# STEPPING UP TO THE MARK

## Building Societies Responding to the Housing Affordability Crisis

**A report by Peter Williams**

BUILDING SOCIETIES ASSOCIATION

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**The Building Societies Association** is the trade association for the UK's building societies. There are 59 building societies in the UK with total assets of almost £315 billion. About 15 million adults have building society saving accounts and over two and a half million adults are currently buying their own homes with the help of building society loans.

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The Building Societies Association
6th Floor, York House
23 Kingsway, London WC2B 6UJ

www.bsa.org.uk

BUILDING SOCIETIES ASSOCIATION

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# FOREWORD

The problems that are faced by young people seeking to buy their first home are well documented. With house prices continuing to rise far faster than wages, home ownership is increasingly difficult for many potential first time buyers, and home owners seeking to 'trade up' can also struggle to bridge the gap between different types of property.

But despite these pressures the desire for home ownership remains as strong as ever, and it is no surprise that building societies are at the forefront in finding ways to help people buy a home. After all, giving people access to finance to buy a house is the reason that building societies were first established.

When I meet colleagues from building societies around the country, I am always struck not just by how widespread the housing affordability problem now is, but also by how effectively societies are responding to the challenges that this is creating.

Some societies, my own included, are working closely with the government on the programme that it has established to give key workers the opportunity to buy a share in their home. Others societies have established their own schemes which come in a variety of different forms. Some, for example, are working with local authorities and directly fund new build properties. Others have developed their own schemes directed at specific occupations, while many also offer 100% or more mortgage products.

This report seeks to highlight the initiatives that building societies have in place to help people afford to buy. However, it is more than just a celebration of what building societies are doing – it also looks at what is and isn't working with current schemes, and makes recommendations over what building societies, government and other stakeholders could do to allow even more families the opportunity to buy their home.

Affordable housing has never had a higher social and political profile than now, making this report particularly timely. I commend it to anyone with an interest in housing issues.

Iain Cornish
Chairman, BSA

# EXECUTIVE SUMMARY

Building societies have been at the forefront of allowing people to buy their homes since the first were established in the eighteenth century.

With housing affordability problems now being so acute, societies are anxious to do what they can to facilitate people buying a home. They are particularly keen to help first time buyers onto the property ladder.

Many societies are working with the government and other public sector organisations to help. Although the HomeBuy schemes have attracted the greatest attention, they are involved with a wide number of schemes to help people buy. Many are also active with their own schemes, that often respond to particular local issues and needs.

It is clear that societies are doing more to try to help than is widely recognised, and they have a wide range of innovative and competitively priced products that are designed to allow people to buy.

However, they believe that more can, and needs to, be done to help more people buy. These include:

- greater lender input into the development of government schemes to ensure that they reflect the needs of lenders and borrowers as well as government and other public sector organisations
- reform of the section 106 planning system to ensure that such agreements don't conflict with lenders' requirements
- Government needs to help identify ways in which first time buyers can be helped to save for a deposit
- There are fundamental issues that need to be addressed by government around housing supply (not enough being built) and the cost of home purchase (taxation and fees) to resolve affordability problems.

# INTRODUCTION

CHAPTER 1

Housing market and affordability issues are high on the current agenda. Many years of rapid house price inflation and continuing shortages have not just propelled affordability to the centre stage but held it there. One of the big questions this raises is, of course, what can be done to help the many thousands of households who have been excluded from home ownership as a consequence.

Building societies have long been at the heart of the affordable housing agenda in the UK. Although they have evolved into large and important financial institutions on a regional and national scale they remain very closely identified with housing in general and home ownership in particular. And this agenda is one that all societies would identify with. For example, the Progressive Building Society based in Northern Ireland sums it up well;

> "Since 1914 the Progressive Building Society has held firm to the principle that whatever happens there should always be money for local people to buy their own homes."

Although the concept of what is local might have changed, the reality is that all societies have a continuing commitment to helping members and customers fulfil their aspirations to own.

Over the years societies have been active in looking for ways this aspiration can be realised whether through their own policies and products or by working with government. The editorial for *The Times* special edition produced on 31 May 1938 commented (Times, 1938, p 4)

> "Building societies have been the chief agencies in the establishment in this country of what one of our contributors calls 'the new freeholders'. They have made possible the purchase of hundreds of thousands of houses by occupants who, but for their help, would have remained rent-paying tenants all of their lives"

It is worth remembering that in 1918 some 76% of the population would have been private tenants. By 2006, 70% were owners and building societies have been central to this tenure transformation and to the creation of a safe and orderly market.

The growth of home ownership in England has been slowing over the last decade or more and the recent *Survey of English Housing* (CLG, 2007) suggests there has now been a fall in the total number of owners, from 14,646,000 in 2005 to 14,621,000 in 2006, a decline of 25,000 (and well within the sampling error of the survey). This together with continued affordability pressures and concerns about the stability of the housing market provide an important backdrop to this report.

Societies continue to be at the forefront of products and programmes designed to help ensure first time buyers can access the market. The recent launch of the government/lender shared equity loan programme saw both the Nationwide and Yorkshire Building Societies as two of the four initial participants. Two other societies are now looking to join the scheme.

Looking back there is a long history of such engagement. For example, through the Building Societies Association societies set up the Option Mortgage Scheme with the government in 1967 (this enabled mortgage borrowers with incomes below the income tax threshold to obtain a benefit equivalent to mortgage interest tax relief) and agreed a Memorandum of Understanding (and a Joint Advisory Committee) with government in 1973 around how to support home ownership while funds were in short supply and when local authority mortgage lending was cut back (Boleat and Coles, 1987).

However, although this report covers issues such as working with the government, the reality is that the housing market is driven by a complex amalgam of players including the Bank of England, lenders, builders, estate agents, buyers and sellers. Government plays its part in a whole variety of ways including management of the economy, fiscal policy and much more.

Although government does not control the market, in recent years it has made strident efforts to influence it in ever greater degrees. This is because housing is seen as central to the economy and to future political success. Rapid house price inflation and worsening affordability are widely viewed as failure by government. It thus has to address the market in a variety of ways through policy. Sadly this is not always well developed as is manifest in the recent HIPS debacle.

The main purpose of this report is to explore what societies themselves are doing to tackle access and affordability issues in the UK. The report was commissioned by the Building Societies Association in December 2006 and it was published in October 2007.

The methodology for the study was to base it around a survey of BSA members, follow up phone interviews with a small number of societies and desk based work looking at websites and literature.

The questionnaire survey was drawn up by the BSA and the researcher with a view to finding out what societies were doing. This was mailed out in January and followed up by reminders. Of the 60 societies contacted, we had responses from 42, a response rate of over 70% with a good spread across all sizes of societies and taken together these societies represented 98% of the assets of the sector.
A draft report was discussed with the BSA Secretariat and with the BSA Mortgage Panel prior to publication.

## References

Boleat, M and Coles, A (1987) *The Mortgage Market; Theory and Practice of Housing Finance*, Allen and Unwin, London

CLG (2007) *Survey of English Housing 2006*, CLG, London

Times (1938) British Homes; *The Building Society Movement*, Special Edition of the Times, May 31, 1938, Times, London

# BUILDING SOCIETIES AND THE HOUSING MARKET

CHAPTER 2

This report is being written at a time of considerable pressure and change in the UK's housing and mortgage markets. Affordability pressures have been sustained over a considerable period through rising house prices. The consequence of this is seen as the relatively low numbers of first time buyers entering the market. This has attracted a lot of media attention but perhaps less recognised has been the fall in the numbers of households buying a home with a mortgage in England and what might be the first signs that the long period of growth of home ownership has come to an end.

In this chapter the aim is to review the role of building societies in the housing market, looking at published statistics and commentaries, especially around first time buyers. The focus will be on the current situation but it will also look back at the way the mortgage market has evolved.

## The Current Housing Market

Table 1: First Time Buyers: Lending and Affordability, UK

| | Number of loans | Number of loans | Value of loans | Age of borrower | Advance £ | Income £ | Percent advance | Income multiple | Interest payments as % of income |
|---|---|---|---|---|---|---|---|---|---|
| | Number | % of total for house purchase | £m | median | median | median | median | median | median |
| Year | | | | | | | | | |
| 1996 | 465,300 | 49 | 20,263 | 28 | 39,811 | 17,308 | 95 | 2.36 | 11.2 |
| 1997 | 501,500 | 45 | 23,323 | 29 | 41,800 | 18,080 | 95 | 2.37 | 14.1 |
| 1998 | 525,200 | 48 | 26,791 | 29 | 45,000 | 19,600 | 93 | 2.38 | 15.0 |
| 1999 | 592,400 | 47 | 34,009 | 30 | 49,000 | 21,141 | 90 | 2.41 | 12.9 |
| 2000 | 500,200 | 45 | 30,203 | 30 | 51,253 | 22,018 | 90 | 2.42 | 14.3 |
| 2001 | 568,200 | 43 | 38,145 | 30 | 56,950 | 23,700 | 90 | 2.48 | 13.4 |
| 2002 | 531,800 | 38 | 43,138 | 31 | 69,000 | 26,644 | 90 | 2.67 | 12.2 |
| 2003 | 369,600 | 30 | 32,937 | 31 | 76,412 | 27,137 | 89 | 2.83 | 11.8 |
| 2004 | 358,100 | 29 | 36,266 | 31 | 90,000 | 29,270 | 87 | 3.03 | 15.0 |
| 2005 | 367,900 | 37 | 40,492 | 30 | 97,488 | 31,173 | 89 | 3.09 | 16.8 |
| 2006 | 410,800 | 36 | 49,791 | 29 | 108,917 | 33,997 | 90 | 3.21 | 16.8 |

Source: Council of Mortgage Lenders

Table 1 gives an overview of the affordability pressures as they have been sustained over the last decade of rising house prices. We are now in the 15th year of successive house price rises at a UK level. The fact the market has sustained this upward rise has surprised some commentators despite the benign economic climate, the continuing imbalance between supply and demand that is now found throughout the UK, and relatively low interest rates. Demand pressure has also been sustained by a changing demography with ever more households forming. The latest 2004 English projections are for 223,000 new households a year to 2029 up from 209,000 in the 2003 projections. Single person households make a major contribution to this.

