

Making Home Ownership Affordable

BSA response to the Discussion Paper

Restricted

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 Building
Societies
Association

Introduction

The Building Societies Association (BSA) represents all 43 UK building societies, as well as 5 credit unions. Building societies have total assets of £415 billion and, together with their subsidiaries, hold residential mortgages almost £330 billion, 23% of the total outstanding in the UK. They hold over £280 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies account for 37% of all cash ISA balances. They employ approximately 42,500 full and part-time staff and operate through approximately 1,470 branches.

Just over half of BSA members, with around £2.6bn worth of shared ownership mortgages on their books, are currently active in shared ownership lending to varying degrees and are in general committed to seeing it grow. Building societies are mutual mortgage lenders – owned by and run in the interests of their customers. They were established with the social purpose of increasing home ownership among the population and continue to be driven by this purpose – through shared ownership, Help to Buy, Right to Buy, high loan-to-value mortgage lending and a suite of products aimed at facilitating first-time buyer purchases through the Bank of Mum and Dad.

In a recent BSA report, 97% of building societies agreed that it is part of the distinctive social purpose of building societies to help young households into home ownership. Shared ownership is an important product for helping people with lower incomes or in high-value areas of the country onto the housing ladder. However, it is still a small part of the overall tenure mix – representing less than 1% of building society mortgage lending.

The BSA believes the most important action Government could take to increase the size of the shared ownership market would be to commit significant capital funding to a long-term pipeline of developments. There have been numerous false dawns where it appeared that shared ownership would take off as a tenure in its own right, only to have funding scaled back or for new affordable housing schemes to be announced which crowded out shared ownership developments.

There is a clear opportunity for private shared ownership (PSO) providers to tap new funding sources from institutional investors such as insurers and pension funds. It is important that in seeking to open up this market, however, that Government does not lose sight of the good work that has been achieved over a number of decades to standardise shared ownership documents and processes and embed these across the housing association sector.

It is encouraging that Government is looking to establish a national model for shared ownership. This would be helpful not just for PSO providers but also the growing number of sites developed by housing associations using their surpluses or s106 schemes without grant funding. Where PSO providers are concerned, the BSA believes this should be supported by an industry code of practice to ensure customers are treated fairly.

In terms of staircasing, building societies are supportive of customers increasing their stakes and additional share purchases would normally be backed by further mortgage borrowing. In reality, our members report that very few shared owners take up the opportunity to staircase. It would be useful for Government to conduct further research into the reasons why people do not staircase, as there may be a range of non-financial reasons. For example, it may be that staircasing is not widely or consistently promoted as an option.

As a final point, while the BSA is certainly supportive of the principal of more affordable housing that meets local incomes, we would caution against any attempt to achieve this through the planning system that may restrict the resale market. Such restrictions can also reduce lenders' willingness to offer mortgages on such properties as a result.

Q1.What would be the impacts of smaller staircasing increments on shared ownership mortgage products?

Currently most customers staircasing at 10% increments or above would do so by taking a further advance from their lender, providing them with the funds to purchase the extra share. Some of the language from the Discussion Paper such as 'the main challenge for consumers is saving the money required for a 10% share' appears to suggest that customers do not have credit available to facilitate this, which in the BSA's view is not the case.

Lowering the minimum share from 10% may make sense in areas of high value housing, particularly where inflation is outstripping the customer's ability borrow enough to purchase a further share. However, there will come a point when for a lender it becomes uneconomic to lend against increments much smaller than 10% as the mortgage sales and processing costs will begin to outweigh the extra income.

Products already exist where customers can make overpayments on their mortgage and build up equity in the property. For some customers, paying off the mortgage quicker on the share they currently have may make more sense than taking on further borrowing. At some point they may decide to take the unencumbered equity stake they have built up and use this as a deposit to transition out of shared ownership.

It is unlikely that a mortgage would be the correct product for a customer wishing to staircase in smaller increments of 1-5%. It is more likely that this would be an arrangement between the customer and their landlord, following examples such as the Metropolitan Thames Valley Shared Ownership PLUS scheme.

If it were to be the case that a greater number of housing associations would enter into smaller staircasing agreements with their tenants then it is important that processes are built in to notify lenders of customers building up stakes in this way. A key concern for lenders is to limit their risk in the event of a repossession. Under the Mortgage Protection Clause, lenders have recourse to the full value of the property to recover their debt. If customers are building up an equity stake with the housing association then they need to be aware that they may rank below the lender and the housing association in their claims on the equity, and lenders need to know this to be able to advise properly if a customer falls into arrears.

