Keeping Britain building:
mortgage lending in the new build sector

November 2017

Executive summary

- Lenders' confidence to lend on new build property has grown substantially in recent years. Although new build remains a specialist sector of lending, with a number of unique issues, the concerns raised by losses incurred in the wake of the financial crisis have, to a large extent, been addressed. The Council of Mortgage Lenders (now UK Finance) Disclosure of Incentive Form has allowed valuers to understand the details of each transaction. A shift in the mix toward houses and away from flats has also reduced overall risks to lenders given the greater historical price volatility of flats.

- However, there are concerns about the extent to which the market has become dependent on Help to Buy equity loans, which have supported some 27% of all private new build output. If the Help to Buy equity loan scheme were to be withdrawn on its current timetable, which sees it terminating in 2021 under this government, without a replacement, this might not only hit housebuilders but could depress the value of new homes which in turn could reduce the value of homes already bought under the scheme, weakening lenders', borrowers' and the government's security.

- Help to Buy has proved a boon to housebuilders. Although it has also helped to maintain lending to first time buyers on new properties, lenders have had some concerns about the scheme. Thanks to the 20% equity loan (40% in London), buyers with small deposits can stretch their resources and buy a more expensive home than would be possible with a conventional purchase under current affordability rules. But these buyers have the ongoing liability of an equity loan with interest to pay after 5 years.

- Housebuilders successfully lobbied government for support schemes to fill the gap left by the absence of high loan-to-value (LTV) lending on new build after the financial crisis, from HomeBuy Direct to NewBuy to Help to Buy. However, lenders have been less vocal in calling for schemes that minimise their risk. The shift from NewBuy to Help to Buy increased lender exposure to credit risk yet lenders' response was muted.

- Lenders are still mindful of the problems that beset new build lending during the last recession. Losses on repossession were much higher on new build property, especially high rise new build flats. As a result, lenders have maintained a range of controls including lower maximum LTVs on new build (and lower still on new build flats), exposure limits on sites and the Disclosure of Incentives Form. But there are positives with new properties: default data suggests that those who purchase a new build property are significantly less likely to default.

- New build valuation remains a live issue. It is accepted that there will be a new build premium, justified by the advantages that come from purchasing a new home, such as an NHBC guarantee and lower running costs. However, history shows that the new build premium can also be the result of less sustainable factors including builder incentives and even government support schemes such as Help to Buy. Valuers need to remain vigilant towards any unjustified new build premium.

- Brokers have an even stronger presence in the new build lending market than across the wider mortgage market. While mortgage intermediaries now introduce some 70% of all loans, in the new build market the figure is around 85-90%. One reason for the higher share in new build is that housebuilders encourage buyers to use one of their approved brokers and lenders welcome brokers that have a detailed understanding of new build lending.

- The use of leasehold by housebuilders with the inclusion of onerous ground rent clauses has hit the headlines recently. Some lenders have stopped lending on these properties. Others approach the issue on a case by case basis. But where ground rents double every 10 years, a £250 ground rent will become £8,000 in 50 years and £32,000 in 70 years, making it questionable whether the property has any long term value.

- Despite increased competition amongst lenders in new build sector, most lenders have maintained lower maximum LTVs relative to the second hand market and lower maximum LTVs on new build flats than new build houses. These differentials seem unlikely to disappear in the immediate future as they reflect both past loss experience and the unique issues that lending on new properties can raise.

1. Introduction

A healthy house building sector is a vital element in a balanced housing market. New build can respond to rising housing demand driven by increased population or greater demand per head (driven by factors such as rising living standards or changes in average family sizes). But new build also responds to changes in the geographic pattern of demand and changes in consumer tastes. So new house building acts as a somewhat muted pressure valve, meeting increased housing demand at a national and local level and thus dampening otherwise potentially excessive house price surges.

Table 1 – Size of UK new build market relative to second hand house sales

	UK private sector housing completions	UK housing transactions	New build as % of total housing sales
2005	182,180	1,578,000	11.5%
2006	182,700	1,671,000	10.9%
2007	195,880	1,613,000	12.1%
2008	155,110	900,000	17.2%
2009	121,500	859,000	14.1%
2010	105,230	886,000	11.9%
2011	105,420	885,000	11.9%
2012	107,640	932,000	11.5%
2013	106,520	1,074,000	9.9%
2014	114,940	1,219,000	9.4%
2015	133,480	1,229,580	10.9%
2016	138,190	1,234,880	11.2%

Source: DCLG and HMRC

As Table 1 shows, roughly 10% of housing transactions have been of new properties in recent years, a sizable component of the overall market, although low by international standards. And while owner-occupied home sellers can delay sale in a slow market housebuilders need to maintain sales continuously, ensuring that new house sales form a larger share of the market in times of recession (in 2008 the proportion reached 17%).