Migration to the UK from continental Europe and elsewhere has added to these pressures and far exceeds government's initial projections. Little is known about the long term aspirations of many migrants but it is believed around 20% plan to take up permanent residence in the UK.

We also cannot ignore the strong growth of both the buy to let and second home markets, although the links between these demands and added difficulties for first time buyers has yet to be proven. In 2006, 330,300 buy to let loans with a value of nearly £40 billion were provided (by specialist lenders, building societies and banks) and this has helped keep overall mortgage demand high, but has masked some important changes in the mortgage market.

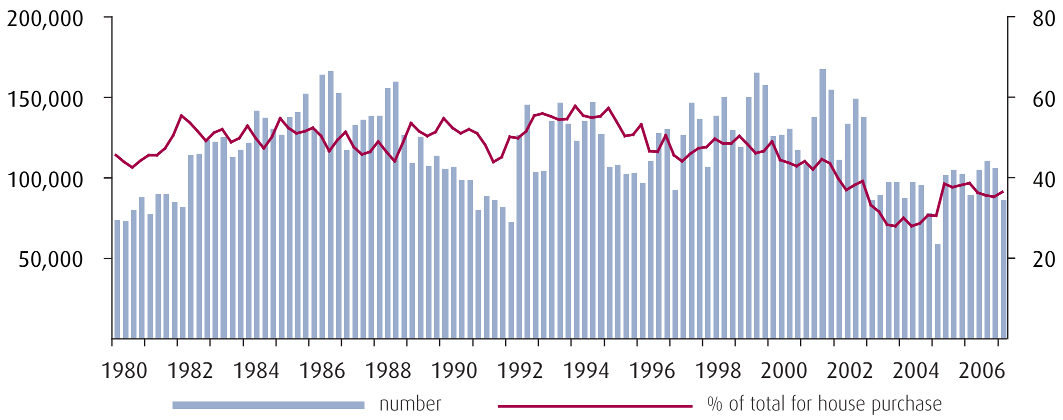
Recent headlines have pointed to the first recorded fall in the total number of home owners in England after some 68 years of what appears to have been sustained growth. The Survey of English Housing estimates that, in 2006, there were 14,621,000 home owners compared to 14,646,000 in 2005, a fall of 25,000 (and well within the margins of error). Perhaps more importantly, the number of mortgaged home owners was estimated to have fallen for the sixth year in succession. Peaking at 8,257,000 in 2000 it now stands at 8,230,000, a decline of 27,000. Partly there is a demographic effect here related to the post 1945 baby boom cohort entering mortgaged home ownership and then exiting to become outright owners, but it also reflects the slower inflow of new buyers.

At the time of writing there is considerable uncertainty regarding the future course of house prices. These have continued to rise fast (roughly 10% per annum) although most commentators are now expecting this rate to fall back. There is a concern that without a slow down the prospects of a recession are enhanced. This is not the ideal context in which to be discussing innovations for first time buyers, although few are predicting a serious long term recession. Indeed government itself has settled for a view that house prices on average will inflate at 6% per annum for the foreseeable future.

However, as a consequence of housing demand exceeding supply in many parts of the country, a severe economic slowdown would be required for substantial falls in property prices. As a consequence, aspirant first time buyers are likely to be faced with affordability problems for the foreseeable future, with there being little chance of the price crash that some are forecasting or hoping for.

## First time buyers

Chart 1: Number and proportion of first-time buyers




Source: Survey of Mortgage Lenders, Regulated Mortgage Survey, CML/BankSearch
Notes: Absolute numbers pre April 2005 are not strictly comparable with those after that point

Chart 1 shows that we have seen sustained falls in the percentage of first time buyers but also the number has gone down from a peak of 612,700 (49% of the total number of first time buyers) in 1986 as a whole (the chart shows quarters) to 410,800 (36%) in 2006. This is an increase from 2004 when these were 358,100. It is worth noting that in the year of the last major housing market recession, 1991, there were 336,200 first time buyers.

Some of the decline was anticipated because of demographic changes feeding their way through the system. Basically, the effects of the 1950s baby boom have rippled their way through the housing system over subsequent decades as the off spring of that generation become adults and home owners and so on. This has led to periodic surges in the numbers of first time buyers. However, those effects are now reducing and Holmans argues that changes in behaviour are now becoming as important as demographic shifts (Holmans 2005) with affordability pressures playing their part. Halifax has recently estimated that 70% of towns are unaffordable for key workers (Halifax Press Release, 2007).

Monthly the flow of first time mortgage borrowers is down to less than 30,000 and in February 2007 it was 25,600. We must also recognise two further factors. First, many of those counted as first time buyers are in fact 'returners' to the market after relationship breakdown or periods spent abroad. Tatch has estimated that up to 30% of first time buyers are in this category. Second, up to 50% of current first time buyers are being assisted by parental or family gifts (Tatch 2006). Such gifts are more likely to be from more affluent families.

What this would then begin to suggest is that there is now a large and growing segment of new first time buyers who are finding access to the market really difficult. This concern is one the government increasingly shares.

A recent Communities and Local Government (CLG) report *Social Mobility and Home Ownership; A Risk Assessment* assesses the scale of the challenge facing the government in sustaining and growing home ownership. It comments (CLG 2006, p38) 'single person households are likely to experience the greatest increase in the rate of home ownership in aggregate. The risks of relying on single households to generate significantly more home ownership are associated with affordability, especially in the southern regions and parts of the midlands. These risks could rise in a major economic downturn.'

The government has set an ambitious target of 75% for home ownership in England by 2016. Currently it is 71%.

This requires a further 1.5 million home owners. Given current affordability pressures it is hard to see how this can be achieved although assuming previous inflows and the built-in increases reflecting the sustained growth over past decades (there are more older tenant households and as they die they are replaced by younger owner households) we could see it get to 75% by 2021.

It is little surprise then that over the past five years we have seen significantly increased government activity around mortgages, housing supply and low cost home ownership in particular. In summary we have had;

The Miles Review of the UK Mortgage Market (2004)
The Barker Review of Housing Supply (2004)
The Home Ownership Task Force Report (2004)
HomeBuy – expanding the opportunity to own (2005)
The Shared Equity Task Force Report (2006)
Homes for the Future: More Affordable, More Sustainable (2007)

What these have revealed is the government's very significant commitment to expanding home ownership (see Williams, 2007 for a review of this). Within this low cost home ownership has become an important policy area after years of limited attention with schemes operating that had not been fully settled from a lender perspective.

Shared ownership (50% mortgage, 50% rent) launched in the 1980s is a sensible product but some lenders have found it operationally difficult. HomeBuy (75% mortgage, 25% government equity loan) launched in the 1990s was much easier from a lender perspective and has been popular with them. Expanded Open Market HomeBuy (75% mortgage, 12.5% lender equity loan, 12.5% government equity loan) launched in 2006 has proved more difficult and to date only four lenders are offering this scheme (though a number of other lenders are planning to join). Most recently a shared equity competition was announced asking the finance industry to come forward with new ideas in this area (Housing Corporation, 2007).

The **Newbury Building Society** offers a range of discounted mortgages for HomeBuy purchasers through the new build and social homebuy schemes. To apply, applicants must come to the society via a zone agent or housing association.

In essence, the government is seeking to respond to the continuing appetite for home ownership. The most recent survey evidence regarding preferred tenure in two years time for households under 25 years of age (Pannell, 2007) points to a recovery of the appetite for home ownership - from a low of 37% in 2003 to 50% in 2007. Earlier research had suggested that many young people were opting to rent better quality homes rather than buy poorer quality homes (Smith et al, 2005). This reflected both the increased and improved private rental sector and the surging housing market. Although the latest data are more positive, Pannell rightly asks if these aspirations are realistic. However it is worth noting that the ten year preference for home ownership for this age group has remained very stable at between 78% and 90% over the period 1975 to 2007.

## Low cost home ownership

As noted earlier, low cost home ownership programmes have been in existence since the late 1970s but there has been constant programme change and the overall volume has been small, with perhaps 150,000 homes funded over the period. Setting aside Right to Buy for the moment, shared ownership (part ownership, part rent through housing associations) has been the most common product, though in recent years HomeBuy (a conventional mortgage and a government equity loan) has become more popular.