Q2.What do you think the minimum staircasing increment should be?

The view of the BSA from consulting with members is that a minimum increment of 5% would balance the benefit to the customer with the fees and charges they would pay, as well as the processing costs for lenders. This is assuming the customer wishes to borrow to buy the further share. Housing associations would be free to have other agreements with the customer, though MHCLG should be wary of not confusing the customer by having multiple different ways of staircasing. Introducing further complexity into shared ownership, which is already seen as a complex product, is as a principle not desirable,

Q3.What products could be developed to support a flexible approach to staircasing that enables people seamlessly invest in their homes from as little as £250?

Paragraph 27 seems to suggest that MHCLG's anticipates customers would staircase in this way through their own savings rather than borrowing. Of course, building societies specialise

in providing savings accounts as well as mortgages. Three building societies currently offer the Cash Lifetime ISA (LISA) and the BSA feels this could be a good vehicle for building up equity stakes in the home. Currently there are barriers to the LISA being used in this way as there is a 25% penalty on withdrawals to purchase further shares. This should be looked at, as purchasing further shares are within the spirit of the LISA's purpose to get more first-time buyers established in the housing market.

Offset mortgages which balance out savings and the mortgage debt are currently available, though the BSA is not aware of any offset products for shared ownership, as they are aimed more at customers with large savings balances which is not the target market for shared ownership.

Q4. How should an estimated HPI-based valuation be implemented to ensure that people can staircase at a fair price?

Under the Shared Ownership PLUS model there is fixed initial price with a 3% compounding increase. This may be acceptable for housing associations agreeing schemes with their customers. However, lenders are required by regulation to have an independent valuation on the mortgage security to support any lending. It would be impossible, therefore, for building societies to use such high-level models of HPI.

Q5. How can we ensure that the administrative costs for each staircasing transaction are fair?

This is purely a commercial decision for lenders and housing associations. An Automated Valuation Model (AVM) might be cheaper and used by some lenders, but by no means all lenders are willing to use AVMs from a risk perspective, and all will have policy rules dictating when the use of an AVM is appropriate. Fees can be added to the mortgage balance with the customer's consent, but while this lowers the upfront cost, it can increase the cost overall.

Q6. What else is preventing people from staircasing?

Feedback from building societies is that very few people staircase in reality. It would be useful for MHCLG to carry out further research into whether the reasons for this are all about cost or whether there are other reasons in play. For example, some customers may be happy with their situation, having relative security of tenure and a place to put down roots. Alternatively, shared ownership may be seen by some as a stepping stone and once the customer has an unencumbered equity stake and has saved in the background they may choose to move into the open market

Q7. Are there other ways to improve staircasing that we should consider?

It would be useful for MHCLG to explore 'nudges' which might encourage staircasing. The BSA is unsighted as to the extent to which housing associations actively promote staircasing post-sales. There could be better signposting and regular communications to remind customers of their ability to staircase. Specialist shared ownership mortgage brokers, and lenders, may address staircasing when advising a customer on a remortgage but the wider market may not have this practice embedded.

A Government 'How To' guide for shared ownership would also be helpful for the industry, as a source of information to be able to point customers towards if they are interested in understanding more about the staircasing process.

Q8. What is the minimum amount of time we need to provide landlords to repurchase the homes without causing a lengthy delay to the sales process?

A right of first refusal for the housing association to be decided on within 4 weeks would appear sensible. Of course, the decision is for housing associations whether they want to buy back stock but ultimately the goal is to increase housing supply and if some shared ownership properties are lost to the open market this at least provides capital which can be recycled into more new build.

Q9. How can we ensure a new standardised product works for all providers of shared ownership homes?

As a general principle, standardisation is beneficial for the whole mortgage process. It enables customers to have a better understanding of their rights and obligations, for mortgage lenders to understand the risk of lending on any particular scheme and more easily process applications, and for solicitors and valuers to be able to advise customers properly. This principle guided all the work that was done in establishing the fundamental clauses in the Homes England model lease, which the vast majority of mortgage lenders insist on being used in all shared ownership cases.

The BSA is supportive, therefore, of a standardised product for all providers. Anecdotally, cases have begun to spring up of housing associations taking a more commercial approach towards rent-setting and service charges where a scheme is non-grant funded, and therefore adapting the model lease. This is fine if the customer is aware of it, and it is flagged to the lender to make a decision, but in reality most customers will not be engaged in the details of whether the property they are buying is grant-funded or not.

