BANK OF ENGLAND

The Rt Hon Philip Hammond
Chancellor of the Exchequer
HM Treasury
Horse Guards Road
SW1A 2HQ

Mark Carney
Governor

22 September 2016

Dear Chancellor

The FPC makes an annual assessment of the impact of the Help to Buy: Mortgage Guarantee scheme on financial stability, including whether the key parameters of the scheme – the house price cap and the fee charged to lenders – are appropriate. Following the Committee's discussions at our September meeting, I am writing to you on behalf of the FPC to provide our third annual assessment.

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 to protecting and enhancing the resilience of the UK financial system. It is with this in mind that it makes this assessment.

Over the past year, use of the scheme has declined significantly. In 2016 Q1, loans in the scheme accounted for only 3% of total mortgage lending for house purchase, and 25% of lending at LTV>90, compared to 6% and 70% respectively in 2014. Although use of the scheme has fallen, total lending at high loan-to-value (LTV) has not declined. Instead, more high LTV lending has taken place outside the scheme, as the availability of high LTV products has recovered from its crisis lows.

Consistent with declining use, the fee does not appear low relative to market pricing. For example, interest rates on 95% LTV mortgages in the scheme have been marginally higher, on average, than comparable loans outside it. In addition, given the decreasing usage of the scheme over time, the Committee judges that the closure of the scheme would be unlikely, in current market conditions, to affect significantly the provision of finance to prospective mortgagors, including high LTV borrowers. This is consistent with the fact that a greater proportion of high-LTV lending has taken place outside of the scheme recently, and it is in line with market intelligence that the Bank of England has collected from major lenders.

The Committee judges that the scheme has not posed material risks to financial stability over the past year.

a. Loans within the scheme do not appear riskier than high LTV loans outside of the scheme. Introducing the cap on scheme loans at 4.5 times income has also prevented a tail of highly indebted borrowers from building up. Further, mortgages inside the scheme represent less than one per cent of the stock of mortgages and make up a relatively small proportion of large lenders' books.

b. Risks to financial stability via the impact of the scheme on the wider mortgage market and household indebtedness have also been limited. The share of lending at LTV ratios above 90% has remained constant over the past year. Spreads on 95% LTV loans have narrowed over the last year but remain well above their average level over the past 20 years. And, in the Committee's judgement, the scheme does not appear to be a material driver of house price growth (and, so, overall household indebtedness). 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. And the price cap (set at £600,000) does not appear to have had a material influence on the value of properties bought through the scheme. The average value of a property purchased or remortgaged through the scheme is around £155,000, with only 8% of properties worth £250,000 or more.

The Committee will continue to monitor the potential risks arising from the scheme, including its conclusion, 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.

Yours,

Mark