Housebuilders can also add liquidity to the wider housing market through part-exchange, where the builder buys the existing home of a customer seeking to move to a new property. This and other benefits (including the 10 year guarantee) that housebuilders can offer that ordinary sellers cannot, can help make new build property a very attractive option for buyers.

Housebuilders are in turn very dependent on a healthy lending market to finance sales. It is thought that at least two thirds of new build transactions involve mortgage finance. Mortgage lenders recognize the role housebuilders play in meeting demand and helping to maintain a stable housing market and have an interest in ensuring that buyers of new build properties can get the mortgage finance they need. But lenders must also always ensure that their lending is prudent and affordable for the borrower and new build property can raise some specific challenges in this respect.

New build is treated as a specialist market segment by lenders because of a range of issues that are specific to lending on new properties. These issues include the potential for a new build premium (i.e. a higher price reflecting its new status), the existence in many cases of incentives provided by the housebuilder to the buyer and the prevalence of government support, currently most notably in the form of the Help to Buy equity loan scheme.

There are also niche lending markets within new build including Help to Buy, shared ownership, properties built with modern methods of construction and self and custom build along with community land trust developments and co-housing schemes. Lending to those building their own homes differs significantly as funds need to be released in stages as construction proceeds and lenders need oversight of the process. Lending on custom build follows the same pattern but with homes built professionally on plots bought by the customer.

The government is keen to expand self and custom build and lenders will need to respond to the expected rise in demand. On community land trusts and co-housing the maximum percent able to be purchased is often 80% along with requirements to sell the home to specified groups of customers. These restrictions can pose lending challenges but typically it has been possible to find solutions which satisfy all parties

The good news is that the number of lenders in the new build market has increased. More than 20 lenders now participate in the Help to Buy scheme alone and other niches such as self build are now also better served. This increased competition has helped to ease restrictions such as LTV caps, widening the range of borrowers. There are now some 20 lenders offering 90% plus on houses (with 6 on 95%).

So in spite of the specialist nature of the market new build is attracting the mortgage funding its customers need. But looking forward, the largest question mark relates to how government can withdraw the support of Help to Buy without undermining the new build sector. This has implications not just for builders but for lenders who have already collectively lent an estimated £21 billion under the Help to Buy equity loan scheme.

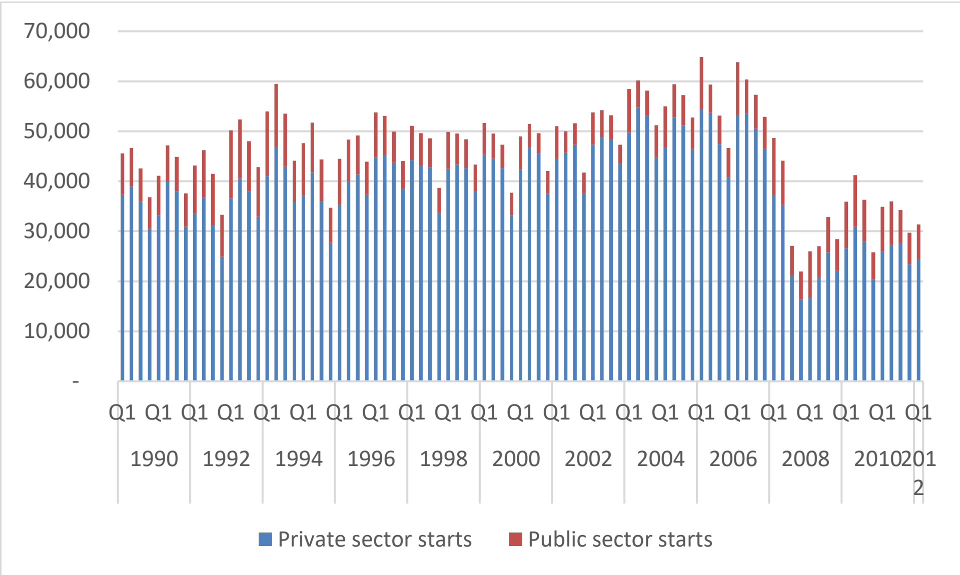
2. A decade of change in the builder lender relationship

How reduced mortgage supply hit housebuilders

Traditionally housebuilders and mortgage lenders have had a good relationship. Even during economic downturns lenders maintained lending on new build properties, helping to support output. But all this changed in 2008 as the financial crisis started to restrict lenders' access to funds needed to maintain lending. With less funding available, mortgage lenders started to restrict riskier forms of lending including adverse credit and high LTV.

The withdrawal of the majority of high LTV mortgage products was a particular blow to housebuilders. The housebuilding industry had relied on high LTV loans for the starter home market aimed at first time buyers, which typically made up some 40% of the new homes built each year. The result was a dramatic decline in private sector new build output (see Chart 1). Private housing starts went from 46,500 in the final quarter of 2007 to 16,400 a year later.