In 2006, after the consultation on expanding home ownership these were all re-launched under the HomeBuy banner with the aim of simplifying and expanding the schemes. There are now three products, New Build HomeBuy (equivalent of old shared ownership), Open Market HomeBuy (equivalent of old HomeBuy but with lenders taking an equity stake alongside government) and Social HomeBuy, a new scheme designed to supplement the Right to Buy and the Right to Acquire by allowing tenants to buy a small equity stake in their home.

Many societies have supported low cost home ownership initiatives. Shared ownership and HomeBuy have been funded albeit there have been different views as to how this should be done. On shared ownership, some societies interpreted the 50% mortgage as a 100% loan even though it was secured against 100% of the property. This then led to the imposition of higher lending charges (HLC) which added significant extra costs to borrowers who already had limited resources. Over time, this has settled down with societies recognising their first charge/full security position and the fact that normally the Housing Corporation Mortgagee Protection Clause (MPC) is in place (this protected the lender against loss in the same way a HLC does). Of the 24 lenders listed in Moneyfacts in March 2007 offering shared ownership loans, 20 are building societies.

The **Yorkshire** and **Nationwide** building societies have joined forces with the government in the Open Market HomeBuy scheme. The scheme allows those employed in a number of `key worker' occupations (such as teachers, police officers and social workers) and other groups (such as social housing tenants) to buy a property in the open market by giving them to opportunity to increase their overall purchasing power by only needing to earn an income that supports 75% of the overall value.

The buyer takes out a conventional mortgage loan for 75% of the property price. The remainder of the purchase price is accounted for by two equity loans, one from the building society and one from the government. When the property is sold, 25% of any increase in value of the property has to be paid back to the society and government.

Frequent changes in the programmes and a rather mixed quality of management of them by housing associations and the Housing Corporation has led some societies to conclude that they should not participate and for others to limit the range of mortgage products that might be accessed by the shared owners.

The **Leeds Building Society** allows buyers of shared ownership properties to borrow 100% of the value of the share that they are buying. This works similar to a 100% mortgage for a conventional purchase by enabling the purchaser to buy without needing to raise a deposit.

Although over time the position has improved, some negative views persist both within societies and elsewhere reflecting continued weaknesses. Feedback to the BSA indicates that some associations are still not conversant with lender practices and processes leading to unnecessary delays and difficulties. There is also continuing concern regarding the government's continuing reluctance to offer the protection of an MPC clause on shared ownership in rural exceptions sites (where development is exceptionally allowed on the edge of a village to allow new homes to be built for local residents) and to recognise the right of the lender to take possession in the event of default. Societies are understandably frustrated at the lack of progress in settling this issue and some have argued that without this protection they cannot lend on shared ownership properties.

Overall, it is disappointing to note continuing problems. In 2004, revised guidance was issued by the Housing Corporation, the CML and the National Housing Federation aimed at developing best practice and better working between organisations. This guidance has recently been revised and a new version has now been issued. In October 2006 a new model lease had been agreed aimed at increasing uniformity across the sector.

The prominence now given to low cost home ownership would suggest this is an area worthy of further research with a view to generating a clear view of the outstanding problems identified by societies and moving to settle them. Clearly such a list will include issues around the provision or otherwise of MPC protection, the management of default and the cascade that could be applied in terms of future eligible buyers as well as covering off detailed practice issues such as the treatment of rent arrears.

These issues provide a backcloth to the response to the government's new programme of Social HomeBuy. This is intended to supplement the Right to Buy and to allow tenants who do not want, cannot afford or were not eligible, to buy their home to acquire an equity stake in it and potentially staircase to full ownership. Launched as a pilot scheme (and voluntary for associations) for tenants to acquire a minimum 25% stake, the initial reaction has been muted and the government has now proposed re-launching it with a 10% minimum stake (and with access to further discounts on the property). At present only a small number of lenders (five) have agreed to participate in this scheme (including three societies) reflecting concerns about the risks involved (Ahmed, 2007)

One year on from the launch of pilot Social HomeBuy schemes, the Housing Corporation has suggested that 41 housing associations and two local authorities are currently participating, with over 500 applications in the pipeline and that a further 37 housing associations and six local authorities are expected to launch schemes shortly.

Societies and lenders generally have been cautious of the proposed changes to schemes. They were particularly concerned that proposals mooted for shares of as little as 10% were imbalanced in the buyer's favour and could lead to mortgage arrears with little prospect of recovery. There is a general concern that this may be a scheme 'too far', that costs will outweigh benefits and that risks are disproportionately high for encouraging societies to participate.

Social HomeBuy is designed to give current tenants an opportunity to acquire a stake and an asset. There are echoes here of proposals over the years of letting tenants overpay their rent to build deposits/take a share. In 2005, the Chartered Institute of Housing/Shelter proposed a Homesave scheme. In 2006 the CLG (ODPM as it was then) ran a very small product test on this with two focus groups/two interviews with local authority and housing association tenants. The research found very low levels of financial awareness and little appetite for a landlord savings scheme but more appetite for an investment account that could combine investing money and acquiring a property. The research pointed to the considerable challenges to be faced in terms of product development in this area.

One question rarely aired in all the discussion of low cost home ownership is the extent to which purchasers ever become full owners and how sustainable some of the arrangements are. Roughly 5% of low cost home owners staircase to full ownership every year but, as this suggests, a large number remain as partial owners for long periods, indeed possibly forever. Arrears and possession rates are low (the Housing Corporation publishes data on both for shared ownership) but are higher than conventional prime borrowers.

For shared owners there is a good case for regular review of their rental costs to see whether they would be better off converting those payments to mortgage costs (some associations charge high rents though given recent interest rate rises these are unlikely to be in excess of the equivalent mortgage cost). For HomeBuy purchasers with an equity loan there is the risk that with rising house prices the value of the equity loan escalates faster than their purchasing power.

With it being so difficult for owners of shared ownership properties to staircase up and out to full ownership, many purchasers may be better advised to seek to buy somewhere outright in a less expensive area than just buy a share in a property.

What all of this might suggest is that low-cost home ownership is becoming a tenure in its own right. For many it is a terminus rather than a way station towards full ownership. There is a degree of ambiguity in policy on this and it would be helpful for this to be clarified. On balance, though societies would prefer to see households move to full ownership, they have no desire to see households take out financially unsustainable mortgage contracts. Partial ownership in that sense is preferable and is something that societies wish to support.

"Roughly 5% of low cost home owners staircase to full ownership every year but, as this suggests, a large number remain as partial owners for long periods, indeed possibly forever."

## The mortgage market

Over the last decade or so the UK has witnessed the growth of a variety of mortgage sub-markets including buy to let (now about 9% of the total stock of mortgages), equity release (1%), sub-prime (including self certification perhaps up to 14%) and of course prime (still around 75%). In addition, there is the commercial mortgage market in which lending to professional firms, businesses and housing associations is now commonplace.

This expansion has reflected a number of factors. These include market demand, a greater willingness by lenders to explore new markets as a consequence of competition in existing markets and the emergence of new lenders with new technologies and funding models that initially allowed them to measure and manage the risks more easily than established lenders. It is difficult to get figures on the different markets, not least because of different views as to how they should be defined. One crude indicator of how quickly the non-prime market has grown are the data regarding outstanding balances for lending secured on dwellings. In 1985, the specialist lenders who might be deemed to have a major part of some of these markets (buy to let and sub-prime until relatively recently) had lent less than £1 billion. By 2000, it had risen slowly to roughly £40 billion. By 2006 it was £281 billion in terms of balances outstanding across a range of firms including a number of building society subsidiaries, compared to the societies` £190 billion outstanding.

Building societies have traditionally occupied the prime, conforming market rather than what are seen as non-prime, non-conforming markets. However, as already noted, societies have moved into a number of these markets, both directly and via newly formed subsidiaries. For example, it has been estimated that societies now have around 5% of the sub-prime market and perhaps 30% of the housing associations loans market. In its latest *Financial Risk Outlook* (FSA, 2007) the FSA comments (page 37);

"Some building societies have also moved into new, higher-risk areas of business, such as commercial and sub-prime lending and, to a more limited extent, investment advice. Total lending to the corporate sector by building societies grew by an annual rate of over 20% in the 12 months to June 2006. Most of this lending will have been for commercial property, and such loans now constitute about 8% of building societies' assets."

These markets are important in a number of ways. First, they reflect the ever increasing diversity of the borrower base. The rise of self employment has meant that there has been a substantial and growing market for self certificated loans. Similarly the various forms of adverse credit lending have allowed many of those with damaged credit histories to return to the housing market and home ownership. Second, the housing market is itself ever more diverse in terms of property types, localities and routes into ownership.

The building societies' role in the housing market has also changed considerably over time in terms of aggregate market share reflecting the conversions of major societies to banks in the 1980s and 1990s. However, six of the top twenty lenders in 2005 (the latest figures available) were societies and between them they had 17% of the total mortgage balances outstanding to this group (around £150 billion out of £873 billion).

Although the building society sector is quite skewed in terms of the concentration of lending (as measured by total assets), with the top ten societies having over 80%, we should not understate the very important role played by all societies in terms of their specified markets. Local and regional societies continue to occupy a special place in the spectrum of lenders reflecting their connectedness and accessibility to local communities. The willingness to address the particular circumstances of individual clients is well understood and relied upon by the intermediary sector. Partly this is a consequence of being long standing and well understood but it also reflects the commitment of many societies to specified geographic areas.

