Interventions to boost the market

Government guarantees and Help to Buy

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TradeRisks

- We are financial advisors, and arrange finance in the capital markets for housing associations, local authorities, utilities, and property companies

- In the last five years we have helped raise £4bn for housing – nearly half of all own name bond issues

- We have introduced new investors into the sector – improving competition on rates and terms

Blowing up a bubble?

- There are six schemes on the go
- How much do they inflate demand and prices?
- I concentrate on market housing initiatives. It is arguable, but not certain, that social, affordable rent, and shared ownership programmes do not lead to market price inflation. But the Affordable Housing Guarantee is worth a look

The schemes

- Affordable Housing Guarantee
- Build to Rent fund
- Housing Debt Guarantee Scheme - PRS
- NewBuy Guarantee
- Help to Buy Equity Loans
- Help to Buy Mortgage Guarantees

- For each I give a brief description, the financial model, quantum, market impact, and outlook.

General points

- Subsidy into the market inflates prices by increasing spending power
- Supply effects on prices are low – 10,000 more dwellings cuts 0.14% from house price growth rates, or less
- It is additionality that counts
- Guarantees (contingent liabilities) are subsidy if they transfer cost and risk to government
- Guarantees can have positive risk sharing (insurance) and negative (moral hazard) effects
- Mortgage default has been driven more by self-certification, un-regulated lending, interest only, and low initial incomes, than high loan to value ratios, but loss given default is related to LTV
- High LTV borrowing (>90%) has dropped to 2% from 35% (average 1981 to 2004) of all lending – perhaps not surprising as few buy leveraged assets that might fall in price

Affordable Housing Guarantee

- A government guarantee, via a subsidiary of The Housing Finance Corporation, to buyers of housing association bonds
- So far £500m of EIB funding at about 40bps over gilt. Not a direct comparison with standard issues by HAs as THFC has some 20bps+ of on-costs and restrictive asset cover covenants which can constrain some HAs. Furthermore EIB funding is only for 50% of project cost. A direct comparator is the "non-guaranteed" £350m EIB funding to Sanctuary at 78bps. Implying the guarantee is worth 38bps. This is "scored" as subsidy under EU State Aid rules
- A £200m guaranteed splinter bond is needed by THFC to make up the rest of the eight HAs investment need. It has not yet been priced by the market.
- Matched with but not linked to £450m of Affordable Homes Guarantee Programme government grant
- The AH guarantee is available for bids for 2015/18 which close in April. A total of £3.5bn of AHG is said to be allocated by government
- On an average HA newbuild dwelling 38bps reduction in borrowing costs enables £8,000 more to be borrowed. But grant bids have been reduced by about this amount
- Therefore there is, as yet, no net increase in subsidy to HAs. ∴ no inflation impact
- A useful, but not sufficient, method of subsidy in a low/no grant environment

Build to Rent Fund

- Targeted at stalled schemes with a significant PRS content
- Government will provide development loans or equity (on a 50/50 basis) to developers up to £1bn in two rounds which have closed
- Funds are priced on a commercial basis, so is EU State Aid compliant
- Development finance is particularly difficult to raise in a weak market so might unlock some activity with high pre-sale/let requirements and low gearing
- Schemes have been shortlisted but, as far as I know, none have received final clearance
- No subsidy ∴ no inflationary impact
- Doubtful benefit as those strong developers with viable schemes will find it simpler to self fund or go to market

Housing Debt Guarantee Scheme - PRS

- Up to £3.5bn available to provide guarantees to long-term investors in PRS for up to 30 years and 80% LTV
- A fee is paid to government for the guarantee which is calculated on the potential loss given default under the guarantee scheme (for that project)
- There is, if the calculations are reasonably accurate, therefore no transfer of risk or subsidy ∴ no inflation effect
- The borrower pays to give the lender comfort
- If this was different then there would be "costs scored" under EU State Aid rules
- No guarantees have been issued so far
- As the fee will be almost the same, and possibly lower given admin costs of extra counterparty, than the market will charge, it is doubtful whether this scheme will take off. It might be useful for new companies with no other assets needing 80% LTV but premiums will be high

NewBuy Guarantee

- Sponsored by the HBF, guaranteed by government, launched in March 2012
- Mortgage guarantees for selected lenders on selected house builders supply – the "insurance" is to isolated cells of parcels of mortgages to minimise cross default between lenders
- The guarantee fee is 3.5% of house price, "paid by the builder" to the insurer, and enables up to 95% LTV for the purchaser
- We were told to expect 30,000 a year but so far 4,876 in the seven quarters to Dec 2013 and a distinct tailing off after the Autumn announcement of Help to Buy 2
- No successful claims against the guarantee so far – biggest risk is in first three years
- In effect the borrower has paid a fee equal to the potential loss given default to government, therefore no subsidy ∴ no inflationary impact
- The scheme may have stimulated some demand – say 50% additionality or 2,400 newbuild. But unlikely to have had a measureable price effect
- Buyers might be better off if they can find more deposit or second loan from family or friends (thus lower mortgage rate) to negotiate a lower price from the house builder for a "cash" purchase.
- The scheme seems to be superseded by Help to Buy 2

