FEBRUARY 2020

MORTGAGE AND PROPERTY REPORT

Kensington

Welcome to the first 2020 edition of the Mortgage and Property Report. In this issue, we look at the impact the government's Help to Buy (HTB) scheme has had on the UK housing market. In particular, we examine how lenders, customers, and housebuilders have benefited or been hurt by the scheme, as well as what the impending end of the HTB Equity Loan scheme means for each group and what, if anything might come in its place

Key Highlights

- The HTB Equity Loan scheme has been one of the UK government's most popular housing initiatives and has helped thousands of aspiring homeowners take their first step on the property ladder or purchase a larger property than they otherwise could have
- Critics argue that it was too widely available and that developers have been its biggest winners, at the expense of homeowners and the government
- The scheme is scheduled to be replaced by a more restricted version in 2021, before closing in 2023, leaving a gap in the market which lenders and some new Fintech companies are trying to fill through private initiatives

Introduction

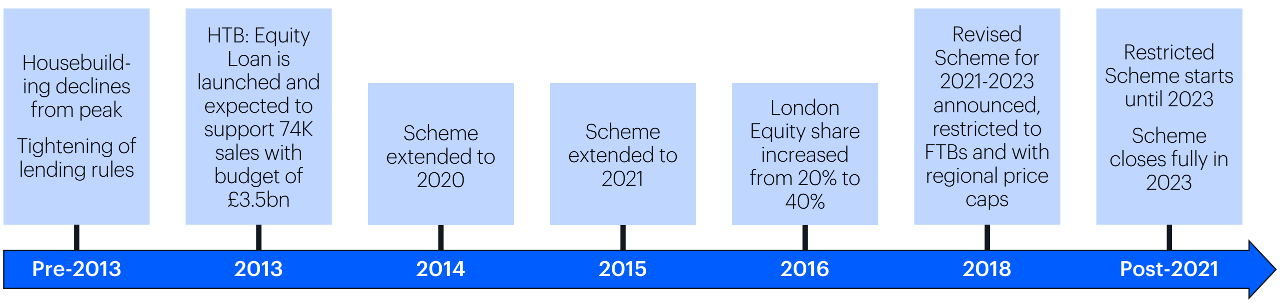
Government initiatives are an important driver of the housing market and no initiative has been more impactful on the UK market in recent times than the government's HTB scheme. While there have been (and still are) several forms of HTB, the most significant has been the HTB Equity Loan scheme. Through the scheme, home buyers can apply for a government equity loan of up to 20% of the price of the property they wish to purchase (or up to 40% in London since February 2016), allowing customers with small deposits to step onto or move up the housing ladder. The loan is only available on new build properties with a maximum purchase price of £600K, and is interest free for 5 years, after which an interest rate of 1.75% applies, rising in line with RPI.The scheme has been very popular, with over 230k HTB loans completed by mid-2019. The governmernt expects this number to surpass 460k by the scheme's end.

The scheme was launched in 2013 to solve for the lack of availability of high LTV products in the market, as well as the sharp decline in the number of new homes being built following the credit crunch. It is generally seen as having achieved these goals, although it has no shortage of critics. Whichever side one is on, one thing is now seemingly certain; the scheme is coming to an end, first through a more restricted version from April 2021 to March 2023, and then fully after this period, with no plans from the government to extend or replace it with another programme. Critics are applauding its end, while supporters worry about the gap it will leave in the market, and what will come in its place.

Background and Performance of the HTB Equity Loan Scheme

The HTB equity loan scheme was introduced almost 7 years ago, with an initial lending budget of £3.5bn through to March 2016 and was forecast to assist with 74K property purchases over the period. Demand quickly exceeded expectations, and in 2014 the scheme was extended to 2020, and then further extended a year later to 2021. It was announced in 2018 that it would carry on for an additional two years post 2021, but in a more restricted scope making it available only to First Time Buyers (FTBs), and with a cap on maximum purchase price to 1.5X the average FTB property price in the region (with the exception of London, where £600K remains the cap).

