may be owned by the local authority; however, some local authorities will deliver legislative requirements in partnership with third parties such as local and national developers and landowners.

- 3.3 The council is a custom and self-build vanguard authority, and has therefore had a custom and self-build register in place for some time. There are many names on the council's register, however, it is recognised that not all of these may be potential customers as there is a great deal of interest nationally in monitoring progress on Graven Hill. Graven Hill is the largest custom and self-build site in the UK; however, research (from both the marketing and sales experience at Graven Hill and consultations with mortgage brokers) suggests that access to self/custom build mortgage finance is a barrier to building.
- 3.4 As such the BCB proposal outlined below (and in the accompanying appendices) provides a good opportunity to partner with a reputable treasury management company and provider of financial advice to offer a product that would directly support the council's commitment to self and custom build.
- 3.5 Arlingclose has developed the BCB mortgage scheme to support local authorities in delivering the new legislative requirements (see appendix 1 for a summary description). The scheme is an extension or refocus of the current LAMS scheme. The BCB scheme has been in existence since 2016, but LAMS was launched in 2011. There were 110 local authorities signed up to the scheme according to the 2013/14 annual report (see appendix 5).
- 3.6 As part of the development of the product Arlingclose have ascertained that, on average, custom and self-build development generates a development uplift in the region of 20%. This 'added value' created by completing the build creates the opportunity for the developer (in this case the council) to generate a return. The council can choose to retain this return and reinvest in housing projects, or share a part with the customer, further increasing the affordability of self-build housing.

### **Bespoke / Custom Build Mortgages**

- 3.7 An overview of how the scheme works is given below:
- The local authority will make land available, or provide financial support for an applicant on land owned by a third party,
  - An applicant will secure a plot of land from the local authority (or a third party), with proof of a pre-approved mortgage from a panel of mortgage lenders,
  - A 5% deposit will be paid by the borrower (some or all of the deposit will be non-refundable),
  - The local authority will enter into a build contract with a contractor to construct the property to completion. The payments to the contractor by the local authority will constitute a bridging loan,
  - On completion, the lender will advance the mortgage and the local authority will recover all costs, including interest and potentially a development uplift,
  - The local authority could recycle the repaid bridging loans to support other borrowers if the pilot scheme is deemed successful,
  - The participating local authority will provide an indemnity of up to 20% of the mortgage, in effect underwriting the difference between 75% lending – the

market norm for custom build mortgages – and 95% lending, for a fee (payable by the lender to the local authority),

- The local authority can leave the scheme at any time; therefore, offering a pilot does not commit the local authority to any further mortgages.

3.8 Lenders do not currently offer high loan to value mortgages on self or custom build properties, hence a key feature of the BCB scheme is that the local authority provides an indemnity of up to 20% of the mortgage, in effect underwriting the difference between a 95% loan to value mortgage and more affordable 75% loan to value mortgage. The indemnity remains in place for 5 years, and may be extended for a further 2 years if a mortgage is in arrears of 3 months + at the end of the initial 5 year period. The council can charge the lenders the market rate to provide the indemnity (in the region of 1% of the mortgage amount).

### **Operation of the scheme**

3.9 Operation of the scheme can be undertaken by the council (i.e. there is no requirement to set up an arm's length entity) in partnership with Arlingclose. Appendix 2 outlines how the scheme works in detail. As the original design of the scheme has assumed that the land for development is owned by the local authority some additional legal work would be required to draw up an agreement between the council and any third party landowners (e.g. the applicant themselves, Graven Hill etc).

3.10 Access to the scheme (i.e. the selection of customers) will be undertaken by the lenders as per a usual mortgage application. The local authority may also choose to set out criteria such as a local connection and it is recommended in this report that local connection criteria is developed in partnership with the Wellbeing and Place & Growth teams. However, the financial assessments will be undertaken as part of the lenders' process and not by the council. As with traditional Local Authority Mortgages (LAMS) the scheme can be closed at any time thereby preventing new applications.

