HM Treasury

The mortgage guarantee scheme
outline

March 2021

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ISBN: 978-1-911680-39-0 PU: 3079

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Chapter 1 Introduction

1.1 The government is committed to supporting people who aspire to become homeowners, helping over 681,000 households to purchase a home since 2010 through government backed schemes including Help to Buy and Right to Buy. The COVID-19 pandemic has led to a reduction in the availability of high loan-to-value (LTV) mortgage products, particularly for prospective homebuyers with only a 5% deposit. This has left many hard-working households unable to get onto the housing ladder. In today's Budget the government has therefore announced a mortgage guarantee scheme to support a new generation in realising the dream of home ownership, in line with the Prime Minister'sambitions. This will enable more households to access mortgages on both new build and existing homes, without the need for prohibitively large deposits.

1.2 The mortgage guarantee scheme is designed to increase the appetite of mortgage lenders for high loan-to-value lending to creditworthy customers. It will provide lenders with the option to purchase a government guarantee that compensates them for a portion of their losses in the event of foreclosure. The government will charge a commercial fee for the provision of this guarantee.

1.3 In 2013 the government launched the Help to Buy: Mortgage Guarantee scheme in response to a similar shortage in the availability of high LTV products following the 2008 financial crisis. That scheme was a success. The number of products available at 95% LTV increased from October 2013 to June 2017 from 43 to 261[1]. The scheme also directly helped over 100,000 households to buy their own home across the United Kingdom.[2]

1.4 This technical paper sets out the overall design of a mortgage guarantee scheme. The intention is to mirror the successful scheme that operated along similar lines between 2013 – 2016, and that reinvigorated the market for lending at up to 95% LTV until the pandemic. The overarching principles of the design are to provide a scheme that:

- is focused on helping borrowers and is simple for the customer
- is as administratively straightforward for lenders as possible
- does not incentivise irresponsible lending
- contains the level of risk being borne by the government and
- can be put in place rapidly and effectively