There are also areas where the model lease could be strengthened – principally around arrears and possessions and lease forfeiture. These are key concerns for lenders, and while there have not been any serious issues in practice this is mainly due to the good relationships with experienced housing associations. It may be more of an issue going forward as newer housing associations enter the market that do not have the same processes embedded in the organisation. Annex 1 is a position paper the BSA has produced with members outlining further how the model lease could be strengthened through a new standardised model.

Similarly, there are concerns around more private providers moving into the shared ownership space. While the BSA is supportive of more investment coming into the market, this cannot be at the expense of the protections and processes that have been established by lenders and housing associations working together over a number of decades. For example, the BSA has heard examples of private providers wishing to negotiate the Mortgagee Protection Clause, which is a fundamental protection for lenders.

Individually, we understand that certain PSO providers have put together service level agreements (SLAs) and Intercreditor Agreements, making commitments to standards of practice. However, in order for PSO to expand as an industry and achieve economies of scale, lenders are ultimately looking for a way to establish a common framework. Annex 2 sets out

the BSA's view that a Code of Practice should be established for PSO providers to sign up to. This would provide an easy 'kitemark' for providers to satisfy lenders that they will treat customers fairly and keep their best interests at heart.

Q10. How else can we improve shared ownership mortgage availability and reduce lending costs?

Prudential regulation can make shared ownership lending relatively expensive from a capital point of view. For capital purposes, the loan-to-value ratio (LTV) is assessed as being determined by the LTV of the share. This is despite the Mortgagee Protection Clause giving lenders recourse to the full market value of the share in the event of a repossession.

For example, a lender providing a £45,000 mortgage for a 25% share of a £200,000 property would have to hold capital as if this were a 95% LTV loan, despite being able to call on the full £200,000 to recover their debt. The BSA would be keen to explore with MHCLG and the Prudential Regulation Authority, whether any strengthening of the Mortgagee Protection Clause would be possible to loosen these capital restrictions.

Q11. We welcome your views on the effectiveness of the shared ownership restricted lease in rural areas

The experience of BSA members is that guaranteed buybacks by the housing association often work well in rural areas. While the BSA is sympathetic with the view that affordable housing should be protected in areas where there is little new housing development, rural restrictions can affect the saleability of these properties if there is no guaranteed buyback scheme, which increases risks for lenders.

Annex 1

BSA draft position paper on strengthening the shared ownership model lease and associated guidance

Background

Just over half of BSA members are active in the shared ownership sector to varying degrees and are committed to seeing it grow. Use of the Homes England model lease is widespread and gives lenders confidence in their security when advancing money on shared ownership schemes.

Previously there had been concerns among some lenders regarding their ability to recover mortgage arrears in the event of a repossession, but this has been addressed through the mortgagee protection clause. The main area of outstanding concern for building societies is around ensuring best practice in arrears and possessions processes. While addressed in various guidance documents, the BSA believes that ideally this best practice should be incorporated into the model lease where possible.

Building societies have good relationships with housing associations that have historically provided the bulk of shared ownership properties currently in the sector. This means that the risks around lease forfeiture and other arrears and possessions risk can be minimised through service level agreements and open communication. However, these protections could potentially become diluted with more providers coming into the market that do not have the same level of experience with the complexities of shared ownership¹.

Lenders will generally expect use of the model lease (particularly when dealing with housing associations). Deviation from this is not expected without good reason and lenders will generally ask for a conveyancer to report where they discover that the model lease has not been used. The BSA therefore believes it is beneficial to all parties to make the model lease as strong as possible.

This is particularly the case where a non-model lease is used to deliver a scheme that goes outside what would be expected in a grant funded model lease case, for example an initial rent of 3.75%. It is therefore in all parties' interests for housing associations to use the model lease regardless of whether a scheme is grant or non-grant funded (with reasons for exception being clearly defined). From a customer's point of view it is very unlikely they will be aware of the type of funding used for their particular shared ownership scheme.