Chart 1 – UK housing starts (quarterly)



Source: DCLG

A question of trust

As the financial crisis progressed and lenders saw a rise in defaults they started to notice that, on repossession, losses on new build properties were often alarmingly high. The worst affected type of property was new build high rise flats which had been popular mainly with investors prior to the financial crisis.

Not only was there considerable over-supply in some markets, leading to substantial price reductions, but it turned out that the original value of the apartments had often been distorted because the transaction between developer and purchaser was not straightforward. It had become normal for housebuilders to offer various incentives to induce purchasers.

These incentives could take the form of free fixtures and fittings such as white goods or even in some cases, free cars. But the biggest concern stemmed from deals involving cash incentives. Cash advances from the developer could be used by the purchaser as part of their deposit or even as the whole deposit. For example, an apartment with a £200,000 sale price and a 10% cashback where the buyer was using the cashback as their whole deposit would appear to the lender to be 90% LTV loan on a £200,000 flat. In reality, it was a 100% LTV loan on a £180,000 flat.

The high rate of losses on new build property undermined the previously good relationship between lenders and builders and was exacerbated by high levels of outright fraud in new build lending. In response lenders started to impose separate, lower LTV limits on new properties as well as adopting a generally more cautious attitude to new build, which included instructions to valuers to value new build properties as if they were already occupied.

Following the higher losses on new build flats, most lenders imposed lower maximum LTV limits on flats than houses. In the wake of the financial crisis the majority of larger lenders imposed maximum LTV limits of 70-75% for new flats and 80-85% for new houses.

Disclosure of Incentives form

To help to restore trust the Council of Mortgage Lenders (CML) working with the Home Builders Federation (HBF) set about creating a new form which builders would need to complete for each sale where a mortgage was involved. The resulting Disclosure of Incentives form collected detailed information on the transaction between the housebuilder and buyer, to be used by the valuer to understand if the value of the property was influenced by factors such as incentives or a part exchange agreement.

It is clear now that the Disclosure of Incentives form has played a vital role in improving relations between lenders and builders. But as the economy and housing markets have gradually improved lenders have also benefitted from more benign credit conditions. Moreover, the tougher underwriting of borrowers that is normal after a period of higher defaults has been reinforced since 2014 by enhanced affordability requirements under the Mortgage Market Review (MMR).

As a result, defaults and credit losses on post-recession lending have been exceptionally low on new build and secondhand properties alike. But, interestingly, default rates were already substantially lower on new build owner-occupied lending than the average across the market (although losses on repossession are often higher). This suggests there is something about new properties or the people who buy them that makes default less likely, although it is not immediately clear as to what the key factors driving this differential experience are. So lenders now have more confidence in new build but there are still some concerns and we turn to these next.

3. Lender concerns with new build lending

The new build premium

Valuation has always been a live issue on new properties because of the so-called new build premium. A brand new home can command a premium over a similar secondhand property in the same locality as buyers are prepared to pay a premium for a new home just as they are willing to pay a premium for a new car.

But with property, the new build premium not only reflects newness, it is also a product of certain inherent advantages new homes have over older ones. New properties come with an NHBC or similar 10 year guarantee providing peace of mind to the buyer that structural problems will be rectified without additional cost. New homes are also typically more energy-efficient in most cases and often come with features not found in most older properties.

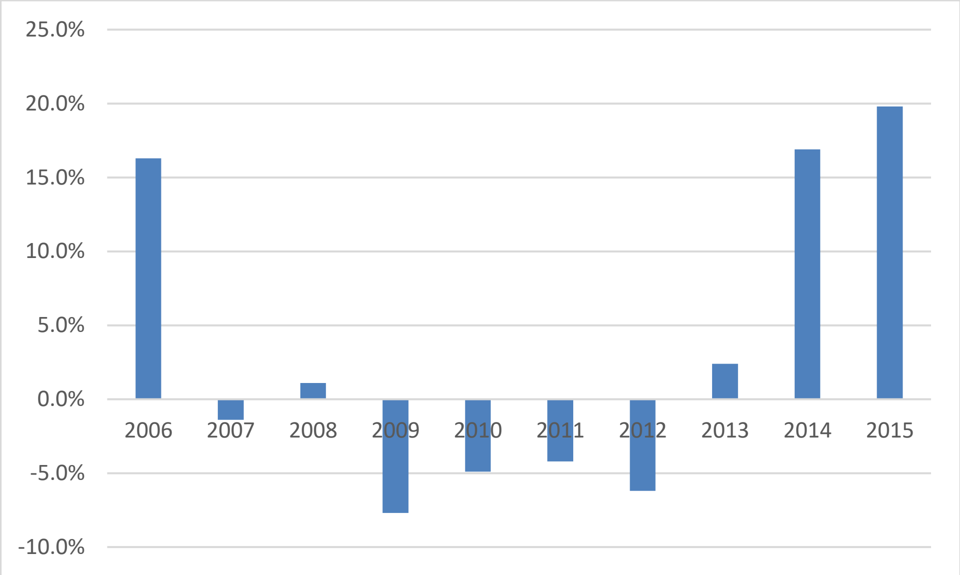
Indeed, the HBF publication *Why buy new: avoid the money pit* published in May 2017 stated “New HBF research suggests that for an average 3 bedroom, semi-detached home the cost of upgrading a secondhand property to the basic level of specifications an owner would be able to expect from a new build can be over £50,000.” This included £7,900 for the kitchen, £3,800 for bathrooms and £4,000 for roofing.