According to the previous year's *Financial Risk Outlook*, building societies' market share of outstanding mortgages by value had declined slightly over the last two years and is currently at 18.1%. Moreover as the FSA noted, 'their share of new mortgages approved has declined more markedly over the same period, to 15.1%' (FSA, 2006). Unlike the banks' share of mortgage lending, the building societies' share is extremely concentrated among a few societies; of the 59 UK building societies, only four have a market share of more than 1%.

As at the first half of 2005 the stock of fixed/capped-rate mortgages represented 43.9% of loan balances. The FSA in its *Financial Risk Outlook* (FSA, 2007, 37) notes that

"Overall, credit quality in the building society sector still appears to be relatively good. Arrears above 2.5% of balances on building society mortgages and repossessions on building society mortgages account for only 0.43% of total balances, which is about half that for banks. However, the equivalent figures for building society subsidiaries (which hold a significant proportion of the sub-prime, buy-to-let and other non-standard lending of the sector) are currently at more than five times the building society-only number."

The FSA has previously noted that there was some evidence of increased risk taking, with the proportion of mortgage loans that fall into the combined high income multiple and high loan-to-value (LTV) grouping continuing the upward trend observed since 2003. However this must be viewed against the backcloth of continuing pressures to assist first time buyers and others and the market pressures (and political pressures) that generates.

It is evident that societies have adopted different business strategies in the face of competitive pressures. Some have focussed their products/sales strategy around existing customers and existing home owners. Given the heavy discounting that characterised the first time buyer market, the price sensitivity of this client group and a likely reliance upon intermediaries and the web, this strategy is understandable. Others have, however, taken the view that they must continue to give some considerable priority to this market and have launched products aimed at helping first time buyers overcome the affordability gap. These include generational and family lending structures, equity loans and graduate mortgage schemes.

Recent research on the use of automated underwriting, credit scoring techniques and affordability models (Oxera, 2006) supports the view that the bigger the lender the more likely these more sophisticated techniques are in place (though smaller lenders may well use established relationships). The data are not broken down by type of lender but it would suggest some societies have adopted these techniques and that this will work its way through the sector. This will be helpful in giving societies better insights into the credit risks they may be taking on as well as allowing them to segment borrowers more carefully. This might add to their capacity to consider the different types of first time buyers.

## A brief look back

Finally, it is worth reminding ourselves how far building society lending has moved in the last thirty years. Up until the 1970s there was considerable reluctance to lend on pre 1919 street front property and on any non-traditionally built home. Today societies along with other lenders have widened their lending criteria very significantly. They have also added near prime and sub prime markets to their overall portfolio. As this suggests societies have learned how to manage a wider spectrum of risk without endangering their reserves or reputations. Admittedly this has taken place for the most part in a favourable environment – falling interest rates and rising house prices – but there can be no doubting there has been real progress.

## Conclusion

The housing market has evolved very significantly over the last few decades and societies have changed alongside it. Deregulation of the market in the 1980s drove fundamental changes in the market around interest rates, the supply of mortgages and competition. Societies have responded positively to this new environment. The competitive pressures across the entire financial services sector have also seen a number of bank and building society mergers and take overs.

The first time buyer market has also changed, reflecting demographic change and affordability pressures. At the same time, it has also become more segmented with many more types of first time buyers entering the market. Reflecting growing political and economic pressures the government has been seeking to enhance its support for home ownership in general and first time buyers in particular. This has created some new opportunities for lenders although these schemes are not without their problems.

Underpinning all of these opportunities for societies is a genuine willingness to try to help people buy that is tempered with a realisation of the futility that many potential first time buyers find themselves in as a consequence of the very high level of house prices. With house prices being so high, we must accept that homeownership is financially beyond many people, and as much as building societies would like to help them buy a home, responsible lending criteria means they are unable to do so.

While building societies are keen to do what they can to help people buy, while affordability pressures remain, not everyone will be able to do so. If the government is serious about addressing these issues, the answer is to increase housebuilding.

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# BUILDING SOCIETIES IN ACTION

CHAPTER 3

As the previous chapters indicate, building societies play a key role in the housing market. In order to glean an up to date picture of activity and appetite the BSA carried out a short survey of its members with the researcher. This was emailed out in January 2007 with regular reminders for responses from the Secretariat. Responses were compiled by Andrew Gall at the BSA and analysed by Peter Williams.

The response rate was an excellent 70% (42 societies representing 98% of assets) with a good spread across all sizes of societies, particularly the larger firms (Table 1). The focus of the survey was on first time buyers and affordable housing.

### Table 1: Response Rates

| Rank by Assets | Number | Percent |
|---|---|---|
| A 1-10 | 10 | 100 |
| B 11-20 | 10 | 100 |
| C 21-30 | 8 | 80 |
| D 31-40 | 7 | 70 |
| E 41-60 | 7 | 35 |
| All | 42 | |

Source: BSA Survey, 2007

That response rates were highest amongst the larger societies is itself telling. It was clear from the responses (and discussed later in the report) that the first time buyer market is now sufficiently small that many of the smaller societies believe that it is not worth developing products to serve it. Many suggested that house prices in their area are now so high, that very few can actually afford to purchase a property if they already do not have housing equity, meaning that the market is too small to justify participation.

Table 2 shows the approximate rankings given by societies in each group to the barriers faced by first time buyers. There was general agreement across all sizes of society that the biggest barrier was raising a deposit. Being able to make the monthly payments given the cost of homes was the second most important factor with Stamp Duty costs third and legal and other costs last. A number of societies raised concerns about households not being able to borrow sufficient funds in relation to house prices while others were worried about the outstanding debt and credit history of the borrowers.

### Table 2: Rankings of the most significant barriers to first time buyers by size of society

| | Making monthly payments | Raising a deposit | Stamp Duty | Legal, valuation & other official costs |
|---|---|---|---|---|
| A | 2 | 1 | 3 | 4 |
| B | 2 | 1 | 3 | 4 |
| C | 2 | 1 | 3 | 4 |
| D | 1 | 1 | 3 | 4 |
| E | 2 | 1 | 3 | 4 |
| ALL | 2 | 1 | 3 | 4 |

Source: BSA Survey, 2007

This is significant since the government schemes focus only on reducing the monthly mortgage repayment figure. The government schemes offer no help to aspirant first time buyers who are having difficulty saving for a deposit. With house prices being so high, even for a modest first time buyer type property, a purchaser can be faced with having to raise a deposit well into five figures.

Despite the lack of government support for first time buyers in this area, a number of societies have responded to these challenges by offering products such as 100% mortgages that do not require a deposit. These are explored later in this report.

The **Norwich and Peterborough** Building Society's Lend a Hand scheme allows a borrower's parents' income to be used in the affordability calculation for the loan, allowing the borrower access to greater finance than would otherwise be available. The scheme is not a specific product, but can be used across the society's mortgage range.

Societies were asked about products they were offering for first time buyers and the extent to which this was through government schemes. Just over half of the responding societies offered specific first time buyer products (54% or 23 out of 42). Many of these were in conjunction with central and local government and housing associations including shared ownership, HomeBuy and shared equity. However, about a third or 14 societies had taken their own initiatives including a rent to share scheme (Stroud and Swindon Building Society) and a number of schemes taking parental property or incomes into account (eg, Norwich and Peterborough's Lend a Hand scheme). Although there was a tendency for them to be the more urban based societies, the willingness to take initiatives was spread across the sector.

It is also clear that many societies offer products such as 100% mortgages and high income multiple mortgages that are attractive to first time buyers but, since they are also of interest to existing homeowners, they choose to bundle them with their standard mortgage products.

**Stroud and Swindon's** Buy to Share mortgage is available on all its residential mortgage products. Borrowers can increase the amount they are able to borrow by taking into account income gained by renting out a spare room. Consumers who use the 'Buy-to-Share' option will be allowed to add £4,250 (the amount home owners can charge for renting out a room without paying tax on the income) to their annual income for the first room rented and then £2,125 for the second room. This product is ideally suited to first-time buyers who are struggling to get onto the property ladder and are happy to share but don't want to purchase a home with friends. This arrangement applies across the entire range for purchases and remortgages and increases the amount buyers can borrow in a sensible, sustainable manner.

Twelve societies were funding government HomeBuy and shared ownership schemes. Nine were supporting key worker programmes. Typically, if a society was involved in one scheme it would be involved in a number. Nationwide was unique in being involved in them all. The numbers involved might be thought to be low and this is explored later.

In response to the question why societies were involved in schemes it is evident from the quotes below that it was seen as relating to ethos and culture of the organisations. The sentiment within these quotes would be widely echoed across the sector;

"Fits with our organisational culture and mutual status and the first time buyer (FTB) problem is a major social problem which we want to try to help address" (national society)

"We believe that as a mutual society it is incumbent upon us to try and assist all segments of our community in purchasing their own homes. The unique schemes we offer go some way to meeting this ambition of assisting customers struggling to get on the property ladder" (regional/national society)

"The society views this as a major part of our social responsibility strategy" (regional society)

"Our own scheme has been designed to allow us to provide a service to this important sector of the market whilst still ensuring that risk is adequately mitigated and rewarded" (small society)

"Part of our ethos to help lower income first time buyers into home ownership" (small society)

In response to being asked why the society was not involved in these different schemes there were a wide range of responses to the different questions posed. Table 3 below shows a majority of societies responding to that specific question felt that administration was onerous and there was a lack of demand (even though the majority thought that the products were appropriate). A slight majority thought the schemes were unprofitable. Societies supplemented their responses with a number of comments suggesting that these schemes were for larger lenders only and had a southern bias. Costs and administrative burdens were seen as excessive and a number had taken a strategic decision not to participate.