### **Risks and Returns**

3.11 No scheme of this nature is risk free and appendix 3 sets out the key risks associated with the proposal. To mitigate and manage the risk profile it is recommended that, if members were to implement the scheme, initial numbers are limited to a pilot of 10. This would limit the council's financial exposure and ensure a deliverable market for the product.

3.12 Tables 1 and 2 below set out the potential returns associated with this product. It is based on average local land and building costs. The cost of home construction in Cherwell is currently in the region of £1,800 per square metre; therefore, the build cost below would yield a property with a gross internal area of 138 square metres. This is between the averages for 3- and 4-bedroom homes. Any returns can be recycled into housing projects and/or held in a risk reserve.

## Potential Returns

**Table 1: Capital Receipts**

	£	£
Land Cost	100,000	
Construction Cost	250,000	
Total Development Cost		350,000
Market price of development		450,000
Development uplift		100,000
Return from pilot of 10		1,000,000

**Table 2: Revenue Receipts**

	£	£
Bridging loan	250,000	
Interest charged to customer at 5%	5,200	
Indemnity charge to lenders at 1% of mortgage amount	4,275	
Council cost of borrowing at 2.5%	(2,600)	
Net interest and fees		6,875
Net interest and fees from pilot of 10		68,750

- 3.13 Interest on the bridging loan is assumed to be for 9 months to reflect the average time required to construct a house and are modelled at a market interest rate of approximately 5%. The loan balance is assumed to increase evenly over that period to reflect the staged payments typical of a construction contract. Council borrowing costs are assumed at 2.5% based on current PWLB rates. The indemnity charge to lenders is at a market rate of 1% on the value of the mortgage; however, due to accounting rules must be held in reserve as a financial liability. It can be released to the I&E at the end of the indemnity period.

### How the indemnity would work

- 3.14 The LAMS indemnity will remain in place for 5 years. This may be extended by a further 2 years if a mortgage is more than 3 months in arrears in the last 6 months of the initial period. A cash payment is not required from the local authority to support the indemnity, and the local authority receives a one-off State Aid compliant premium per mortgage from the lender to compensate for the risk taken. As there

is no supporting deposit involved, the indemnity is accounted for as a financial guarantee with a premium, as set out in the Arlingclose Accounting Paper.

- 3.15 The indemnity will be called in only if a loss is crystallised by the lender. Tables 3 and 4 below demonstrate two scenarios:

**Table 3: worked example 1**

<b>Example 1</b>	<b>£</b>
Market Value	450,000
Mortgage Value	427,500
Indemnity provided by CDC	90,000
Sale price (less attributable costs)	325,000
Loss to lender	102,500
<b>Indemnity called in from CDC</b>	<b>90,000</b>

**Table 4: worked example 2**

<b>Example 2</b>	<b>£</b>
Market Value	450,000
Mortgage Value	427,500
Indemnity provided by CDC	90,000
Sale price (less attributable costs)	400,000
Loss to lender	27,500
<b>Indemnity called in from CDC</b>	<b>27,500</b>

- 3.16 Any loss in excess of the value of the indemnity is attributable to the lender. Using the examples above, the pilot of 10 would result in the council indemnifying £900,000. The risk of this being called upon is quite low. Arlingclose have not had any to date.

## **4.0 Conclusion and Reasons for Recommendations**

- 4.1 The scheme has been developed as an evolution of the local authority mortgage scheme (LAMS) to be relevant and available for customers wanting to self or custom build. The approach generates small returns for the authority and as a partnership activity does not require significant investment in people and expertise to run the scheme. The primary benefits are the ability to start small and test the extent to which the product may increase access to the self-build market.
- 4.2 The next stage, if Executive agrees this proposal, is to launch the pilot and review the scheme's potential to be rolled out to additional applications.

## **5.0 Consultation**

- 5.1 This proposal is a product of the council's Succeeding in a Commercial Environment (SIACE) programme which seeks to improve the commercial skills of

participants through instruction and application of commercial techniques to a selection of ideas generated by other council initiatives (e.g. Innovation Weeks).

