Local Authority Mortgage Guarantee Scheme – state aid issues

1. Introduction and disclaimer

1.1 This paper outlines the steps that have been taken and will continue to be taken to avoid or minimise the risk of the Local Authority Mortgage Guarantee Scheme (LAMGS) giving rise to unlawful state aid. It is not intended to be, nor should it be relied on, as legal advice. Any authority or lender participating in the LAMGS should take their own advice on the state aid position in the light of issues raised in this paper.

2. Why does the LAMGS give rise to a state aid issue?

2.1 State aid arises whenever State resources are used to give a selective advantage to one or more undertakings with the effect of distorting competition and trade between Member States of the EU. State aid is unlawful unless and until notified to the European Commission and a clearance obtained. Any kind of State support which involves placing a burden on State funds may be considered to be state aid including the provision of a guarantee by a public body.

2.2 Under LAMGS, Local Authorities will provide an indemnity/guarantee of up to 20% of a mortgage for potential first-time-buyers (FTB**s)** who qualify for Local Authority support and who meet the lending criteria set by the mortgage lender. At launch, the LAMGS is supported by one bank, Lloyds Banking Group (LBG) (with the proposed mortgage lenders including Lloyds TSB Bank plc and Lloyds TSB Scotland plc). It is envisaged that other banks will join the LAMGS shortly after launch.

2.3 There are two possible groups of beneficiaries of the LAMGS, namely:

(a) the mortgage borrowers (in this case, the FTBs who qualify for the Scheme); and

(b) participating banks.

2.4 The primary beneficiaries of the guarantee will be the borrowers. The guarantee will enable borrowers to obtain lower interest rates and/or offer less security. Specifically, the LAMGS will enable a potential FTB to obtain a mortgage of up to 95% at a competitive mortgage rate significantly below typical rates for 95% lending, but without the need to provide a more substantial deposit. The rates will be substantially more favourable than those generally payable on mortgages above 75% loan-to-value.

2.5 Participating banks could also benefit from the guarantee in the form of the extra mortgage lending business (and profit on the business) that they would acquire by relying on the guarantee to expand their loan book to include borrowers who would not otherwise have been eligible for a mortgage.

3. How have the state aid issues been addressed?

3.1 In the case of individual borrowers it is unlikely that any state aid issues arises. Borrowers will be private individuals and FTBs - only individuals who have never previously owned a property are eligible for the LAMGS Because the state aid rules catch advantages provided through State resource to "undertakings" – which broadly speaking are businesses offering goods or services on a market – State support for private individuals is not normally considered to be state aid. In two similar state aid cases (the *UK Homeowners Mortgage Support Scheme*[1] and *Hungarian Support Scheme for Housing Loans*[2]), the European Commission has concluded that owner occupiers who do not own more than one property, cannot be considered as undertakings and therefore fall outside of the scope of State aid rules.

3.2 The benefit of the guarantee to participating banks could, however, be regarded as state aid because it will allow to take on additional, profit-making business. Various steps have been taken to minimise the risk of there being any aid:

(a) The state aid rules do not preclude public authorities from using State resources to invest in ventures or activities on the same commercial terms as a private investor would (the so-called "Market Economy Investor Principle"). The LAMGS has therefore been structured so as to require participating banks to pay a market-based premium for the benefit of the guarantee. The premium will be paid either by way of an above-market interest rate on any cash deposited by the local authority with the participating bank as a bond for the indemnity/guarantee, or, where the bank does not require a cash deposit by way of a bond, by way of a simply payment of a premium. The value of premium has been calculated to equal or exceed over the first five years an estimated hypothetical market value of the indemnity/guarantee. The premium will only apply for the five-year period of the guarantee/indemnity. Where local authorities have provide a cash deposit by way of bond, the bank will continue to pay a normal commercial rate of interest after the end of the five-year period.

(b) The LAMGS will operate on a nationwide basis and there will be no restrictions on the type or number of banks who will be entitled to participate in the LAMGS (provided of course that they have the necessary authorisation

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[1] Commission decision N 179/2009 – United Kingdom, UK Homeowners Mortgage Support Scheme C(2009)3047.
[2] Commission decision N 358/2009 – Hungary, Support scheme for housing loans C(2009)5658.

to offer residential mortgages in the UK). Borrowers will be entitled to choose any bank that has decided to participate in the scheme. Banks will be entitled to join or leave the scheme at any time during its operation and the scheme has been designed so as to be as simple as possible for both banks and local authorities to set up and operate. These arrangements will ensure that the scheme operates on a non-discriminatory, UK-wide basis.

(c) Sector Treasury Services Limited ("Sector"), which is promoting the LAMGS, is actively seeking to recruit banks and local authorities to join the LAMGS. An advertisement inviting expressions of interest has been published in the OJEU on a non-mandatory basis and a national campaign will shortly be under way. Sector Treasury Services will make direct contact with all FSA approved mortgage lenders in the UK, and work closely with the Council of Mortgage Lenders to raise awareness of the scheme. Sector Treasury Services will also promote the scheme to local authorities at forthcoming seminars and workshops.

4. Has guidance been sought from either BIS State Aid branch and/or the European Commission?

4.1 BIS State Aid branch is fully aware of the proposed scheme and has provided guidance on its design. No formal notification has been made to the European Commission but the essential features of the scheme as proposed have been made available via BIS to Commission officials.

4.2 The feedback obtained from the Commission was broadly favourable from a state aid point of view. The main concern of the Commission officials who considered the proposed scheme was to ensure that the scheme is open to all banks without favouring one or more particular banks and that borrowers must be free to choose the bank with whom they would take out a mortgage, both of which are considered to be the case on the basis of the scheme as designed. As described above, active steps are being taken to promote the scheme and to recruit further banks.