### Table 3: Reasons for not being involved with government schemes

| Reason for not participating | Yes | % | No | % | Total |
|---|---|---|---|---|---|
| High levels of administration | 13 | 65 | 7 | 35 | 16 |
| Unprofitable | 9 | 56 | 7 | 44 | 13 |
| Lack of demand | 12 | 60 | 8 | 40 | 19 |
| Not included | 6 | 46 | 7 | 54 | 12 |
| Products unsuitable for applicants | 4 | 31 | 9 | 69 | 11 |

**Source:** BSA Survey 2007; multiple answers were possible

This feedback from almost all the respondents overall does suggest that government schemes are not well designed, promoted or understood by lenders. This must be a matter of concern in an era when government is keen to secure greater participation by the private sector in general and private finance in particular. We will return to this issue later in the report. Asked if they wanted to be involved 15 (35%) said yes and 13 (31%) said no, four gave no reply and for 10 it did not apply because they were already engaged.

A small number of societies had developed specific schemes with other agencies such as English Partnerships and local authorities. However, the most significant was lending to housing associations to fund new development.

Financing housing associations is a well established route with Nationwide being the pioneer in opening up this sector. The total private finance facilities for housing associations in the UK now exceed £40 billion. Societies that have been active participants in this market include Nationwide, Britannia, Cheshire and Newcastle (and not overlooking the Dunfermline in Scotland) as major participants.

It is sometimes suggested societies are pre-occupied with increasing home ownership. Though this does remain a core objective it is important to recognise that societies have also helped fund the expansion of the housing association sector through both new build and the transfer of housing stock from local authorities. A number of societies expressed concern about housing supply in response to the survey and this funding is a very practical expression of societies contributing to solving this problem. Add to this the funding of buy to let and private landlords more generally and what we have is societies active across all three tenures in delivering housing solutions.

The **Bath Building Society's** Buy for Uni mortgage allows students (or their parents) to purchase a property for them to live in while at university. The mortgage holder is allowed to rent out spare rooms to help meet the cost of the mortgage, and parents can also guarantee the loan.

Recently, there is some evidence of a weakening appetite for lending to housing associations, reflecting the low margins now being received. Some societies, such as the Derbyshire, have sold their books recently (albeit to another building society), and others have reduced their level of activity. Because housing association lending is deemed low risk, margins have fallen over the years and the market has become dominated by a few major players (who benefit from a variety of mechanisms including banking facilities, swap facilities, syndication and securitisation, as ways of increasing margins/making deals look more attractive and which are not always available to societies). The Newcastle Building Society syndicates some of its loans to housing associations by selling shares to other societies for example. Given the favourable weightings lending to associations attract under the new CRD regime, economic capital returns have risen recently.

At the same time associations are coming under increased pressure to borrow more and make better use of their extensive property assets. Policy is in a state of flux at present but it will be important for societies to gauge how best to work with this sector in the future given the opportunities that may exist around low cost home ownership.

Returning to our main theme and the results of the survey, around 35% (15) of societies (across the size spectrum) had developed their own initiatives/products to respond to the pressures on first time buyers (though a further 40% (17) had explicitly rejected such a strategy). Of these initiatives the most common (eight) were guarantor type arrangements put in place with the express aim of stretching the first time buyers' capacity and a further six who had introduced 100% advances.  Such activity is significant in such a competitive market place.

24 or 57% of societies indicated that they had definite plans to take initiatives to help first time buyers in 2007. Some 19 (45%) had considered offering equity loans and again this was across the spectrum of societies. In discussing the barriers to offering such loans societies had a wide range of concerns but they were dominated by questions about pricing and the costs of setting up the product in relation to the return (35% or 15), the demand for such products (mentioned by 23% or ten respondents) and the risks associated with equity loans (21% or nine).  A small number indicated they would follow the lead of larger societies or that their main issue was how such loans would be treated in capital weighting terms.

Asked what are the biggest barriers to societies doing more to help first time buyers, the biggest by far was risk to the society. This was expressed in a variety of ways but included both price and market changes and regulatory repercussions (over 40% mentioned this). Six mentioned capital weightings. Although these concerns were spread across the spectrum of societies, smaller societies were notably focussed around them along with reflections on their competitive position vis à vis larger organisations.

Overall, the findings of the survey point to societies being very engaged with the issues of affordability and the needs of first time buyers.  Societies clearly recognise the pressures and have been working creatively to overcome them.  However, balanced against this are concerns about risk and reward and a pragmatic view as to what many feel they can do given the scale of the affordability problem since it is not something of their making.

Moreover, in a regulated mortgage market, any initiatives have to be balanced against regulatory risks; while being member lead organisations societies regard treating customers fairly and responsible lending with the utmost importance.

Trying to find mortgage solutions to the almost intractable problems of affordability for those at the margins of home ownership is difficult. The client group is by definition more vulnerable to changes in circumstances over which neither they nor societies may have any real control, such as rising interest rates or unemployment. Structuring products that can insulate borrowers from change and thus subsequent difficulty can be problematic although the emergence of longer term fixed rate loans does help. Ironically, mortgage interest tax relief was in a sense one solution because at an individual borrower level it helped nullify interest rate change.

Equally, as noted earlier, it must be recognised that societies have different strategies and market contexts. Diversity in market and geography are strengths of the sector though in the media and the public's minds this is perhaps not as well understood as it should be. The following two quotes give some sense of that.

> "The first time buyer market in our 'heartland' is not buoyant, there has been a major growth in the private landlord market." (smaller society)

> "We tend to operate in 'complex-prime' mortgages, and do not offer rates that would attract first-time buyers versus other high street institutions." (smaller society)

It is also evident from responses that there are a range of issues with the government schemes based both on direct practical experience and received wisdom. Complexity, time and cost are three factors but perhaps the biggest concern is that they question the demand for some schemes and thus the extent to which the effort put in can be rewarded. Again comments from societies re-enforce issues government should be tackling;

"We should encourage the standardisation of schemes across the LCHO sector and more discriminating choice of titles and terminology to avoid the current confusion." (national society)

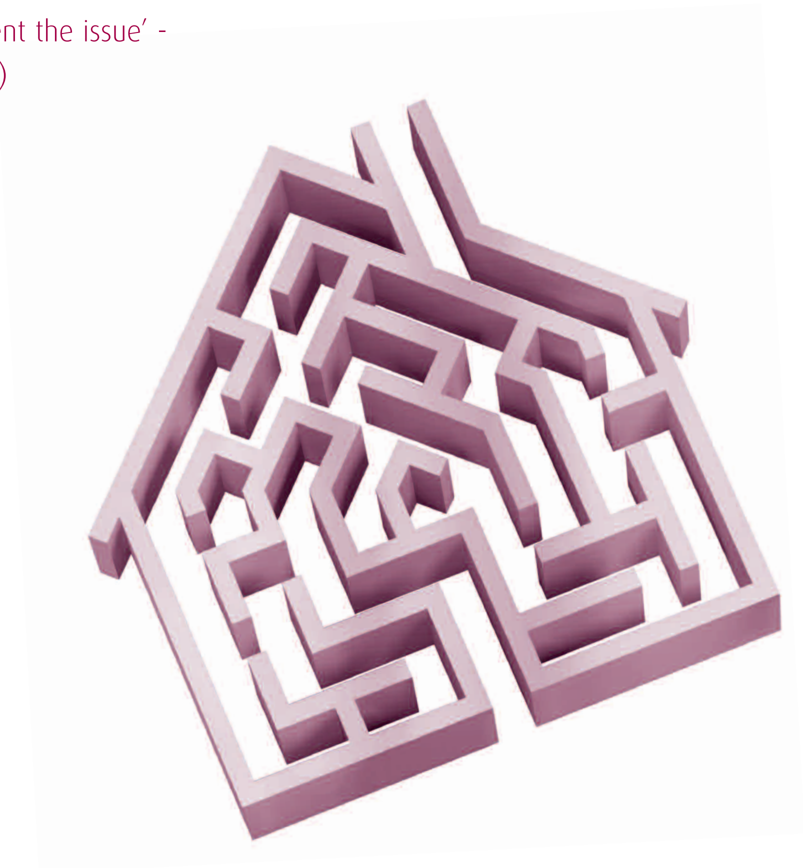
"Although finding a deposit is the biggest challenge to FTBs, schemes are available to overcome this. However, stamp duty is draconian." (smaller society)

Unprompted one society then added somewhat provocatively, without going into details, as to what might be done.

"The BSA needs to do more than just 'represent the issue' - it needs to sponsor change" (smaller society)

### Conclusion

This is the first survey of building society activity in the housing market for some considerable time. The findings give a clear indication of a number of common views and concerns across the sector and the very considerable efforts being made by societies to tackle problems associated with affordability and access to the market. The report returns to these in Chapter 5 with conclusions and recommendations.



CHAPTER 4

# SOCIETIES RESPONDING TO THE FUTURE

## Introduction

This chapter brings together a number of dimensions from previous chapters. It covers the changing housing market and demographic context and the reshaping of the first time buyer market. It also looks at possible policy agendas which might assist this group and the role societies might play. However, it begins with a short report back on a survey of society web pages from a first time buyer perspective and the ways societies seem to be positioning themselves for this market through this medium. As will be obvious, looking to the future the assumption is that first time buyers will make ever more use of the web to begin their housing market journey.