Fig 1: Timeline of Key HTB Events[1]



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These changes were driven by a desire to ensure the scheme principally helps those in the greatest need of support. In its current form, it is open to FTBs as well as existing homeowners and is not means-tested. A government survey[1] found that well over half of buyers who used it could have bought a property without the support of the scheme, and c. a third could have purchased the property they bought without it (MLGH). Its wide availability is one of the reasons it has proven so popular, and government estimates forecast the total amount loaned when the scheme ends in 2023 to reach £29bn.

Since its inception, HTB has played an important role in the UK property and mortgage market. Together with the slower house price growth of recent years, it helped a significant number of borrowers buy properties they otherwise could not have. It has had a marked impact on the number of FTBs buying properties, as well as the number of properties being built, which was one of its key goals. A governement report commisioned to measure its success suggests it has increased the rate of housebuilding by 14.5%[(1)]. HTB purchases accounted for over half of all new build sales in Q2-2019, evidence of the impact it has had on the new build sector (Fig 2). Over the same period, the percent of homes purchased (with a mortgage) by FTBs in England increased from 43% to 53% (UK Finance).

Fig 2: New HTB Equity Loan Mortgages[1]

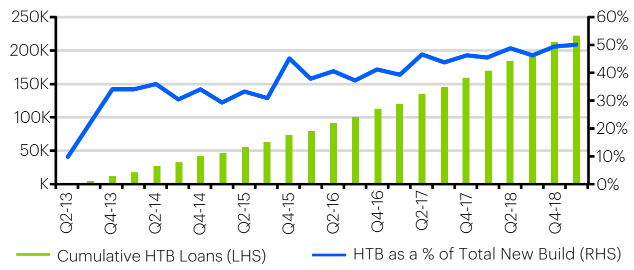
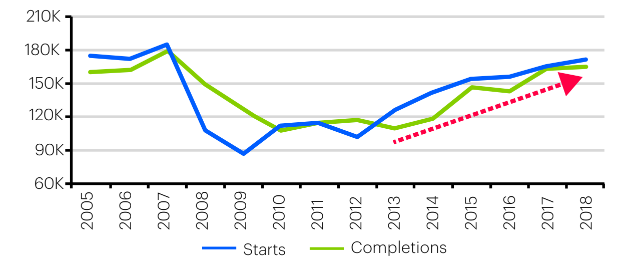


Fig 3: UK Housebuilding Starts and Completions[3]



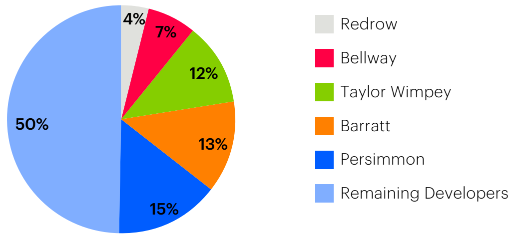
In many ways, the scheme's success is one of the reasons the government feels comfortable closing it. Moreover, the current market is a very different one than the one HTB was launched in, and the support it offers less needed. At the beginning of the last decade, high LTV products had all but evaporated, and new housebuilding ground to a halt. As seen in figure 4, the number of 95% LTV products has increased dramatically in recent years, and with the introduction of more products, rates dropped drastically, making loans more affordable. Housebuilding starts are also back to pre-crisis levels, although private initiatives may be needed to fill the gap HTB leaves when it ends to ensure these numbers stay where they are.

Fig 4 : Availability of 95% LTV products[2]

	# of Providers	# of Products	Avg 2yr Fixed	Avg 5yr Fixed
Apr-09	3	3	N/A	7.1%
Apr-14	47	181	5.3%	5.5%
Apr-18	53	304	4.0%	4.4%
Apr-19	60	405	3.3%	3.7%

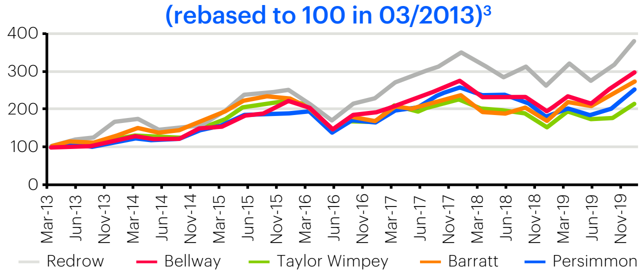
Aside from being too widely available, the other key criticism HTB has faced is that although it has succeeded in increasing new housebuilding, it has disproportionally boosted the profits of the largest developers, often at the expense of the homeowners it is designed to help. Despite attracting as many as 2,000 developers to participate in the scheme, over half of all HTB sales were made by the five largest developers (Fig 5), while a majority of the remaining developers only accounted for 10 or fewer transactions per year.