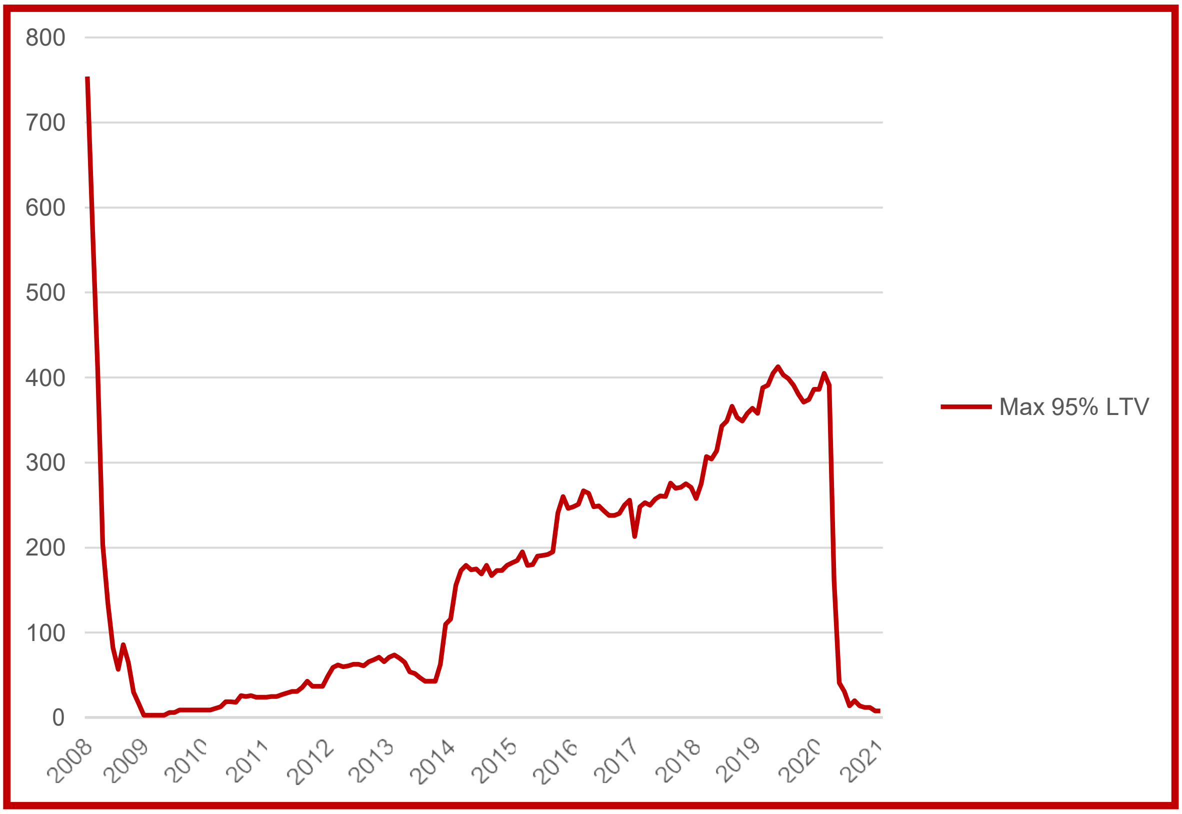
[1] Moneyfacts Treasury Report

[2] Help to Buy: Mortgage Guarantee Scheme quarterly statistics, 28 September 2017.

Chapter 2
Trends in high loan-to-value lending

2.1 The availability of high loan-to-value (LTV) lending has seen a sharp reduction throughout the COVID-19 pandemic, as shown in chart 2.A. This reduction in high LTV mortgage availability has reduced the ability of first-time buyers with smaller deposits to access mortgage products and has been reflected in a sharp jump in average deposits for first-time buyers during 2020.

Chart 2.A: Availability of high LTV products (monthly)



Source: Moneyfacts Treasury report

2.2 Accumulating a sufficient deposit remains the largest hurdle for most prospective home buyers. According to the Bank of England's (BoE) Financial Stability Report, published on 11 December 2020, around 75% of renters are likely to be constrained by a lack of sufficient savings to meet deposit requirements, rather than by the affordability of repayments determined by the size of their household income.[3]

2.3 It is not just first-time buyers who have been affected by the lack of high LTV lending throughout the pandemic. Existing homeowners with low levels of equity in their property are also struggling to move or remortgage onto a more competitive offer. In many cases, these frustrated homeowners are looking to climb onto the next rung of the ladder, and their inability to move has limited the number of properties on the market available to first-time buyers

2.4 In general, the mortgage lending market has functioned well throughout COVID-19. The number of mortgage approvals (House purchases and remortgage) in October 2020 was 97,500, a significant increase from the number of approvals in October 2019[4]. But consumers who are unable to afford a deposit of more than 10% have been restricted in their access to mortgage products during the pandemic.

2.5 The government also believes many consumers, and particularly those who find it harder to save and therefore for whom lower deposit mortgages are most important, may benefit from the security offered by longer term fixed rate mortgage products. Fixing for a longer period provides borrowers with valuable extra certainty, allowing them to budget for a fixed monthly repayment over a period of several years, and will shield them from any potential interest rate increases over that period.

2.6 The mortgage guarantee scheme announced today will build on the government's previous commitments to support homeownership. This includes a temporary Stamp Duty Land Tax cut to encourage and maintain confidence in the property market and support the jobs of people whose employment relies on the property industry. First time buyers can also benefit from The Lifetime ISA (LISA), a long-term savings product intended to support younger people saving for their first home, or for later life. From 6 April 2017, adults under 40 have been able to open a LISA and save up to £4,000 each year until they reach 50, receiving a 25% government bonus on their savings. These funds can be used to purchase a first home 12 months after opening a LISA. In addition, first-time buyers who already hold a Help to Buy: ISA can continue to save into their accounts until November 2029 and have until December 2030 to claim up to a maximum £3,000 government bonus towards the purchase of their first home.