This is backed by the findings of a recent Equifax survey on financial services (Equifax, 2007). The Equifax survey revealed that 82% of respondents used the internet to search for financial services and of these, 85% were aged 18-25, compared to 82% for 26-45 year olds and 75% for 46-60 year olds. Of those that had bought financial services online, it was the 26 - 35 year olds that did so most frequently at 50%, followed by the 18 – 25 year olds at 44%. The group that bought financial services via the internet the least was the 46-60 year olds. Ninety percent of 25-35 year olds used on line banking. 55% of this age group have used the internet to search for loans. Convenience and ease of use were their main reasons for using the internet for financial services.

## Societies on the Internet

Given the target market a review was undertaken of the websites of all 59 societies using a simple two click test of use for first time buyers. This 'test', devised by the researcher, was aimed at seeing how quickly the site would bring up a screen most likely to be useful to a first time buyer. The view was taken that, at most, a first time buyer would expect to find this within two clicks of opening the site.

There is clearly a debate to be had about what is useful to a first time buyer. Here the view was taken that mention of the category 'first time buyer' was essential. Lists of products and services are fine but for someone who does not know precisely what to look for because of lack of experience taking them into their own page was deemed a good start. Then the question was what was on that page. In some cases there was then a short narrative recognising the challenges facing the first time buyer and offering to help them through it with then a sequence of screens to pull up which would take them through issues/products. In others there was simply a list of products and terms. The former was viewed as good, the latter as less good. In some cases societies had prepared a full guide for first time buyers which could be read on the screen or downloaded. Again regardless of the contents of the guide (and they varied considerably in terms of quality) this was seen as a positive.

This was a simple survey but it was nonetheless revealing. Some broad conclusions emerged. These were;

- Less than half of all societies met the two click test for first time buyers.
- Some sites were very first time buyer unfriendly with too much complexity and a very provider driven menu rather than a customer facing menu. There was considerable variety across the spectrum with some large societies having poor sites for first time buyers.
- As a generality it felt like many societies were not expecting first time buyers to come through this route but rather to have gone via the branch or brokers. While this rightly recognises the ultimate need for advice and guidance it neglects the nature of the research process that younger households would now automatically engage in.
- Rightly the contents of the websites revealed the strategy/targeting of the society. Some were very clearly directed to existing customers/owners.
- The bigger the society the more likely the opening web page had a first time buyer category to click on though this was by no means a universal truth. Some large societies did not and some small societies did.
- The bigger the society the more likely it was to have a web guide for first time buyers.
- A considerable number of societies had a mortgage calculator on their site though it would be interesting to know how much they were used.
- Relatively few societies list the government related schemes they were prepared to assist/lend to.
- A few societies had not updated their sites for some considerable time and two were not instantly accessible.

What was striking on getting inside some websites were both interesting products and approaches. Products included guarantor (Chelsea) and step up mortgages (Coventry), brown mortgages (Newcastle), mortgages for young professionals (Dunfermline), mortgages for clergy (Catholic) and cooperatives (Ecology), a back on track mortgage (Beverley) and a buy for university mortgage (Bath). The survey pointed to some real creative energy in societies in terms of identifying niche markets.

Reflecting the society's long involvement with trade unions, the **Britannia** and the **Police Mutual Assurance Society** have an arrangement whereby the society offers a cashback to mortgage borrowers working in the police service.

Equally there were some surprising gaps. Very few societies mentioned the Right to Buy (for example, sales in England are still running at between 4,000 and 5,000 per quarter) and how they might help tenants buy their homes. Over two million households have done this and with few problems of default. As noted above there were also not many mentions of schemes such as shared ownership and ways societies might help those on the margins of affordability (though there were a number of no deposit/100% loans).

A number of societies lend to buyers exercising their "Right to Buy" a council property. The **West Bromwich**, for example, will lend up to 100% of the discounted price, provide £300 towards solicitors fees and, subject to conditions, make additional funds available for home improvements

### Going forward; the first time buyer market

Relatively few societies appeared to recognise the diversity of first time buyers, for example, relationship breakdown 'returners', those with damaged credit history, young professionals, single people, friends, family assisted, immigrants to the UK, returners from abroad and of course the growing numbers of self employed. Given stronger market segmentation and flows it now suggests we do need a more refined approach to the market than previously. Of course this is partly where intermediaries and societies succeed (and where the new market in lead generation is developing), the former by being able to undertake wide market searches to find relevant products/approaches and the latter because of a greater willingness to tailor solutions than might exist in some types of lending organisations and especially where most effort is being applied to the volume/co modified markets.

There are some difficult strategic issues regarding the FTB market. With margin compression taking place because of the intensity of competition overall and the likelihood that first time buyers will be very price sensitive, there may be limits to which societies can offer a tailored service and secure the volumes of sales that might justify it. Building awareness with a group of buyers new to the market and retaining their custom over time would be the desirable outcome but many would question as to how achievable that is. At the same time with the myriad of products on the market and with high levels of uncertainty and inexperience there should be opportunities to nurture such customers.

This raises the question of whether we know enough about first time buyers, what they are looking for and how they go about making their mortgage selections. It is self evident that not all first time buyers are the same and there will be groups who are very risk averse and who are looking for the overall good value/good service proposition rather than the cheapest. It is also clear that some first time buyers are good credit risks and some less good.

We know from experience that first time buyers as a generality are higher risk. Some societies may take the view that higher risk lending and looking after member interests do not sit comfortably together. However, this needs re-examination. It is members' daughters and sons that are the potential customers and those members may themselves have considerable assets whether in the form of a home or savings. Linking the two is a fruitful area for exploration.

The **Catholic's Guarantor Plus Mortgage** was introduced in 2006. The product allows potential applicants to borrow up to 100% of the property value, with 25% of the loan secured with additional suitable security such as a cash deposit placed with the society.

This generation of first time buyers are also very 'busy' in terms of careers, relationships, life and travel reflecting the expanded expectations of each successive generation. In that sense, the mortgage is a means to an end and it needs to be dealt with quickly and efficiently.

Recent research by the CML (Pannell, 2007) has pointed to the pressures on first time buyers. Of the 860 buyers responding to a survey 40% were spending more than a quarter and up to a half of the household's total take home pay on repaying borrowing (25% of this group were paying more than half).

The **Tipton & Coseley's Guarantor** product allows a borrower to use a parent's property as collateral against a loan, further increasing their borrowing power. The mortgage also includes a £500 cashback feature to help with moving costs.

An earlier CML study (CML/BMRB, 2005) based on a small number of group discussions in four locations pointed up the desire of first time buyers to be in a settled career/location before seeking to buy. Up to that point renting was seen as a reasonable substitute but stability and the possibility of family helped households drive towards the decision to purchase. Partnership, whether with a potential longer term partner or a friend, was seen as an essential way of entering the market.

This begins to suggest for such households there is a lot going on in their lives at this time, let alone buying a home. Alongside the personal pressures are market pressures (such as rising interest rates, rising prices and a shortage of supply) that create a context in which time and timing becomes very important. Press reporting of the housing market added to their anxieties and on balance might hasten a purchase decision. This limited research along with other pieces of market research on products points towards the need for lenders' processes to be simple and clear and for there to be a degree of urgency.

The **West Bromwich** is one of a number of societies that offers an offset mortgage though their product has a Family Offset feature. It is possible to offset savings accounts belonging to your family in a linked mortgage savings account with the society. The notional return on their investments is increased through the tax saving on their investment interest and this is passed on to their children to save them interest by shortening the mortgage term. The society is now exploring other options which might more directly assist first time buyers.

Many first time buyers will already be savers and there is a question as to how far societies link these two markets both in terms of contacting savers of a particular age in terms of their appetite/desire for a mortgage and whether there can be any linked product. Offset accounts are one way of achieving that with savings held offsetting mortgage costs in a very tax efficient way.

Societies are active providers of 100% advances for first time buyers. Of the 31 lenders listed in the March 2007 edition of Moneyfacts as offering 100% loans, 10 are societies. The same edition shows that 30 of the 48 lenders ready to offer higher income multiples (four times or more for single applicants) are societies and 29 societies are also listed as being prepared to deal with multiple borrowers (out of 58 firms listed). 25 out of 35 lenders to the self build market are also societies.

Your level of education can help you get a mortgage – the **Newcastle's Guarantor Mortgage**, for example, allows the newly qualified professional to apply for a loan worth £100,000 providing a close relative is prepared to act as a guarantor. In all situations it is a requirement that full status checks are carried out on both the borrower and the guarantor. The scheme has been designed exclusively for the professional who, due to accelerated earnings potential, expects to be able to cover the entire mortgage within a five year period.

Other activities by societies point up the theme of the diversity of the population and the range of different needs/demands. The Kent Reliance Building Society, for example, participates in a shared ownership scheme in conjunction with housing associations for people with disabilities whether physical, learning, mental health or long term illness.

