BANK OF ENGLAND

The Rt Hon George Osborne
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Mark Carney
Governor

25 September 2015

Dear Chancellor,

ASSESSMENT OF HELP TO BUY: MORTGAGE GUARANTEE

The FPC was asked to provide an annual assessment of the impact of the *Help to Buy: Mortgage Guarantee* (HTB) scheme on financial stability, including 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 our second annual assessment. Under current market conditions, the Committee assesses that the scheme does not pose material risks to financial stability.

The Committee has considered this subject in the context of its ongoing 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 systemic risks with a view of protecting and enhancing the resilience of the financial system. It is with this in mind that it makes this assessment.

Use of the scheme has been modest in the past year, in line with our expectations. HTB loans accounted for just under 6% of the flow of mortgages for house purchase and HTB lending to date only makes up a relatively small proportion of large lenders' books. Furthermore, our estimates suggest lenders are still earning enough income on scheme loans to cover both the scheme fee and potential losses, even under a very severe stress.

The latest data suggest underwriting standards within the scheme and for high LTV (above 90%) loans more generally remain reasonably prudent, suggesting HTB has not driven any increase in riskier lending. The median loan-to-income (LTI) for high loan-to-value (LTV) loans has remained broadly flat since last year, in line with LTIs for the rest of the market. And the share of loans within the scheme with high LTI ratios has been falling since your decision to cap scheme loans at 4.5 times income. Mortgage tenors for loans in the scheme remain slightly above the rest of the market, but in line with comparable loans outside of the scheme. Finally, affordability testing for high LTV borrowers appears to have remained prudent;

since the introduction of the scheme around 1% of new loans extended for house purchase with an LTV greater than 90% would have a debt service ratio greater than 40 if rates were to rise to 7%. [1]

Under current market conditions, the Committee assesses that the scheme does not pose any material risks to wider underwriting standards in the mortgage market and household indebtedness. While the share of high LTV lending has picked up slightly over the past year, it remains low relative to the level before the crisis. High LTV loans accounted for about 11% of new mortgages over the past four quarters, compared with roughly a quarter in 2007. Spreads on high LTV loans have narrowed over the past year. But this trend does not appear to have been driven by the scheme and levels remain well above pre-crisis. 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. Regions where HTB loans have accounted for the highest market share have tended to experience house price growth below the national average since the launch of the scheme. This implies that at current volumes of lending, neither the scheme nor the associated return to high LTV lending pose a systemic risk.

In light of the assessment of limited financial stability risks, the Committee does not see a case for changing the fee or the current setting of the house price cap on financial stability grounds at this point.

The Committee will continue to monitor the impact of the scheme as part of its regular assessment of risks to financial stability, including potential risks arising from ending the scheme in 2016. 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.

[1] Evidence from the British Household Panel Survey suggests mortgage arrears increase sharply for households with DSRs over 40.