So valuers can justify a new build premium but the difficult question for them is how large this premium should be. Past experience has shown that the new build premium can be inflated by other factors that will not sustain a higher price over time, including incentives offered to buyers and even government intervention. For example, the Help to Buy equity loan scheme is available only on new homes. The 20% equity loan (40% in London) allows buyers to access a much lower LTV loan than they otherwise could, increasing the value of property a buyer can purchase within the constraints imposed by the lender’s affordability limits. This helps to stimulate demand for new homes, potentially raising the price builders can charge.

Sometimes comparable properties outside a new build development are hard to find, making it difficult for the valuer to establish a local benchmark for a given type of property and for lenders to have confidence in the price they are lending against. This was certainly the case with many high rise apartments built prior to the financial crisis. Where these properties were built in areas of urban renewal local secondhand stock was often poor quality older houses or ex-council flats, making them poor comparables. Developers sold luxury flats at prices far above the previous local price ceiling and when demand fell back, these prices proved unsustainable as established market prices emerged.

The issue of the new build premium on flats has abated to a degree as builders have switched towards building more houses and fewer flats since the financial crisis. But more recently the number of high rise flats being constructed has again risen, particularly in London, and the premium they command has returned (see Chart 2). However, most lenders still stipulate a lower maximum LTV for new flats, so lenders should be reasonably insulated from the potential for further volatility in the price of new flats.

Chart 2 – New build premium on flats in London



Source: Propertybrain

So valuers must use judgement to determine whether an observed new build premium is justified by the superior features of the property. But where demand is forthcoming at the sale price, buoyed for example by buyers having access to Help to Buy equity loans, it is hard for valuers to argue against this as a genuine market price.

Concentration of lending

Another unique aspect to lending on new build property is lenders' desire to control their total exposure to particular development sites. This is not a new phenomenon and reflects concerns that lenders have that if they lend on a disproportionate number of properties on one site they might suffer high losses if demand for the development proves problematic for some reason.

It is normal for lenders to limit lending to 20-25% of a new build site. This could be a problem when fewer lenders operated in the new build market, when the market was dominated by a few large lenders and in particular by two lenders, Halifax and Nationwide Building Society. Then, brokers could find it difficult to source mortgages once these larger lenders had reached their site limits. But now that more lenders are active in the new build market site limits have become less of a problem. Halifax has removed formal site limits altogether, seeing them as a blunt instrument to control credit risk while more broadly site limits are becoming more of a guideline for lenders, prompting further assessment rather than being a hard limit.

New build leasehold property

In recent years several major housebuilders established more onerous clauses for ground rents on leasehold properties, increasing the amount that ground rents will rise in the longer term, with houses being sold on a leasehold basis as well as flats. Some of these builders have also then sold the freehold interest to external investors, although in the face of the bad publicity now surrounding these arrangements major builders appear to have retreated from these practices on new sales.

Ground rents are payments due to the freeholder, which provide the freeholder with a return on their investment in the land. They do not provide any amenity beyond use of the land, and any communal costs associated with a leasehold block (such as maintenance of shared stairwells) are collected separately through a service charge.

Ground rents are usually modest sums initially (£250 a year would be typical) but commonly are set to double or rise by 50% every 25 years to ensure the freeholder does not suffer declining purchase power in the face of long term inflation. But the more aggressive charging structure that some builders have introduced, with ground rents that double every 10 years, sees ground rents increasing far faster than needed to keep pace with inflation, although some builders have capped at least some of these increases after 50 years. In addition, some builders sold off these ground rents to specialist companies making possible future recompense to purchasers more difficult.

It is clear from Table 2 that such ground rents will become unsustainably large if inflation remains broadly in line with the current rate. A seemingly modest payment of £250 a year over the first 10 years will reach £8,000 after 50 years (nearly £3,000 adjusted for 2% pa inflation) and £32,000 after 70 years. Inflation would need to be sustained at 7.18% per annum for these ground rents to remain constant in real terms.