The survey reported on in Chapter 3 indicated there were a number of societies funding government related first time buyer schemes in conjunction with housing associations. Mention was also made of the large number of societies that directly fund these organisations providing development finance to build new homes for rent and sale or refurbish existing homes. In 2006, Nationwide, Britannia, Newcastle, Cheshire, Dunfermline and Principality all lent significant sums (between £20 million and £1.7bn) and indeed Nationwide is now the top social housing lender in the UK with around £8.4 billion of facilities outstanding to the sector.

The housing association sector is undergoing considerable change at present and is under increasing pressure to increase its housing output whether grant funded or not. This is opening up opportunities to work with associations in developing joint venture schemes. This suggests societies with established business relationships might benefit from exploration of other ways of meeting first time buyer needs.

Similarly there has been an appetite from local government to finance home improvement loans as a consequence of government moving away from a grant based regime. Dudley Building Society works closely with the Home Improvement Trust (HIT) and provides funding which is then on-lent by HIT to individual households (over £3 million in the last 12 months with HIT meeting the administration costs). Darlington Building Society supports the Redcar and Cleveland Home Improvement Scheme in a not dissimilar way. Recently consortia of authorities in the North West and the West Midlands have also been looking for funding partners.

It is clear from earlier comments that societies often take the view that although there may be public relations benefits in some of these ventures, the costs of some schemes in terms of time and resources outweigh the likely benefits in terms of volumes and profit. It can be a difficult judgement call but in the right circumstances the outcomes can be favourable. The Darlington has, for example, been an active innovator with respect to local schemes, setting up Darlington Homes (a property development arm), a Helping Hand affinity account scheme with five housing associations and is exploring its own shared ownership scheme with a number of other initiatives in the pipeline.

The **West Bromwich** allows first time buyers to not just spread their mortgage term to as long as 40 years, but it also allows them to convert what was initially an interest only mortgage to a repayment product free of charge for up to five years (or age 35).

Perhaps most ambitious is the Melton Mowbray Building Society's new Housing Foundation which has been set up to help first time buyers in the local area (within the triangle of Melton, Grantham and Oakham). The operational details of the foundation are still being worked on but the society would hope to operate a shared ownership scheme possibly with some form of equity participation. Over the longer term it will explore other possibilities in conjunction with the local authority and through the development route. The Melton Mowbray, like a number of other societies, is looking to see how it might deploy capital to more effect.

**Chelsea's Helping Hand Mortgage** enables first time buyers to get onto the property ladder. It links the buyer's income with that of close relatives (up to three incomes in total) and allows a loan term of up to 40 years.

There can be no pre-defined outcome for such explorations. Much turns on individual appetite and circumstances. However, with the benefits of Basel 2 beginning to flow in terms of capital relief, it is important new markets are developed. Commercial lending and non prime lending have attracted considerable interest in recent years though these are increasingly crowded and deeply competitive markets with the latter being untried in a recessionary environment.

The **Hinckley and Rugby's Offset Mortgage** allows savers to offset their savings against their mortgage. As a consequence, the outstanding mortgage amount is reduced by the amount of any savings, reducing the interest that has to be paid, and thus shortening the term of the loan.

The first time buyer market, and especially 100% loans, have identifiable risks as past recessions have shown. However societies have proved themselves adept at managing higher risks not least though close controls on accounts. Higher lending charges (HLC) have themselves come under pressure in competitive terms though some insurance companies have ensured their products secure a favourable capital relief treatment. Equally, lending on shared ownership is seen as risky by some but again it benefits for the most part from the Housing Corporation (HC) mortgagee protection clause (the equivalent of HLC and with costs met by the HC).

First time buyers are important from the point of view of overall market liquidity. The value of all homes in the market rests on there being a supply of new buyers/new entrants. In that regard it is in every society's interest to assist first time buyers.

The **Skipton** offers a guarantor option on any of its mortgage products. They also allow the guarantor the option to only guarantee the 'top slice' of the loan. As a consequence, when calculating affordability, instead of having to guarantee the whole loan, the guarantor must be able to cover their own mortgage (if applicable) and any proportion of the new loan not covered by the primary borrower. The Society is also generous with its income multiples when there are more than two people on the loan.

What more could be done? A number of societies have flagged up their concerns with the taxation system in general and stamp duty in particular. More favourable treatment for first time buyers has been suggested but to date the government has rejected this.

The BSA has recently agreed that it should argue for a review of the stamp duty regime with a view to removing the distortions created by the current `slab' system. This is an important development with the BSA adding its voice to the number of other trade bodies who are pressing for this to be done. At the same time the BSA is very clear it would not want to introduce further distortions to the housing market as a consequence of any change.

It has been suggested the BSA should take a more direct lead in this area. This might include pressuring the government for more support for home ownership. The BSA might also consider doing more to flag up what societies are doing and have on offer. This report is part of that process although a more permanent role might be considered, for example, building a first time buyer microsite attached to the BSA site which could act as a portal to promote and give access to individual society schemes and sites?

## Conclusion

This chapter has considered how societies are approaching the first time buyer and affordable housing markets. There are clearly a wide variety of stances, not least reflecting some of the difficulties of making this a profitable business segment without taking undue risks. However it is very evident from Chapter 3 that a large number of societies are very actively looking for ways they can assist and have developed products and partnerships to do this. The pressure to do this varies considerably between societies and is perhaps felt strongest by societies with a strong regional focus.

The **Cambridge** offers a family loyalty bonus so that a borrower with savings or an existing mortgage (as the scheme extends to relations as well) with the society does not have to pay a range of fees on a number of mortgage products.

Here the aim has been to seek out new agendas for societies in relation to affordability and first time buyers. There can be no doubting this is a difficult and challenging area for all the parties involved and not least for the trade body.

The chapter has explored the use of the web in a limited way and pointed to a number of areas societies might wish to consider further.

The scale of the problem faced by first time buyers is very great and societies themselves cannot resolve it alone. There are big issues around housing supply (not enough are being built) and the cost of home purchase (taxation, fees etc). However they can and indeed do make a difference.

There is no doubt all societies recognise the problems and would like to do more, if for no other reason than to meet their corporate social responsibility requirements. Beyond individual products and initiatives is there a case for some wider partnership approach along the lines of Mutual One or in conjunction with a joint venture partner? Could societies create a joint funding vehicle, taking equity stakes in property and perhaps using new tax efficient vehicles such as REITS?

In part, the question is does the current problem create an opportunity for societies individually and for the sector as a whole? Could it be used to enhance the standing and status of the mutual sector while at the same time not exposing it to undue risk? For very obvious reasons, collective solutions have been notoriously difficult to get off the ground but the problem for any individual society is capacity, appetite and overall balance.

Looking back we can see the sector was very active in discussions with government and indeed led on a range of initiatives around shared ownership, the supply of mortgage finance and working with local authorities. Is there a case for returning to this type of agenda? Indeed if there is a general lack of dialogue with government around these agendas does it create an opportunity for the BSA to engage with government as to what might be done?

The **Coventry**, for example, offers a range of 100% mortgages that allow borrowers to fund all of their potential purchase. And in recognition of the high costs that are involved with moving house, the society's Moregage product allows a borrower to combine a mortgage with a loan to raise up to 125% of the property price - this can represent an important contribution to costs such as legal and surveyors fees and removal charges.

Experience in other sectors suggests that typically the big problems are the ones everyone avoids and goes about normal business as far as possible. Then someone makes a breakthrough. There may be a case for reviewing the problems faced and seeing whether the issues can be broken down into more manageable concerns that could then be tackled. It is interesting to note that though our focus here has been on first time buyers we now more explicitly recognise the link between them and their parents' assets and ways those might be mobilised. Equally there is some evidence to suggest that households further up the housing ladder are themselves having difficultly moving because of increased house price differentials. If this group are less able to move that reduces the supply of homes to those wanting to get on the ladder and adds to price pressures. Again a solution to one problem may come from a different direction.

**Kent Reliance** is a lender to the SOLD scheme, shared ownership for people with learning disabilities. Operated through housing associations this scheme has helped ease access to mortgage finance and to provide real opportunities to a seriously disadvantaged group. This has already enabled over 300 people with learning disabilities to purchase their own homes, near friends and family, thereby improving their quality of life, increase their sense of independence and reduce the overall cost to the state and benefit agencies. The scheme has recently been extended to help other vulnerable adults including HIV/Aids sufferers and borrowers with mental health problems.

Given the complexity of the issues it should be no surprise that at this stage there is no obvious single way forward. However further discussion with societies to establish the appetite for other initiatives might assist that. Clearly more can be done in the low cost home ownership area in terms of clarifying rules and ensuring that there is the best fit possible between these government schemes and societies. A portal hosted by the BSA might also be a step in the direction of more collective action. This could list a range of products and give links to the societies providing them. If the BSA then promoted and marketed the site there would be an incentive for societies to ensure the relevant products were listed.

The **Darlington Building Society** has been working with Redcar and Cleveland Borough Council to provide mortgages for clients of the local Home Improvement Agency who are no longer eligible for full grants. The Darlington is able to provide funding packages for housing assistance. Each package is tailored to meet the needs of the individual client.

What we do know is that the interest around an agenda for helping households enter home ownership is perhaps as strong now as it has ever been. No one organisation would want to own the solution but the case for dialogue is strong.