3 https://www.bankofengland.co.uk/financial-stability-report/2020/december-2020#S4_The_UK_mortgage_market

4 Bank of England, Money and Credit October 2020, November 2020, https://www.bankofengland.co.uk/statistics/money-and-credit/2020/october-2020

Chapter 3
Mortgage guarantee scheme

3.1 The mortgage guarantee scheme will be significantly based on the successful version launched in 2013. As well as being a tried and tested approach to reinvigorating the high LTV mortgage market, the scheme design will be familiar to lenders, enabling them to quickly begin offering new 91-95% mortgage products.

Scheme mechanics

3.2 The government will provide lenders with the option to purchase a guarantee on the top- slice of the mortgage. In other words, the government will compensate the mortgage lender for a portion of the net losses suffered in the event of repossession. The guarantee will apply down to 80 per cent of the purchase value of the guaranteed property.

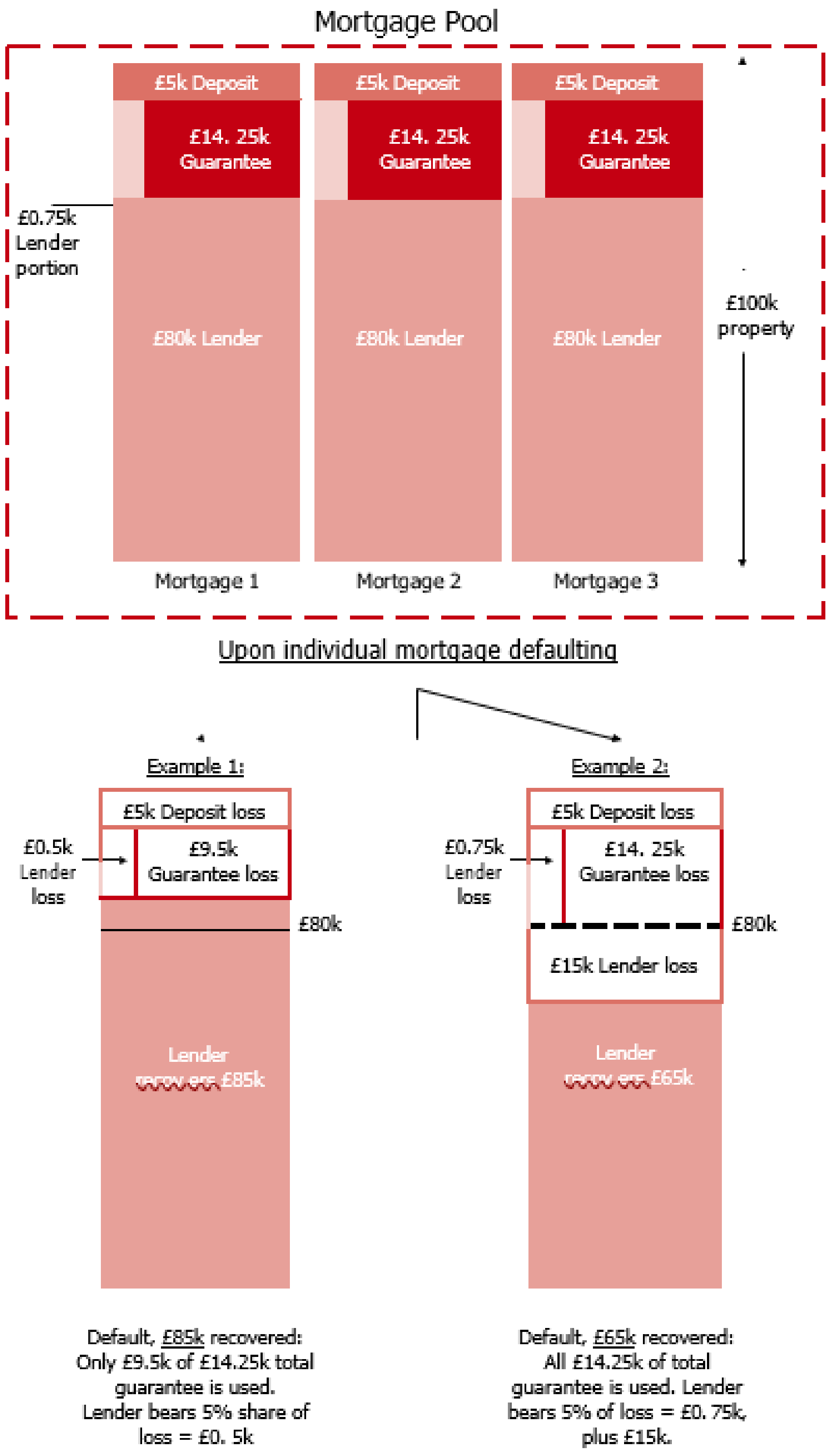
3.3 The guarantee will compensate lenders for the same losses and reasonable costs that the lender is entitled to recover from the borrower, in the event of foreclosure. The relevant costs should be determined in accordance with the FCA's Mortgage Conduct of Business (MCOB) rules, which explain that lenders are entitled to recover a reasonable estimate of the cost of the additional administration required as a result of the customer being in arrears or having their home repossessed. It precludes lenders from imposing charges in order to increase profits or offset costs from other parts of the business, however.