Fig 5: HTB Sales by Developer[1]



The combined housing completions of the top five developers increased by over 50% since the start of the scheme and their combined market valuation increased by c. £1bn (Fig 6). Over this period, Homes England (which administers the scheme) lent a total of £13.5bn[(4)]. As these loans are interest-free for 5 years, and subsequently only carry an interest rate of 1.75% which rises by 1% + RPI, they are significantly cheaper than any alternative available on the market. To estimate the value of this subsidy, we've assumed that if HTB were not available, a customer might replace the HTB component with a standard second charge loan, which in recent years have had an average rate of 6%[(5)]. Assuming HPI of 3.4% and RPI of 3.1% (both based on the average of the last 10 years), the government subsidy is worth 11.6% (on a NPV basis), which on the £13.5bn lent to mid-2019 equates to £1.6bn over a 5 period.

Fig 6: Share Price of Largest Developers (rebased to 100 in 03/2013)[3]



In addition to this, it is generally agreed that new build properties sell at a premium to second-hand homes (estimated by some to be as high as 15%), and that this premium is often wiped off the value as soon as the customer purchases the property. HTB has been accused of exacerbating this and pushing up prices. Moreover, because HTB

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properties must be sold through a registered developer, it has been alleged that they often carry an additional "HTB premium" charged by developers. With housing activity slowing significantly in recent years due to Brexit, and prices moving the same way, HTB buyers who purchased a home several years ago could find it difficult to recoup their equity if they were to try to sell their property now. The government rebuts these claims, and has suggested that if a HTB premium was paid, it was 1% or less. With many factors impacting house prices, and true like-for-like comparisons notoriously difficult, consensus will be hard to establish.

The end of Help to Buy: what comes next?

Given the signficant role HTB has played in the UK housing market - it accounted for 7.5% of all sales in the last 5 years – it is important to consider the impact of its end. Developers have been given ample warning of its closing, but the reality is that housebuilding is still well below government targets of delivering 300K homes a year by the mid-2020s, so rather than scaling back construction, solutions need to be found to support the current supply by ensuring demand can be kept at existing levels. Moreover, after years of decline, housing activity has started and is expected to continue to rebound on the back of the December election and the renewed stability it has offered to the housing market. This has already resulted in a rebound in house prices, and although healthy for the economy, this will create further hurdles to FTBs. With no governenment plans for an alternative, the private sector will have to step in when the scheme ends. The abundance of 95% LTV mortgages is helpful, although these are often not available on new build properties. Potential other options include private schemes which offer an equity loan (i.e. a private version of HTB), although the downside for customers is that private investors will be significantly less inclined to offer that loan on an interest free basis, as HTB initially does, or a rate which is significantly below market average, as HTB does from Year 6 onwards; if RPI stays at c. 3%, even by Year 20, a HTB borrower would only be paying a rate of 3.15% - a rate unlikely to be offered by any lender without government subsidy. Additional options include expansion of existing shared ownership programs and second charge loan offers, or high LTV products with a risk sharing feature, for example with family members. HTB has played an important role in many lender's (including Kensington's) originations, so they are undoubtebly contemplating ways to fill the gap it will create in their own lending. Whether it can live up to HTB remains to be seen.

Sources:

1. Help to Buy: Equity Loan scheme – Progress review – National Audit Office
2. Moneyfacts
3. Bloomberg
4. Help to Buy (Equity Loan scheme) Data to 30 June 2019, England, MHCLG
5. Based on observed market averages in public securitisations

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