The **Dudley Building Society** has built up a long term relationship with the Home Improvement Trust, a non profit national agency set up in 1997 that assists elderly and disabled home owners access loan finance. Loans from £3,000 are available for essential repairs rather than for lifestyle changes and clients are referred to the Dudley by the Home Improvement Trust. Half of all loans are arranged on interest only payment terms when assistance is often received through Income Support. The remainder of loans are evenly split between capital and interest repayment and interest roll up. The society lends approximately £3m a year and will ultimately bring in other lenders who have expressed an interest when volumes grow.

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# CONCLUSIONS

CHAPTER 5

This report has been prepared during a period of some uncertainty in terms of both market and policy direction. Interest rate increases have continued with the June 2007 0.25% rise to 5.75%. This is the fifth increase since August 2006 and takes rates in the UK to their highest level for six years (with rumours of a further increase possible). This is adding pressures to existing first time buyers, albeit that this may further curb house price inflation.

The new Prime Minister has identified affordable housing as one of his priorities, and a Green Paper (promising three million new homes by 2020) has already been published looking at housing issues. New investment in housing has been promised in the Spending Review due out in October though the focus may well be on rental housing. The Prime Minister has appointed Yvette Cooper MP as Minister of Housing and given her the right to attend Cabinet meetings and champion housing issues. Mr Brown has made clear that he wants to do more for first time buyers and to attract further private finance support. Though this is focussed upon England recent reviews in Northern Ireland, Scotland and Wales regarding low cost home ownership would suggest a similar appetite across the UK. Tracking market trends and policy responses will be important over the rest of this year.

This report has examined current and planned building society engagement in tackling affordability and access to the housing market. What is very evident is that in practice there is a high level of engagement even if in media terms this may have been overlooked. If this is the case in part this is because many societies are regionally and locally based and the media tends to be London dominated, not least with respect to housing issues.

Indeed, the survey evidence suggests that many societies will be launching new products in 2007 specifically aimed at easing the widespread affordability problems across the UK. In addition, alongside such products a number of societies have been working with other bodies to develop schemes to help specific groups or areas.

Though engagement is high in a variety of ways the report has also shown a degree of frustration by societies in terms of the ways current low cost home ownership schemes are operating. There is clearly some dissatisfaction with both procedures and practices around Section 106 agreements (the planning agreements that lead to the provision of affordable homes in a development) and the administration of shared ownership schemes. This is despite the existing standardised agreements on both (though it is accepted that the issue of restricted sales on rural exceptions sites and lender access to their security has not been resolved). Societies have expressed frustration at the time and cost of trying to settle arrangements.

Despite these concerns there is a real willingness on the part of many societies to engage with government. A number have explored the possibility of offering equity loans and two further societies are seeking to join the current government equity loan scheme in which Nationwide and Yorkshire are already active participants. There is clearly some further potential for government to engage with societies around its Shared Equity Competition and for which initial expressions of interest had to be made by the end of June.

At the same time and in the context of the government's Social HomeBuy scheme the recent suggested reduction to 10% in the minimum share able to be purchased has prompted some societies to question the government's understanding of lending and what is realistic from both a borrower and a lender perspective. Such announcements in advance of discussions with societies are seen as setting up unhelpful expectations amongst consumers about what products may be being bought to market.

Although the survey evidence suggests few societies see tax reform as the best way of tackling affordability and access issues there can be no doubt that this is seen as an important strand in two senses. First, if government is asking others to be creative and supportive the question rightly is put regarding how government itself is contributing to the problem and then second, how government might contribute to the solution? There is widespread dissatisfaction with the current structure of Stamp Duty (the slab system whereby the top rate is charged against the price of the property rather than a graduated charge with each successive slice of the price having a different rate) and with the modest and selective impact of the reliefs in 'low value' areas.

As noted earlier societies are taking their own initiatives pushing forward with products that can ease access to home ownership. Setting aside possible developments around equity loans, it was clear that guarantor type arrangements were being creatively explored and introduced. Though societies recognise this does nothing to ease the underlying supply issue, it does help individual households and does link back to strategies re members and mutuality. There is the potential here for a wide agenda around savings and mortgages, asset accumulation and use and intergenerational life cycles.

The recent BSA report on individual's saving decisions (BSA, 2007) sets out ways in which the savings process might be enhanced. It also makes clear the partial link between the rise of the housing market and the decline of savings. Homes are seen as a form of saving. The report makes clear that consumers do not see the need to save yet in a different context they might recognise the value of doing so (eg, home ownership). Could more be done to link these agendas?

In some respects, it marks a return to an earlier era when home ownership levels were much lower and families had by definition to help each other to access the market. In the 1980s and 1990s that seemed to be less necessary, but perhaps once again it will become normality.

Any initiatives have to balance potential risks against possible benefits both in terms of the society itself and the borrower. It was clear from the survey responses that societies are acutely aware of their responsibility to members and the need to safeguard their interests. The measurement and management of risk is thus a matter of considerable importance.  Initiatives around affordability clearly link to this agenda and societies will approach the problem from both commercial and risk perspectives, albeit linked to a desire to help tackle the problem.

To those outside the industry risk and home ownership are not well understood. Crudely, house prices are seen to rise over the long term so while there may be short term risks, societies are perceived to be well insulated from house price falls. Reality tells us otherwise and though the memory has faded, the 1991 recession saw societies along with all other lenders being forced to write off considerable sums of money as owners defaulted on their payments and homes were sold at prices below their mortgaged value.

The FSA has forcefully reminded societies of this risk. Clive Briault, Managing Director of Retail Markets at the FSA reminded lenders at the CML Annual Lunch on the 20th April when he commented;

> "Reference points issued by us for assessing downturn Loss Given Defaults suggest that when lenders are calculating their Loss Given Defaults on mortgage portfolios they should allow for a 20% reduction in house prices, and a further 20% reduction from forced sale after a property has been repossessed; and should allow for 35% of loans in default to end up in repossession."

Societies have accumulated long experience in the housing market and this does condition their response. Lending on homes does not guarantee no losses and given that buoyant markets have typically been followed by poor markets all have to look to the long term. Government can help societies manage these longer term risks through schemes such as shared ownership where losses are refunded. Guarantee schemes have become less commonplace in recent years but have much to recommend them in that government is able to back its desire to see a programme in place with its own view of likely losses and through a guarantee based around this to bring in private finance to actually fund the scheme.

The challenge here is to bring the different interests and issues together around a policy need and to explore whether there is a creative way through the different challenges. What is very clear is that societies do wish to engage but it must be from a commercially sound perspective. Helping first time buyers should not be seen as being driven by a corporate social responsibility agenda (see BSA, 2006) but rather as part of their core mainstream business. There is some confusion around this. Some external commentators argue societies should offer products at low rates to first time buyers as part of their social responsibility as mutual organisations. However, societies' first responsibility is to their members as savers and borrowers and that requires them to secure reasonable returns. Failure to do otherwise would jeopardise the long term future of the societies themselves.

Finally, the somewhat unscientific internet survey perhaps raises some issues for societies in terms of future markets and engagements and at the very least how they might begin to think around these topics.

### Drawing the strands together this report suggests;

- Societies are doing far more to help address affordability issues than is being widely recognised. They have developed a range of innovative and competitively priced products that allow people to buy. However, the scale of the affordability 'problem' is now such that the ability of building societies to help everyone who would like to buy is limited.

- Stronger promotion of what societies are doing to help tackle affordability and access. This might be strengthened via the creation of a first time buyer portal on the BSA website.

- Further engagement with the relevant organisations around current/future government schemes aimed at helping first time buyers with a view to ironing out a number of on-going practical difficulties and building a stronger common understanding that might inform future initiatives is required.

- Societies have a continuing concern with the tax treatment of home ownership in terms of the current structure of Stamp Duty and would argue the case for urgent reform.

- Reform of the Section 106 system to ensure that Section 106 agreements don't conflict with lender's requirements would significantly reduce the costs for societies of entering into shared ownership and social housing markets.

- Currently many potential buyers have difficulties accumulating the size of deposit needed to enter the housing market. The provision of 100% loans by societies is one way through that. Another is to consider whether more could be done via savings schemes (and even dormant accounts) to help overcome these problems. Could government help facilitate this process?

- Joint ventures do not have a strong history in the sector. However, is it now time for societies to explore creating a joint fund that societies could contribute to with a view to creating a pool of shared equity loans? Participation need not be limited to societies, but could be extended to other mutual groups.

- Is there a case for a discussion with mutual employers regarding key worker schemes?

- Could societies create a joint funding vehicle, taking equity stakes in properties and perhaps using tax efficient vehicles such as REITs?

- With devolution at national and regional level, and with many societies being regionally based, there is a possibility of developing new regional agendas. The connections between societies and regional/ national governments should be explored further.

- Although many societies are doing what they can to help, the scale of the problem faced by first time buyers is very great, and societies themselves cannot resolve it alone. There are fundamental issues that need to be addressed by government around housing supply (not enough being built) and the cost of home purchase (taxation and fees) to resolve the problems faced by first time buyers.

- Societies don't own the problems of the housing. However, as government builds its own policies around the housing market it is important that it engages with lenders in general and societies in particular. As this report has shown societies have accumulated valuable experience, often in specific localities, with respect to what works or not.

- Societies have had a long and continuing engagement with home ownership and the housing market. It is quite clear the societies' appetite to address the problems of the market remains very strong and this is being tackled via both product innovation and partnership solutions.

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The Building Societies Association
6th Floor, York House
23 Kingsway
London WC2B 6UJ

Telephone: 020 7437 0655
www.bsa.org.uk

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