Table 2 – Impact of ground rent doubling every 10 years

Year	Ground rent (doubling every 10 years)	Ground rent (if rising by 2% pa)	Ground rent in real terms (assuming 2% pa inflation)
0	£250	£250	£250
10	£500	£305	£410
20	£1,000	£371	£673
30	£2,000	£453	£1,104
40	£4,000	£552	£1,812
50	£8,000	£673	£2,972
60	£16,000	£820	£4,877
70	£32,000	£1,000	£8,001

Source: Instinctif Partners

It is the role of the purchaser's solicitor to advise of any liabilities that could prove onerous. But in practice solicitors or conveyancers will often see their role as flagging issues rather than warning of their repercussions and, as a result, some buyers have proceeded with purchases with a ground rent of the kind illustrated in Table 2, while the buyer, lender and the valuer may not be aware of the exact terms of the ground rent clause. As housebuilders often recommend a solicitor or conveyancer to purchasers there is also concern that these solicitors or conveyancers may be too close to the builder and therefore less likely to raise concerns.

Initially lenders took the view that if the purchaser advised by the solicitor/conveyancer had agreed to the ground rent terms, the lender should not object as ground rents would remain modest over the life of a 25 year mortgage (reaching £1,000 after year 20 in the above example). However, earlier this year Nationwide Building Society stated that it will not lend on properties whose ground rent doubles every five, 10 or 15 years. This must be a sensible step given that such ground rent increases undermine the long-term value of the property whether the buyer recognizes this or not.

Government has also responded to concerns about leasehold clauses with a public consultation that ended on 19 September 2017. The consultation description states that “This consultation looks at a range of measures to tackle unfair and unreasonable abuses of leasehold; in particular, the sale of new leasehold houses and onerous ground rents”. One option it raises is changes to the Help to Buy scheme that might restrict its availability on leasehold houses.

4. The role of brokers

Intermediaries play an even larger role in the new build sector than in mortgage lending more broadly. While around 70% of lending now involves a broker, this figure rises to 85-90% in new build. One reason for such high broker penetration of the new build market is the way people search for a new home. Many will start with a visit to a show home. If they express an interest in proceeding, the staff on site will typically provide them with a name from their approved list of brokers, explaining that these brokers provide a quick and efficient route to sourcing a mortgage loan.

These brokers will of course have a detailed working knowledge of new build transactions and the different requirements lenders have in the sector. This is another reason why brokers have a larger share of new build lending, with a number specializing in new build. On top of the market wide differences in lender criteria that brokers need to be familiar with, lenders' specific requirements surrounding new build can enhance the role of the intermediary, as a broker can save the buyer time through their understanding of each lender's specific requirements on new build.

For instance, not all lenders participate in the Help to Buy scheme and while Halifax lends up to 95% LTV on new build houses and flats (with selected brokers and builders), relatively few other lenders do the same (this may in part reflect Lloyds Banking Group's deeper commercial relationship with many housebuilders). Barclays only lends to 85% and Nationwide only to 85% on houses and 75% on flats.

There are also a range of different policies on builder incentives. For example, Halifax will accept up to a 5% cash incentive from the builder as long as the purchaser is putting down at least 5% while Clydesdale does not accept any builder cashback. Table 3 shows a range of different requirements from selected leading lenders, illustrating the role brokers can play in helping a new build purchaser to determine which lender has appropriate lending criteria.

Lenders have their own panels of brokers approved to undertake new build transactions as lenders also require brokers with specialist new build knowledge. For example, most builders require that exchange of contracts takes place within 28 days of an agreed sale, which adds time pressure to the parties involved. Lenders need to know that the broker is geared up to meet this timescale.

Halifax even publishes its panel of mortgage brokers approved to deal with new build cases. Only these approved new build brokers are allowed to deal with loans where the LTV is above 85%, reflecting Halifax's experience where the arrears performance has been worse with loans originated by intermediaries that supplied only the odd new build loan.

Table 3 – New build lending requirements of selected leading mortgage lenders

	Residential			Incentives		
New build lender	**House LTV**	**Flat LTV**	**Part Exchange**	**Builder - Cash**	**Builder - Other**	**Site Exposure limit**
Barclays Woolwich	85%	85%	Yes	Up-to 5% accepted	Legals, Stamp Duty, white goods, carpets & curtains etc accepted	40% sites >10 units, 50% sites<= 10 units
Clydesdale	90%	80%	Yes	No builder's deposit or cash back	Will consider stamp duty, legal fees and non-cash upgrades - subject to valuer's comments	refer
Halifax	95%	95%	No	Customer must provide minimum of 5% deposit in addition to any builder incentive. At 90% will now accept 5% customer deposit with 5% provided by the builder	White goods, carpets & curtains etc accepted	Refer to lender / surveyor
Nationwide	85%	75%	Yes (can't be used in conjunction with any other schemes)	Up-to 5% accepted	Legals, Stamp Duty. white goods, carpets & curtains etc accepted	20%
NatWest	85%	75%	Yes	Up-to 5% now accepted	Max value of 5% overall	25%
Santander	85%	80%	Yes (at market value - can't be overinflated to include builder gifted deposit over 5%)	Up-to 5% accepted	Legals, Stamp Duty, white goods, carpets & curtains etc accepted	down to valuer's comments

Source: Legal & General

5. Government support schemes for new build – from HomeBuy Direct to Help to Buy and beyond

As high LTV lending started to dry up in 2008, UK housing starts plunged from 46,500 in the final quarter of 2007 to 16,400 by Q4 2008, one of the sharpest falls on record. In response housebuilders called for a government scheme to fill the gap as well as introducing their own shared equity schemes to maintain sales. The government responded relatively quickly with HomeBuy Direct, which launched in 2009.

