paragon

HOUSINGMATTERS

The inside track from the UK's leading specialist lender to landlords

The view from the conferences

A round-up of opinions on housing at the party political conferences

Housing was once again a hot topic of conversation at the party political conferences. There was added interest to this perennial big issue as a result of the Government's current reforms to planning laws, local authority homeless duty, social housing and direct payments.

At all three major conferences, fringe events sponsored by a variety of organisations, including think tanks, pressure groups and professional associations, grappled with the question of how to alleviate the chronic shortage of housing in the UK, which all participants recognised was the underlying cause of other problems in the sector.

We were pleased to hear commentators from across the political spectrum recognise that the private rented sector (PRS) is not just a stop-gap but is a legitimate, long-term option for many. Policymakers must take a holistic view of the housing market and recognise that reforms in one area will have significant impacts on other tenures, including the PRS.

Many organisations and individuals also spoke about the need for greater institutional investment in the PRS. This refrain does not recognise the limited role institutional investment plays in the market, both in the UK and comparable economies, even when it has been encouraged by successive governments. Private landlords remain the backbone of the sector and investing more support in this sector would be wise.

Policy activity and the private rented sector

A look ahead at the issues affecting the private rented sector

Buy-to-let has been a relative success story in an otherwise difficult year for the mortgage markets – lending levels are up and arrears continue to subside. However, winter 2011 will see a great deal of policy activity that will impact on the private rented sector (PRS) and potentially landlords' demand for buy-to-let finance.

In the UK, the Energy Act is now law and the Government will consult on secondary legislation detailing how the Green Deal will operate. The FSA is also due to report on its Mortgage Market Review (MMR), which is likely to impact on lenders' mainstream residential activities.

In Europe, the European Parliament continues to consider extending consumer protection in regard to residential property backed mortgages and there is a possibility that the proposals will include buy-to-let. Other member states, that do not have as strong a buy-to-let sector as the UK, may overlook the impact that the proposals will have, so it is important that the UK authorities continue to make the case for buy-to-let's exclusion.

Buy-to-let is essentially a commercial, not a consumer, activity. It is important that the UK Government continues pressing the case of keeping buy-to-let out of inappropriate regulation given its importance to PRS supply and the housing market in this country.

Green Deal update

The Government's Green Deal has implications for the private rented sector

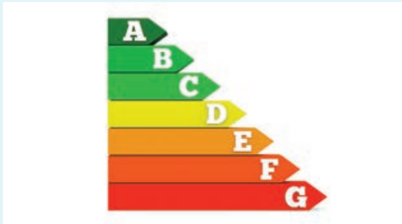
At the time of going to press, the Government was still to launch its consultation on the secondary legislation that implements the Green Deal energy efficiency framework.

In the spring we saw a significant shift in the Government's approach from implementation on a voluntary basis to regulation within the Energy Bill. From 2016 landlords will not be permitted to refuse reasonable requests from tenants for energy efficiency improvements and from 2018 it will be illegal to market or let properties with an energy efficiency rating of F and G. The Government also announced the ambitious target of all properties being rated A by 2030.

By setting a 2018 deadline, the Government has given a degree of regulatory certainty to the sector and enough time for landlords to make improvements during periods when the property is unoccupied. DECC estimates that 80-90 per cent of properties will have been through the 'tenancy cycle' by 2018.

We recognise the need to improve the energy efficiency of stock across the entire housing market, including the private rented sector (PRS), and we welcome any proportionate measures that encourage landlords to improve their properties. It should also be recognised that most landlords take the upkeep of their properties seriously and have already made improvements.

To avoid causing a reduction of supply in the PRS, at a time when demand has never been higher, it is essential that the Government's analysis of the impact of the Energy Bill is robust. The Government must also ensure landlords are made fully aware of what the changes mean for them and their properties through comprehensive promotion and education.



59.3%

decrease in the proportion of PRS homes in the F and G bands since 1996

Government approach to housing

Approach should support the majority of landlords

Landlords must already adhere to 50 Acts of Parliament and 70 sets of regulations

The Government has committed to setting out its overarching approach to housing policy in a paper due to be published this winter.

Key Government policies have proved controversial, especially the reforms to social housing. These include cuts to housing benefit, the introduction of the affordable rent model and the ability of local authorities to discharge their duty to provide housing by placing families in private rented accommodation. All of which place greater pressure on the private rented sector (PRS).

There are initiatives to alleviate this pressure, including a reform of planning laws, the release of public sector land and a commitment not to introduce new regulation for the sector. We have already seen the latter commitment wavering in the wake of changes to the Energy Bill and it is important that the Government sticks to its position.

Schemes proposed by some politicians, such as the licensing regime for private landlords, could have a negative impact on the ability of the PRS to supply much needed housing stock. It is important that policymakers do not impose extra regulation that will discourage private investors when the vast majority of landlords adhere to the significant regulatory requirements already in place.

The important role of securitisation to UK mortgage lending

Regulatory changes could restrict lenders' ability to originate new loans

A substantial proportion of mortgage lending for both deposit and non-deposit taking lenders is funded through Residential Mortgage Backed Securities (RMBS).

Between 2000 and 2007, the total amount of outstanding RMBS and Covered Bonds rose from £13bn to £257bn. This equated to moving from funding 2.5% of UK mortgage stock to 21.5% of all mortgages.

However, regulatory changes currently being drafted by the European Commision threaten to substantially undermine the attractiveness of RMBS to investors in favour of Covered Bonds. A reduction in the attractiveness of RMBS could derail the recovery of this important source of funding and severely restrict all lenders' ability to originate new loans.

What are the changes?