3.4 Lenders will also take a five per cent share of net losses above this 80 per cent threshold. This will help to ensure that lenders are not incentivised to originate poor quality loans.

3.5 The guarantee will be valid for up to seven years after the mortgage is originated, evidence shows that loans are unlikely to default after such a period has elapsed. Furthermore, a mortgage taken out on a repayment basis would normally have paid down sufficient capital after this time so that the borrower's equity stake would be close to or greater than 20 per cent, meaning that the guarantee would effectively no longer offer any protection.

3.6 Chart 3.A below provides an illustration of how the scheme operates.

Chart 3.A: Illustration of scheme mechanism



Mortgage eligibility

3.7 The scheme is designed to help creditworthy households struggling to save for the higher mortgage deposits required by lenders in the current environment. For this reason, a mortgage eligible for a guarantee under the scheme will need to:

- be a residential mortgage (not second homes) and not buy-to-let
- be taken out by an individual or individuals rather than an incorporated company
- be on a property in the UK with purchase value of £600,000 or less
- have a loan-to-value of between 91 per cent and 95 per cent
- be originated between the dates specified by the scheme
- be a repayment mortgage and not interest-only and
- meet standard requirements in terms of the assessment of the borrower's ability to pay the mortgage, for example a loan-to-income and credit score test

3.8 The scheme is also designed to ensure that lenders cannot use the government guarantee to restructure the riskiest part of their existing loan book, and that borrowers remain the beneficiaries of the intervention.

Long term fixed rate mortgages

3.9 The scheme will help to ensure the mortgage market provides options for consumers with smaller deposits who also want a mortgage with the security of predictable repayments for a longer period. For this reason it will be a requirement that any lender participating in the scheme must offer a five year fixed rate product as part of their range of mortgages offered under the guarantee.

Lender eligibility

3.10 The scheme will be open to any lender that has a permission under the Financial Services and Markets Act to enter into regulated mortgage contracts in the UK.

Scheme duration

3.11 The scheme is intended as a temporary measure. It will be open for new mortgage applications from April 2021 to December 2022, in line with the government's view that the current scarcity of high loan-to-value lending is primarily a response to the pandemic rather than a symptom of a longer-term structural change in the mortgage market. The government will review the continuing need for the scheme towards the planned end date, and determine whether extending the period of eligibility for new mortgages would continue to deliver benefits for prospective homeowners.

Commercial fee

3.12 Lenders will need to pay the government a commercial fee for each mortgage in the scheme. This fee will be set so that the scheme is self-financing, and lenders will therefore need to compensate the government for:

- expected losses under the scheme
- the cost of capital of providing the guarantee and
- the administrative costs of the scheme

Scheme administration

3.13 National Savings and Investments will administer the scheme on behalf of HM Treasury to manage fee collection and claims processes.

Scale of scheme

3.14 There will be a cap on the size of the government's contingent liability under the scheme of £3.9 billion. However, the cap is set so as not to constrain the ability of lenders to access the scheme.

HM Treasury contacts

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