HomeBuy Direct and FirstBuy

Under the HomeBuy Direct scheme, launched in 2009, anyone with an income of £60,000 or less buying a new home could apply for an equity loan of up to 30% of the value of the home. The equity loan was provided jointly by the government and the housebuilder. The remaining 70% of the purchase price had to be provided by the buyer, at least 5% being a deposit and the balance financed by a conventional mortgage.

The equity loan was repayable on sale of the property. It was interest free for the first five years but after that, interest of 1.75% became due, rising annually by the Retail Price Index (RPI) plus 1%. As the equity loan took the form of a second charge, with the conventional lender taking the first charge, lenders accepted this arrangement as being broadly equivalent to lending at 65% LTV, a comparatively safe level at which to lend, although with the buyer dependent on an additional equity loan with interest payable in later years, this was not equivalent to a conventional 65% LTV mortgage.

The FirstBuy scheme was introduced by the Coalition government in 2010 after it suspended HomeBuy Direct. The design of the scheme was broadly the same, but the equity loan was reduced to a maximum of 20% and a maximum purchase price was set at £280,000. The scheme was open to first time buyers and moving owner-occupiers. It was replaced by NewBuy in 2012.

NewBuy

The government backed NewBuy scheme had its origins in a private sector framework developed for insurers JLT. The scheme, which launched in 2012, was designed to make more efficient use of the capital provided from housebuilders and government. Instead of providing capital against every individual property (most of which would never be repossessed) as FirstBuy did, builders placed capital into ring-fenced funds to cover credit losses for all of the properties they sold that were mortgaged by each participating lender. Under the terms of the NewBuy scheme, the fund would meet 95% of all lender losses regardless of how cheaply the repossessed property was sold (like a mortgage indemnity guarantee but without the usual cut-off excluding losses below an LTV of 75% or 80%).

A simple comparative example illustrates the different way that builder capital is used to protect the lender in NewBuy and HomeBuy Direct/FirstBuy. Imagine a lender lends on 100 new homes sold for £200,000 each by a housebuilder with a 20% FirstBuy equity loan, half provided by government and half by the builder themselves. The builder will have tied up £2,000,000 of capital out of total sale proceeds of £20,000,000, with the government also tying up £2,000,000. The lender advances 75% LTV loans on each property (£150,000). Now imagine that one of these homes is subsequently repossessed and sold for £100,000. The lender will be facing losses before arrears of £50,000 and builder and government capital supporting the other 99 properties is not available to offset these losses.

Alternatively, with 95% LTV lending under a NewBuy type scheme the £2,000,000 of builder capital would be placed in a single fund to meet losses on any repossessions with that lender. With the repossessed property sold for £100,000, credit losses would amount to £90,000. 95% of these losses (£85,500) would be met from the builder’s capital and 5% (£4,500) by the lender. So lender credit losses would amount to £4,500 rather than £50,000 and as credit losses in the UK mortgage market have never reached anything like 10% of the value of homes in a loan portfolio, the builder could safely provide a much smaller pot of capital with little additional risk to the lender.

Under the NewBuy scheme the builder contribution to each fund was set at 3.5%, with an additional government guarantee of 5.5%, available in the unlikely event that the builder pot with a particular lender was exhausted by credit losses. After 7 years the pot would be returned to the builder less any credit losses but by this time the outstanding mortgage balance would be considerably lower due to capital repayments.

Builders preferred the scheme to FirstBuy as it tied up far less of their capital (3.5% versus 10%). And housebuilders’ experience with equity loans had not been an altogether happy one as they were not well equipped to manage these loans post completion. Some builders even sold their equity loan portfolios for discounts to free up working capital.

Lenders felt that NewBuy provided builders with the right incentives by ensuring that the builder stood to take the bulk of the losses if the homes they sold were repossessed. But despite this and the superior credit protection the scheme offered lenders and the removal of the complication of the borrower having a second charge equity loan, when the scheme launched in 2012 lender mortgage pricing was not very competitive. This may have reflected a lack of capital relief or just a lack of experience with such a scheme. This undermined the scheme and led the government to look for alternative solutions. In 2013 they announced the Help to Buy equity loan scheme.

Help to Buy equity loan scheme

The Help to Buy equity loan scheme, which was launched in 2013, was a return to the FirstBuy format but with government providing the entire equity loan. The scheme was a triumph for housebuilders, who now needed to contribute no capital to support each sale. To reflect high house prices in London, from February 2016, the government increased the maximum equity loan in Greater London from 20% to 40%.