The Basel III regulations, proposed as a result of the worldwide banking crisis, focus on new capital, leverage and liquidity standards to strengthen global capital and liquidity regulations. All G20 financial centres must commit to adopt the Basel III framework by the end of 2011, with a phased implementation to 2019.

In addition, Solvency II, a fundamental review of the capital adequacy regime for insurance firms within the 27 European Union member states, is to be implemented through 2012, and be fully in place by 1 January 2013. The aim is to enable the development of a Single Market with an adequate level of consumer protection.

Both Senior RMBS and Covered Bonds are AAA rated and, in that respect, carry similar levels of risk. However, regulatory authorities appear to be greatly favouring Covered Bonds over RMBS under these new regulatory regimes:

- Covered Bonds are eligible to count significantly towards a bank's Liquidity Coverage Ratio (LCR) whilst RMBS will barely register; an inconsistent approach given their similar risk profile and one that can only serve to reduce the available liquidity in RMBS markets.
- The capital treatment of RMBS is likely to be much harsher than Covered Bonds, meaning that for investments of similar risk, RMBS would require much more capital than Covered Bonds.

How will this impact the lenders?

A reduction in RMBS as a source of funding will impact non-deposit taking lending institutions more severely and result in less competition in the UK mortgage market, reducing diversity of mortgage finance available to UK borrowers. Prospective owner occupiers and professional private landlords alike will ultimately suffer even greater constraints on their access to credit. In addition, it will reinforce the already dominant position of the major high street banks.

If finance is not reaching the private rented sector it will hamper the sector's ability to meet the increasing demand from the UK population for privately rented homes. The Council of Mortgage Lenders has warned that retail deposits will be insufficient to meet consumer mortgage demand and has highlighted a £300 billion funding gap for the wider mortgage market up to 2015.

To avoid these risks, it is vital that every effort is made by legislators and regulators to equalise the treatment of covered bonds and RMBS during the implementation phase.

Securitisation Vs Covered Bonds

Covered Bonds are dual recourse bonds (recourse both to the assets and the issuing bank) which are issued by the bank but guaranteed by a pool of ring-fenced assets (the guarantee being called upon in the event of the bank's default). Covered Bonds tend to be issued as bullet maturities (repayment of the principal amount of the bonds is on a specified date in the future) which have some reliance upon the liquidity of the issuing bank and therefore, for rating agency reasons, have a link to the bank issuer.

Securitisation of assets is where they are sold into a company separate from the originator; from this separate company bonds are issued. Repayment of principal on these bonds is made as the assets repay.

> "retail deposits will be insufficient to meet consumer mortgage demand"

Return of buy-to-let

Recent figures show the buy-to-let market is recovering

The credit crunch that began in 2007 had a drastic effect on the buy-to-let market, forcing out many players and almost choking off supply. Competition in the market declined significantly, and the number of mortgage products available fell from over 3,500 in July 2007 to a low of less than 200 at the start of 2009. This decline in product volumes was reflected in buy-to-let activity, with lending falling to its lowest level since 2001.

> "The PRS is home to one-in-six households in the UK - a rise of 70% since 2001. If the current trends continue it will make up 21% of housing stock by 2020"

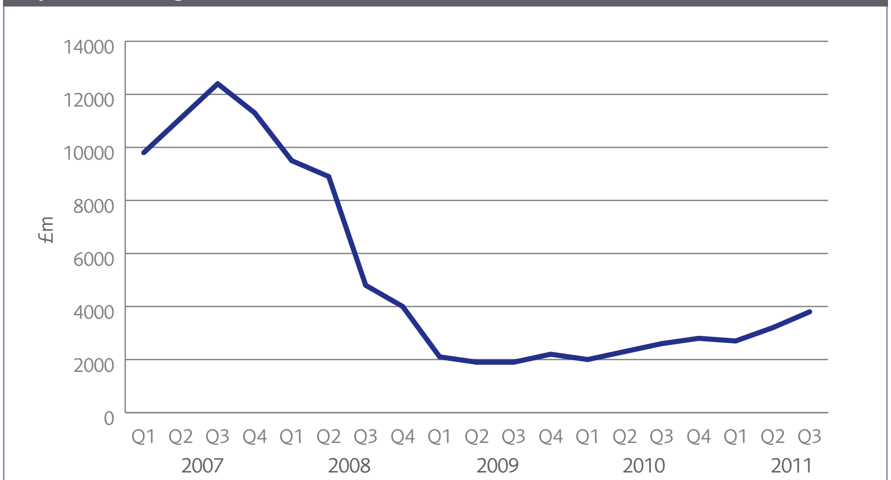
In the last few months the market has begun to see an improvement. Recently, there have been fears of another liquidity shortage, similar to 2007, but lenders and landlords are feeling more confident about the private rented sector (PRS) as an investment and the sector is poised to grow further.

Changes in the PRS have been responsible for much of the pick-up. The PRS is now home to one-in-six households in the UK – approximately 3.4 million – which is a rise of 70% since 2001. If the current trends continue it will make up 21% of housing stock by 2020 and over a quarter by 2030 reaching a similar level to the historic highs of the 1960s.

A number of factors have influenced the growth of the PRS. A reduction in high loan-to-value mortgages has meant some potential owner occupiers find it difficult to access finance. Others are choosing to buy later in life. Rented accommodation is no longer solely the preserve of students and migrants; it is becoming the tenure of choice for lifestyle reasons that mirror those of continental Europe.

This increasing demand puts pressure on the PRS and changes to housing benefit are likely to stretch the capability of the existing PRS stock to meet that demand even further. PRS supply needs to be encouraged and it is important that policymakers consider carefully any policies that may discourage potential private landlords from entering the market.

Buy-to-let lending levels



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