Help to Buy 1 - Equity Loans

- This is a massive programme with potentially no cost to government (depending on house price growth)
- Up to 20% loans are available via Help to Buy Agents enabling newbuild buyers to borrow at a 75% LTV mortgage rate and put down a deposit of 5%
- The loan is interest free for five years then at 1.75% indexed to RPI+1% with 20% of, then, value repaid to government at will, on sale or after 25 years. The total “cost of borrowing” is about 5%; more with higher HP growth; but much less than a second charge, without recourse ,covering the 75% to 95% band of value (estimated at 12.5% interest rate from market rates)
- If the repayment is after 12 years (average tenure) on a £200,000 dwelling and HPI is 4%pa (OfBR forecast long-term) then the subsidy present value is £7,000 per buyer
- If HPI is 6%pa then there is no subsidy
- Launched in April 2013, there have been 14,823 takers to end Jan 2014, indicating a settled run rate of 25,000 to 30,000pa
- If 50% of this is additional to what would have happened then this represents a significant proportion of the 57,000 newbuild (private individual) purchasers of newbuild in 2013 – say 25%

Help to Buy 1 - Equity Loans - continued

- So if 25% of newbuild purchasers are paying £7,000 (3.5%) more than they would have done that's 1% price inflation pa on newbuild or 0.1% on total HPI, for £210m of government input pa – this will vary depending on actual HPI
- This assumes of course that people aren't buying more housing utility (space) for the extra money. Some are and that reduces inflationary effects
- There could also be a small supply/demand price effect, over and above spending power effect, if the 15,000 additional demand is not met by additional supply. But there are signs that output is increasing to meet this additional demand
- This programme is now extended to 2020 (Budget 2014) and on the principal projection will pump a total of £1.4bn into the house building sector
- It is an un-targeted programme – there are no income limits. Current take up is well within the £600,000 house price limit and well spread geographically, and around different sized house building operations
- Household income levels average £40,000, 89% FTBs, and house prices £203,000 perhaps kept downmarket by some filtering by Help to Buy Agents.
- It is likely to remain popular, maybe at the expense of shared ownership
- It is probably reducing take up of parental money, second charges, or even personal savings which can remain "within" the economy

Help to Buy 2 - Mortgage Guarantees

- Government guarantee for lenders for part of the debt for borrowers with LTVs over 80% and up to 95%, for seven years from Jan 2014. The scheme closes to new approvals in December 2016
- The scheme is for any individual purchaser of new or existing up to £600,000 house price but excludes second homes, Buy to Let or combining with other schemes
- Lenders are invited to join in but have to agree to scheme rules
- The lender pays a fee to government to cover the expected loss given default, by LTV bands – a form of group insurance
- The fee amounts appear to have been well calculated and compare exactly to the risk adjusted "open market" mortgage rates for higher LTVs
- The moral hazard risk is covered by the requirements on lenders to assess creditworthiness so that the scheme avoids above average numbers of high risk customers. In any event government reserves the right to adjust the fees if LGD is assessed as materially different from today's assessment
- Take up to date (very early days) is low at 2,572 with 82% FTBs and an average HP of £148,000
- This is what a household on £40,000 a year can afford with a 95% LTV mortgage ie 25% to 30% less than with an equity loan or 75% LTV mortgage

Help to Buy 2 - Mortgage Guarantees

- When people realise the cost and the reduced "spending power" the take up is bound to be lower. It is hard to call the settled run rate but my guess is around 10,000 pa. It would be optimistic to say 20,000
- There is no subsidy ∴ no inflation effect from the guarantee
- There is some demand effect. This scheme undoubtedly boosted confidence in the later part of 2013 but how much of the market change was caused by this or by general economic growth is hard to say
- There are now as many banks/building societies offering 95% LTV mortgages outside of the scheme as those who have joined, which indicates that the risk of negative equity for new borrowers in the next three years is receding, and there are alternatives to Help to Buy 2
- Whatever the extra demand increase now it almost certainly will have an opposite effect when the scheme winds down post Dec 2016
- Say 10,000 additional purchases this year that wouldn't have happened, and again in 2015 and 2016 but reversed in 2017 and 2018 then the net extra demand of 10,000 would have increased house prices by 0.14% at most
- The original announcement of £12bn of debt guaranteed supporting £130bn of mortgage lending seems unlikely now. My guess is £0.7bn and £4bn respectively

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