In contrast to NewBuy, where the buyer had to qualify for a conventional 95% LTV mortgage, Help to Buy was specifically aimed at buyers who could not afford the full price of appropriate property in their area. The equity loan was thus no longer just an attempt to fill a gap in high LTV loans but was explicitly an attempt to stretch affordability. It was thus at odds with the principles of the MMR, which imposed stringent affordability requirements. Under the scheme lenders are given regulatory dispensation to assess affordability without regard to the repayment of equity loan capital. And although lenders are netting off 3% of income to cover future interest costs, the uncertain level of future payments, given that these are linked to future rates of RPI inflation, must be a concern.

Between April 2013 and March 2017, 137,000 Help to Buy equity loans were advanced across the UK (see Table 4), equal to an estimated 27% of all new housing completions and 5% of all housing transactions. For the top 10 housebuilder it is estimated that Help to Buy has supported 35-40% of sales. In the North East of England, Help to Buy equity loans have been an even more important part of the market, accounting for nearly 9% of all transactions over this period.

Table 4 – Regional Help to Buy equity loans advanced April 2013 to March 2017

	Number of Help-to-Buy equity loans	Total homeowner house purchases	Help-to-Buy equity loans % of total purchases
North East	8,476	94,900	8.9%
Yorkshire & Humber	11,455	210,400	5.4%
East Midlands	14,436	208,200	6.9%
East	15,427	286,800	5.4%
London	7,476	311,600	2.4%
South East	19,669	427,200	4.6%
South West	14,833	246,800	6.0%
West Midlands	13,381	218,200	6.1%
North West	15,711	275,300	5.7%
Scotland	10,530	245,000	4.3%
Wales	5,482	110,400	5.0%
Northern Ireland	NA	54,700	NA
Total	136,876	2,690,600	5.1%

Source: DCLG

Clearly, the Help to Buy equity loan scheme has been the most successful of government support schemes for new build. Indeed, there are concerns that it has been too successful, pushing up demand for new build property to the extent that housebuilders have been able to significantly increase prices. There are also concerns that while the scheme has helped to raise housebuilders' profits it has done less to stimulate supply because builders have focused more on margins than volumes. And the CML report *Government Housing Schemes: Accident or Design?* (Chris Walker, November 2016) also pointed out that it has not stimulated supply as much in the areas where it is most needed (London and the South East) as shown in Table 4.

The Help to Buy scheme is set to expire in 2021, but there is also a cap on the funds available under the scheme. This was £8.6 billion, and there were concerns that this cap could be reached before 2021 as some £6 billion had already been used by summer 2017. But in early October the government announced that an additional £10 billion would be made available in England, although the termination date was not extended. In Scotland, where the scheme is funded from Scottish government funds, the equity loan has already been reduced to a maximum of 15% of the property's value. The Department of Communities and Local Government (DCLG) is currently undertaking a review of the operation of scheme over the period 2015 to 2017, updating a previous study published in 2015.

Given the importance of Help to Buy equity loans for builders and the lack of cost to them, it is unsurprising that they are, in the main, keen for the scheme to be extended. But for lenders it is less clear that such overt government support for the market is healthy. By increasing demand, in part from households that could not afford the properties they are buying without an equity loan, the scheme has pushed up new build property prices (Chart 2 on page 9 would seem to evidence this). Also, by assessing affordability without regard to the future repayment of capital on the equity loan, it could be argued that lenders are being asked by the government to effectively circumvent the current affordability requirements.

Starter Homes initiative

In December 2014 the then coalition government announced the Starter Homes initiative under which it wanted 100,000 new homes to be sold to first time buyers at discounts of at least 20% to market value. This would be made possible by changes 'to the planning system to free under-used or unviable brownfield land from planning costs and levies in return for a below market value sale price on the homes built on the site'.

Although progress on the Starter Homes initiative has been slow, in January this year then Housing Minister Gavin Barwell announced that the first homes under the scheme will be built this year with support from the government's £1.2 billion Starter Homes Land Fund. It is unclear how large an impact the scheme may have but the delays to date suggest that implementing the proposal is far from straightforward. The regulations for running the scheme have yet to be published.

Discounted market sale

Discounted market sale (DMS) mimics the Starter Homes Initiative in that a discount is built into the initial sale price of new properties sold under the scheme, being provided by local authorities. Buyers get a discount of up to 30% on purchase but the council then has the legal right to buy back the property if the buyer chooses to sell, with the owner receiving the same share of open market value that they originally purchased (being at least 70%).

For the buyer the scheme is advantageous as, in contrast to shared ownership, they are not required to rent part of the property. However, while some lenders including Halifax do lend on DMS properties, many do not, perhaps reflecting the small size of this scheme to date.

