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Briefing Note
Mortgage Indemnity Guarantees

January 2012

Mortgage Indemnity Guarantees will see the government, developers and lenders share the risk on 95% loan to value mortgages on new build property, with a view to facilitate up to 33,000 new home purchases each year until the end of parliament

How does it work?

- The purchaser pays a 5% deposit on the new property, with the lender applying their usual criteria for eligibility;
- The house builder deposits 3.5% of the property value in an indemnity fund;
- The government provide a guarantee for 5.5% of the property value;
- The mortgagee takes the usual lender's risk on the remaining property value.

This policy opens up assisted purchase of new build property to all qualifying purchasers, not only first time buyers.

There will be income and house price caps, but these details are not yet known.

Buy-to-let purchasers and second homes are excluded.

The scheme is to be officially launched on 14th March in England. Homes for Scotland are setting up a similar scheme for its members.

The Home Builders Federation (HBF) is in discussions with the Welsh government with a view to offer a comparable scheme.

What are the benefits?

For house builders and government, the advantage of this scheme is that it ties up only 9% of the property value to be set aside compared to the 20% capital requirement of FirstBuy. Funds will therefore go further, covering broadly twice as many homes.

The Government has made provision to facilitate up to a threefold increase on the significant contribution FirstBuy is already making. While optimistic, this looks like it will have a positive impact on house building volumes.

"The advantage of this scheme is that it ties up only 9% of the property value to be set aside compared to the 20% capital requirement of FirstBuy." Savills Research

The scheme provides more potential purchasers with access to higher ratio loan to value (LTV) mortgages, while mitigating the risks for lenders.

The HBF anticipates interest rates to be closer to 80-85% LTV mortgages, rather than the higher rates applying to 95% LTV mortgages. Rates for the scheme will be set independently by each lender.

Normal rules of mortgage lending apply, with the lender determining purchaser eligibility for a 95% LTV mortgage under their usual criteria.

Therefore, lending quality will not be compromised. The purchaser takes on exactly the same risks as under a conventional mortgage.

What are the risks?

Concern has been raised that the scheme may lead to inflated property valuations, with subsequent reductions in value immediately after purchase.

This would effectively inflate the LTV ratio above 95%. CML and RICS are formulating measures to ensure that valuations reflect market value. The use of financial incentives on properties subject to a Mortgage Indemnity Guarantee may not be possible.

The indemnity fund

The HBF has appointed insurance broker JLT to deliver a Captive fund registered in Guernsey for its members to administer the scheme.

The HBF will own the Guernsey Captive on behalf of its members, and will provide 'cells' to individual housebuilders.

"The scheme provides more potential purchasers with access to higher LTV mortgages, while mitigating the risks for lenders." Savills Research

Where smaller housebuilders do not have sufficient sales to provide adequate cover for a lender in a single cell, there may be potential to create one co-mingled cell with each lender. Such cells would involve a number of home builders sharing risk jointly.

JLT apply a fee of 0.35% to the sales price of each property. Regulatory costs are likely to be £9,000 per cell per year. More details are to follow.

Marketing in anticipation

Guidance from the HBF stresses the importance of presenting the scheme accurately to potential customers, and not overselling.

The indemnity is to protect lenders, not customers, and the HBF notes that customers must not be led to believe the scheme offers any special protection over and above that offered for mortgages outside the scheme.

While it is hoped that lenders' criteria will reflect the lower risk attached to these mortgages, each lender will determine its own underwriting and credit scoring data. ■

For advice on the role of Mortgage Indemnity Guarantees in residential development sales, contact our development team (details below). For information relating to mortgages, contact a qualified mortgage advisor, such as SPF Private Clients.

Please contact us for further information

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