Model lease and other documents

As MHCLG is aware, the relationship between customer, landlord and lender is currently governed by the Homes England model lease and various other pieces of guidance:

- The shared ownership model leases for flats and houses
- The capital funding guide
- The Homes England Shared Ownership Joint Guidance for England
- The Guidance for Handling Arrears and Possession sales of shared ownership properties

¹ <https://www.insidehousing.co.uk/news/news/lender-shared-ownership-must-change-to-expand-47140>

- Various service level agreements

The BSA believes that, where possible, key risks for lenders should be covered in the model lease. This is a legally enforceable agreement, whereas other guidance documents are unlikely to hold much weight in the event of litigation. The last substantial review of the model lease was in 2010 with the aim of strengthening the protection offered to lenders by the shared ownership model and resulted in amendments to the content of the mortgagee protection clause.

While reference is made in the capital funding guide and Homes England Joint Guidance to lenders' requirements around arrears and possessions processes, specifically with the aim of avoiding lease forfeiture, this is not currently a fundamental clause in the model lease. This results in lenders needing to obtain an undertaking from the housing association that they will give reasonable notice to the lender before legal proceedings are commenced for rent arrears.

- (i) The BSA is of the view that provisions around providing reasonable notice to the lender before legal proceedings are commenced for rent arrears should be incorporated into the model lease.**

While the model lease primarily governs the rights and obligations of landlords and leaseholders, there are certain areas which address the legal relationship between the landlord and mortgagee.

The main areas where this is the case are:

- The mortgagee protection clause
- The proviso for re-entry
- The staircasing provisions
- The pre-emption clause

(1) The **mortgagee protection clause**, at a high level, entitles a lender to be able to claim against the landlord in the event that they need to enforce their security for losses where the landlord has consented to the secured loan.

(2) The **proviso for re-entry** gives the landlord power to terminate the lease and re-enter the property with a Court Order for unpaid rent or breach of covenant. However, it also requires the landlord to give notice to the lender before commencing proceedings and details service standards for remedying the issue.

(3) The **staircasing provisions** set out the process for a leaseholder to increase their equity share in the property, but can also be exercised by the lender.

(4) Finally, the **pre-emption clause** requires the landlord to repay the mortgage and any mortgagee protection claim when exercising the right of pre-emption.

Clause 5.1.3 of the proviso for re-entry aims to address the risks of lease forfeiture by requiring the landlord to give notice to the mortgagee/lender before commencing any proceedings. A period of 28 days is allowed for the lender to indicate to the landlord that it wishes to remedy the breach and a further 28 days to do so.

- (ii) **As far as the BSA is aware, most housing associations adopt the model lease in full and therefore adhere to the proviso for re-entry. However, as provisions around lease forfeiture are fundamental for lenders, in order to make this crystal clear the BSA believes that the proviso for re-entry could be elevated to a 'fundamental clause' on the same terms as the mortgagee protection clause.**

In combination with (i) the benefit of these changes is that they would do away with the need for housing associations to sign a separate undertaking to give reasonable notice.

Guidance for handling arrears and possessions of shared ownership properties

This guidance was produced in 2014 by the BSA, UK Finance, the National Housing Federation and Homes England. The aim of the document was to explain best practice in handling mortgage and/or rent arrears. While in need of an update to reflect current practice, we believe that incorporating the guidance into the model lease would be beneficial as a way of providing newer housing associations and lenders shared ownership an immediate point of reference for best practice on handling arrears. It would also have the wider benefit of giving shared owners a better understanding of the effect of the processes around arrears collection.

- (iii) **The BSA believes the *Guidance for handling arrears and possession sales of shared ownership properties* should be incorporated into the model lease as an appendix.**
- (iv) **Any remaining arrears and possessions guidance that does not make it into the model lease should be rationalised into the Homes England joint guidance document so that all parties have a single source of the truth.**

The BSA and its members are open to discussing the contents of this paper with MHCLG and any other interested stakeholders.

Annex 2

BSA draft position paper on a non-regulated shared ownership code of practice

Background

In October 2018 the Ministry of Housing, Communities and Local Government (MHCLG) released a call for proposals on private shared homeownership. In its response the BSA welcomed the prospect of more investment in shared ownership from institutional sources such as insurers and pension funds. With Help to Buy due to end in 2023, shared ownership is expected to grow further as a tenure in its own right.

Just over half of BSA members are active in the shared ownership sector to varying degrees and are committed to seeing it grow. The money lent into the sector overwhelmingly sits in schemes where a private registered provider (PRP), regulated by the Regulator for Social Housing (RSH), is the landlord. Lenders take comfort from the regulated nature of these providers, in that there is recourse for consumers if the provider fails to treat them fairly.