- 5.2 As part of that programme, this proposal has been thoroughly researched, market tested, presented to a panel of officers and directors and to the Commercial Development Panel.

## **6.0 Alternative Options and Reasons for Rejection**

- 6.1 The following alternative options have been identified and rejected for the reasons as set out below.

Option 1: To not join the scheme. This option has been rejected because the council may fail to meet housing needs in the district.

Option 2: To join the scheme without first conducting a pilot. This option has been rejected because it is more prudent to test the waters with a pilot to manage the expectations of the custom and self build community.

## **7.0 Implications**

### **Financial and Resource Implications**

- 7.1 Council were asked in December to approve the creation of a £2,500,000 capital budget to fund 10 bridging loans for the pilot scheme. Interest charged to homebuilders will result in revenue income to the council and there will be a deferred receipt from lenders for providing the indemnity.

The financial implications of the pilot have been detailed in sections 3.12 and 3.15. The pilot scheme is intended to recover its costs and may provide a modest return if the council's borrowing costs are significantly lower than the rate applied to the bridging loans. The full financial implications of rolling out the scheme to additional applications will be prepared following the pilot scheme.

Comments checked by:

Sanjay Sharma, Interim Head of Finance, 01295 221564  
[Sanjay.sharma@cherwellandsouthnorthants.gov.uk](mailto:Sanjay.sharma@cherwellandsouthnorthants.gov.uk)

### **Legal Implications**

- 7.2 There are a number of legal issues which arise in connection with the BCB scheme overall on which we have consulted Bevan Brittan (see appendix 4). To assist members in understanding these issues, a summary of the advice is set out below:

*The Council has the statutory power to indemnify mortgage lenders in certain circumstances pursuant to section 442 of the Housing Act 1985.*

*The Council can supplement the power under the Housing Act 1985 with the general power of competence pursuant to section 1 of the Localism Act 2011 and*

*the incidental power under section 111 of the Local Government Act 1972 to mitigate any risks associated with relying on the Housing Act 1985.*

*The fact that the land is not owned by the Council does not affect its ability to rely on the above powers to enter into the scheme.*

*There are no restrictions on the Council applying any eligibility criteria for borrowers to be eligible to participate in the scheme.*

*There are a number of potential State Aid issues which the scheme presents but none of these are considered to present a barrier to implementing it. Providing that suitable conditions are attached to the loans to be provided by the Council to carry out the development and the fee paid to the Council by lenders is at a suitable market rate then the Market Economy Operator Principle provides a potential exemption to the State Aid rules which would protect the Council,*

*There are a number of contracts which will be required to be entered in order to govern the management of the scheme and the relationship between the parties.*

*The Council can lawfully receive the development uplift which may arise as a result of participation in the scheme.*

Comments checked by:

Chris Mace, Solicitor, 01327 322125

[christopher.mace@cherwellandsouthnorthants.gov.uk](mailto:christopher.mace@cherwellandsouthnorthants.gov.uk)

## **8.0 Decision Information**

### **Key Decision**

**Financial Threshold Met:                      Yes**

**Community Impact Threshold Met:      Yes**

### **Wards Affected**

All

### **Links to Corporate Plan and Policy Framework**

Housing – Cherwell a Thriving Community

### **Lead Councillor**

Councillor Tony Ilott, Lead Member for Financial Management



## Document Information

<b>Appendix No</b>	<b>Title</b>
Appendix 1	Arlingclose Summary description
Appendix 2	Arlingclose Process
Appendix 3	Arlingclose Risk analysis
Appendix 4	Bevan Brittan legal advice
Appendix 5	LAMS Annual Report 2013/14
<b>Background Papers</b>	
None	
<b>Report Author</b>	Joanne Kaye, Principal Accountant
<b>Contact Information</b>	01295 221545 <a href="mailto:Joanne.kaye@cherwellandsouthnorthants.gov.uk">Joanne.kaye@cherwellandsouthnorthants.gov.uk</a>