The impact of government schemes on lender credit quality

The launch of Help to Buy made sense for the housebuilders as they would no longer have to tie up any of their capital in schemes protecting mortgage lenders. But it is far harder to see why lenders were content with Help to Buy in effect superseding NewBuy. Firstly, under the Help to Buy equity loan the lender is expected to ignore the borrower's future requirement to repay the capital. But even ignoring this issue, the credit protection was inferior to that provided by the NewBuy scheme that it superseded.

Tables 5 and 6 show the author's estimated projected credit losses as a proportion of the value of the loan book for the NewBuy scheme, Help to Buy equity loans and conventional lending at 80% LTV under two scenarios (Table 5 shows losses where there is a distribution of house price falls from 0% to 40% with an average loss of 20% and Table 6 shows losses ranging from 20% to 60% with an average fall of 40%).

While the Help to Buy scheme delivers significantly lower losses than conventional 80% LTV lending (because of the lower LTV), the reduction in credit losses under the NewBuy scheme, even though the lending is at 95% LTV, are more substantial. For example, if repossessions are sold at an average reduction in price of 20% and 5% of loans are repossessed, the lender would face credit losses of 0.06% of total lending under the NewBuy scheme against 0.34% under Help to Buy and 0.53% with conventional 80% LTV lending.

Table 5 – Lender losses as % of mortgage loans (average house price fall of 20%)

	2% of properties repossessed	5% of properties repossessed	10% of properties repossessed
NewBuy (95% LTV)	0.02%	0.06%	0.12%
Help to Buy EL (75% LTV)	0.13%	0.34%	0.67%
Conventional lending (80% LTV)	0.21%	0.53%	1.06%

Table 6 – Lender losses as % of mortgage loans (average house price fall of 40%)

	2% of properties repossessed	5% of properties repossessed	10% of properties repossessed
NewBuy (95% LTV)	0.04%	0.11%	0.22%
Help to Buy EL (75% LTV)	0.56%	1.39%	2.78%
Conventional lending (80% LTV)	0.65%	1.63%	3.27%

Source: Instinctif Partners calculation

It may be that credit losses on loans advanced over the past few years have been so low that lenders feel indifferent to their potential risk. But economic conditions do not remain benign indefinitely and it is surprising that lenders have not been more vocal in support of schemes that offer more favourable protection.

Life after government support schemes

Perhaps the largest single question facing the new build sector is whether the Help to Buy equity loan scheme will be extended beyond 2021 and what will happen if it is terminated as the Help to Buy guarantee scheme was at the end of 2016. With Help to Buy supporting an estimated 27% of all new housing completions and the top 10 housebuilder dependent on the scheme for some 35-40% of sales on average, it is clear that builders have come to rely heavily on the scheme.

But for lenders the scheme is not such an unambiguous positive. The scheme is designed to stretch affordability in a way that the MMR disallows on other types of lending and its credit protection is inferior to the previous NewBuy scheme. Perhaps lenders should develop their own policy position as the housebuilders have been so successful at doing, to ensure that their interests are not ignored when decisions about Help to Buy renewal have to be made.

Behind the impact of decisions on the future of Help to Buy are the other factors that influence lender sentiment towards new build, including the new build premium, which seems to have risen in part thanks to Help to Buy, builder incentives and on-going concerns about the UK housebuilding model, which for a variety of reasons has consistently failed to deliver adequate supply in the context of the UK's still volatile housing market. Lenders will always see new build as different and, indeed, potentially riskier. Whether this means that some on-going support from government will be needed to support high LTV lending after the Help to Buy scheme ends remains to be seen. But lenders should stand ready to support initiatives that ensure that a healthy supply of new homes is maintained for buyers with modest (e.g. 5%) deposits.

With special thanks to Craig Hall, New Build Manager, Legal & General, Douglas Cochrane, Head of Housing Development, Lloyds Banking Group and James Chidgey, New Homes Relationship Manager at Mortgage Advice Bureau for providing their insights into new build lending for this report.

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About IMLA

The Intermediary Mortgage Lenders Association (IMLA) is the trade association that represents mortgage lenders who lend to UK consumers and businesses via the broker channel. Its membership unites 36 banks, building societies and specialist lenders responsible for over £180bn of annual lending across all distribution channels in 2015, including 16 of the top 20 UK mortgage lenders.

IMLA provides a unique, democratic forum where intermediary lenders can work together with industry, regulators and government on initiatives to support a stable and inclusive mortgage market. Originally founded in 1988, IMLA has close working relationships with key stakeholders including the Association of Mortgage Intermediaries (AMI), UK Finance and the Financial Conduct Authority (FCA).

Visit www.imla.org.uk to view the full list of IMLA members and associate members and learn more about IMLA's work.

About the author

Rob Thomas is a Director of Research at Instinctif Partners. He previously served as an economist at the Bank of England (1989-1994), a high profile analyst at the investment bank UBS (1994-2001) and as senior policy adviser to the Council of Mortgage Lenders (2005-12). He was also the project originator and manager at the European Mortgage Finance Agency project (2001-05) and created the blueprint for the government's NewBuy mortgage scheme.