BANK OF ENGLAND

Mark Carney
Governor

The Rt Hon George Osborne
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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2 October 2014

Dear Chancellor,

ASSESSMENT OF HELP TO BUY: MORTGAGE GUARANTEE

You asked the FPC to provide you each year with an assessment of the impact of the *Help to Buy: Mortgage Guarantee* scheme on financial stability, including a view on whether the key parameters of the scheme – the house price cap and the fee charged to lenders – remain appropriate. Following the Committee's discussions at our September meeting, I am writing to you on behalf of the FPC to provide that assessment. Under current market conditions, the Committee assesses that the scheme does not pose material risks to financial stability.

The Committee considered this subject in the context of its continuing assessment of the risks to financial stability arising from the housing market. The FPC's responsibility is to identify, monitor and take action to remove or reduce risks that affect the stability of the UK financial system as a whole. And it is with this in mind that this assessment of the Help to Buy (HTB) scheme is made. This is in keeping with the letter I sent to the Chair of the Treasury Committee on the scope and limits of the FPC's responsibilities.

The scheme has led to a return of lenders to the high (above 90%) loan to value (LTV) market, with many, though not all, major lenders participating in HTB. That said, volumes of lending remain small relative to experience before the financial crisis: high LTV loans, including HTB mortgages, have accounted for 9%

of new mortgages in the year to date, compared to roughly 25% in 2007[1], with HTB loans accounting for about 5% of the flow of mortgaged house purchases in that time[2]. Interest rates on high LTV loans indicate that the spread between low and high LTV lending has narrowed slightly since the introduction of the scheme. Broad estimates suggest that the compensation for credit risk in these spreads is sufficient for banks to protect themselves against the losses they might suffer in a severe housing market downturn. There are of course substantial uncertainties around such judgments. Looking ahead, and based on uptake of the scheme so far, we expect the volume of HTB loans to grow, but to become only a modest proportion of lenders' mortgage books over the life of the scheme.

The latest data give no evidence of looser underwriting standards within the scheme than on wider lending. HTB loans do not seem to have driven an increase in average mortgage tenors for the high LTV market since the launch of the scheme. And while the median loan to income (LTI) ratio for the high LTV market has been rising in recent quarters, it has not exceeded the pre-crisis peak, and indeed it fell slightly in Q2. This contrasts with the lower LTV market, where the median LTI has surpassed the previous series high and has continued to increase in Q2.

Going forward, the risk of lenders extending loans under the scheme that stretch borrowers' affordability is curtailed both because Help to Buy loans are covered by the Mortgage Market Review and your decision to cap loans in the scheme at 4.5 times income. This will reduce the direct threat to lender resilience from loans that are particularly risky by virtue of their being both high LTV and high LTI.

Under current market conditions, the Committee assesses that the scheme does not pose material risks to financial stability, either directly or through its impact on the wider housing market. There has been strong house price growth in some regions but, in the Committee's judgement, the scheme does not appear to have been a material driver of that growth - for example, take-up of the scheme has been weak in London where house price growth has been strongest. More broadly, borrowers who have taken out a mortgage at a high LTV have a greater chance of falling into negative equity if house prices fall and may thus find it harder to sell or refinance their property. This can be difficult for individual households, but at current volumes of lending does not pose a systemic risk.

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[1] The share of high LTV lending was higher still in the 1980s and 1990s: see Chart 2.9 of the June 2014 *Financial Stability Report* for a time series of higher LTV lending.

[2] Remortgages have accounted for less than 2% of loans advanced under the scheme.

HM Treasury has informed the Committee that the fees for the scheme, priced on an actuarially fair basis and according to State Aid rules, will remain the same for 2015. In the light of the assessment of limited financial stability risks, the Committee does not see a case for changing the fee on financial stability grounds at this point. In addition, in the Committee's view, the current setting of the cap to property values does not represent risk to financial stability.

The Committee will of course continue to monitor the impact of the scheme as part of its regular assessment of risks to financial stability. It may make recommendations on the scheme at any time if it judges that circumstances have changed and risks to financial stability as a result of the scheme are growing.