Consumer protection is an utmost priority for lenders. Failure to treat customers fairly not only has the potential to cause reputational damage to the lender, as many customers do not distinguish between their lender and the landlord, but can also create affordability challenges if, for example, service charge increases are not well regulated.

The model lease

The Homes England model lease for flats and houses was designed to set out the rights and obligations between customer, landlord and lender. Using a lease with the fundamental clauses is a condition of grant funding. In practice, most PRPs use the model lease in its entirety and in our experience also use it regardless of whether grant-funding is employed on a particular scheme.

The model lease is widely used and well understood by lenders. The challenge with 'non-regulated' private providers coming to market is that these providers often want to vary the model lease in ways to suit the scheme they are promoting.

While the BSA does not want to stifle innovation, it is important that there is an element of standardisation in place to make the rights and obligations of the landlord clear and obvious to all parties. It is also resource-intensive for lenders to make case-by-case decisions on each form of lease they receive.

Finally, elements of the model lease such as the mortgagee protection clause are non-negotiable and lenders will refuse to lend if it is unclear how their security will be protected.

'Regulated' v 'non-regulated'

There are various reasons why a 'non-regulated' provider would not want to register as a PRP:

- The start-up costs of becoming authorised in the first place;
- On-going compliance costs;
- The need to recruit people with skills and experience of interacting with the RSH;
- Having to comply with parts of the regulatory framework which are designed to protect social tenants rather than shared owners;

While the BSA is aware that some providers have found it difficult to gain market traction without becoming a PRP and have therefore become registered, it is likely that going forward this will not be the optimal solution.

First, there is a question for Government whether the Regulator for Social Housing, which was primarily set up to protect social housing tenants, would have the resource to regulate a large number of new providers with private shared owners/tenants as their customers.

Second, there is a question whether it is really the role of the RSH, which should be focussed on protecting public money, to become involved in private tenant/landlord relationships.

However, it is also clear that for lenders to become comfortable with lending on schemes where a 'non-regulated' provider is involved, there needs to be a consumer protection framework in place.

Code of Practice

While being mindful of not introducing regulation 'through the back door' the BSA feels there would be merit in 'non-regulated' providers establishing and adhering to a Code of Practice.

Lenders would feel secure that providers signed up to the Code of Practice have a strong consumer protection framework in place and are adhering to guidance and best practice around protecting the lender's security.

While there will need to be systems and processes in place to police non-adherence to the Code, the BSA proposes that as a last resort, any provider continually failing to adhere should be removed as a signatory to the Code. The effect of this would be that lenders will cease lending on that provider's schemes.

'Non-regulated' providers will tend to be for-profit bodies seeking a return for their investors. However it should be possible to adapt elements of the model lease and existing shared ownership framework so that they apply in a more commercial environment. For lenders the mortgagee protection clause and other guidance protecting their security will continue to be non-negotiable.

While not an exhaustive list, the BSA anticipates that the Code of Practice will address:

- Initial rent setting
- Rent increases
- Service charge setting
- Estate rent charges
- Ground rents
- Sinking funds and repair charges
- Lease requirements
- Staircasing provisions
- Covenants of the landlord
- Mortgagee protection
- Agreed service levels
- Lease forfeiture
- Insolvency and administration procedures

- Selling of property portfolios to other non-regulated entities
- Group structures where a PRP is held by a non-regulated parent
- Pre-emption clauses

It is anticipated that the Code of Practice will be largely principles-based to make it flexible enough to accommodate a range of models. It should also be capable of taking in new providers – perhaps with a technical sub-committee established to decide whether new providers fulfil the requirements of the Code.

Governance and the structure of any organisation enforcing the Code would be for providers to agree among themselves. In the first instance, the BSA proposes a working group of providers, interested lenders and any relevant consumer groups to outline a draft Code. This could then be shared with wider interested parties and stakeholders.

How would a Code of Practice benefit all parties?

Lenders will support lending into the private shared ownership sector if non-regulated providers agree to sign up to and abide by the Code. Lenders can then have confidence that customer protection is at the forefront of any Code-protected scheme without having to review each proposal individually.

Providers will have access to a group of lenders willing to provide mortgage finance to signatories of the scheme. This will support growth plans and returns to investors while providing clarity about what lenders expectations are of the relationship.

For Government there is a benefit in terms of being able to provide grant funding to profit-making providers, without having to regulate them through the RSH but with confidence that customers will be treated fairly. Grant funding may make sense, for example, where a private provider sees potential for a scheme but acquisition of land is at marginal viability.

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £400 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.