BRIEFING

NewBuy: HBF Briefing Note

21st February 2012

NEWBUY

Since HBF's last Briefing (9th January) a great deal of progress has been made. This note updates home builders on the scheme and its timetable. As we approach the launch date, HBF will issue further Briefings so that home builders know what they can do, and when.

STRUCTURE, NAME AND LAUNCH DATE

The scheme will operate through a Guernsey-based insurance company which HBF will own on behalf of the participants. We are in the process of establishing this company, to be known as the HBF Insurance PCC Ltd.

HBF has appointed JLT as scheme administrators and Clyde & Co as legal advisors. We are seeking tax advice from KPMG who have also been appointed as auditors to HBF Insurance PCC.

The scheme, now named **NewBuy**, is provisionally planned to be formally launched in the week commencing 12th March, subject to all the relevant agreements being finalized and sufficient lenders having products available so that customers can be processed.

Because setting up NewBuy is such an enormous, unique and fast-evolving undertaking, operating to a very tight timetable, it will not be possible for every home builder and lender intending to participate in the scheme to be open for business by the launch date. However everyone involved in setting up the scheme – HBF, JLT, CML and Government – is committed to rolling it out as quickly as possible to as many builders and lenders who wish to participate.

KEY STEPS TO LAUNCH

A number of key steps must be in place before the scheme is fully ready to operate. Those of primary importance to home builders include:

Home Builders Federation
1st Floor Byron House, 7-9 St James's Street, London SW1A 1EE
Tel: 0207 960 1600 F: 0207 960 1601
Email: info@hbf.co.uk Website: www.hbf.co.uk Twitter: @HomeBuildersFed

- The Guernsey insurance company, owned by HBF and through which HBF will operate the scheme, is currently being set up as reported above. This will house the "cells" through which individual lenders and home builders will participate in the scheme
- The FSA must give its blessing to the scheme and, in particular, advise lenders on the availability of capital relief. Capital relief is an important influence on mortgage pricing, so the FSA's view is important for the scheme's success with home buyers.
- The Government needs to obtain clearance under state aid rules.
- To participate in the scheme, a home builder will have to have a formal relationship with one or more lender. Most of the major lenders want to initiate contacts with home builders, rather than the home builders making the first approaches to lenders. HBF has supplied the CML with an initial list of home builders seeking to participate, with full contact details, based on those builders registered with us. This list has been passed on to the major lenders. We understand contacts are now being made. One important point to note is that lenders will determine which home builders they work with.
- One key issue to be resolved is how many home builders will have one-to-one relationships with individual lenders, through so-called 'single-user cells" (SUC), and how many will participate through "multi-user cells" (MUC) – i.e. a lender will have a cell in which there are a number of home builders.
- The Government, FSA and lenders will all require a minimum cell size – probably 100 sales made over the three years of the scheme. This minimum is critical for capital relief purposes and we understand the FSA may not allow lenders to obtain capital relief until this minimum has been reached, although this is still being discussed. In addition some lenders have indicated they will require home builders to have agreements with at least three lenders (to avoid concentration risk). The minimum cell size and multi-lender per builder requirement will clearly make it impossible for many builders to have single user cells. However the solution we are exploring, and which now looks eminently achievable, is multi-user cells.
- The lenders will need to announce the products they will make available under the scheme, including the mortgage rates they will charge. We understand these will be announced nearer the launch date.
- Non-HBF members may join the scheme and may use the HBF insurance company. In the first instance non-members should contact HBF. They will then be sent all subsequent Briefings. Non-members will of course have to pay their fair share of both the initial set up costs and running costs of the scheme.

SCHEME COSTS

Most of the scheme costs for home builders fall into three broad categories:

- A contribution of premium and capital equal to 3.5% of the sale price per sale (for 7 years less any contribution to lender losses);
- A fee to JLT, the scheme administrators, of 0.35% of the sale price per sale;
- HBF insurance company and cell-specific regulatory and audit costs.

The 3.5% contribution will be split between capital and insurance premium (the latest advice is 1.5% capital/2.0% premium) though this is not yet finalized. Payments of 3.5% into a cell will be required at the issue of the Notice to Complete or at least 10 working days before legal completion.

Payment of the JLT fee will also be required by completion as will Insurance Premium Tax (IPT) which is payable at a rate of 6% on the premium element of the contribution (approximately 1.5% of the sale price). The scheme also has implications for UK corporation tax, though the precise implications have not yet been resolved with HMRC.

As far as the set-up costs and annual costs of the HBF insurance company are concerned, in order to simplify matters for participants HBF has agreed to initially fund the set-up costs which are estimated to be around £200,000, which includes initial share capital of £100,000. HBF will then recover these costs from participating companies at the outset of the scheme on a fair basis. The exact basis is currently being considered by the HBF Board and further details will be available very shortly.

In addition the HBF insurance company will incur annual running costs to comply with Guernsey states requirements and to cover auditing costs etc. Clearly the amount that HBF will need to recover per builder will depend on the number of participating companies, so at this stage it is difficult to provide precise guidance on what the costs of supporting the HBF insurance company will be. We are advised that the total cost is likely to be in the region of £150,000 p.a. So over the ten years that the scheme will exist these annual costs will amount to about £1,500,000. These will also be recovered by HBF from participating companies on a basis to be agreed. However please note that HBF's intention is only to recover the costs incurred so that the project is cost-neutral to HBF.

Each individual cell will also incur set-up costs of approximately £3,000, as well as annual costs of about £2,000. Clearly if a builder is in an SUC, then these costs will be borne entirely by that builder; costs for MUCs will be divided amongst the number of builders in each MUC on a fair basis.

Home Builders Federation
1st Floor Byron House, 7-9 St James's Street, London SW1A 1EE
Tel: 0207 960 1600 F: 0207 960 1601
Email: info@hbf.co.uk Website: www.hbf.co.uk Twitter: @HomeBuildersFed

SINGLE-USER CELLS AND MULTI-USER CELLS

As discussed above, the scheme will have single-user cells and multi-user cells. If we assume:

- a minimum cell size of 100 units,
- that a builder would want to see this minimum achieved as quickly as possible – certainly during the first year – so that the lender could obtain capital relief and reflect this in the mortgage rate, and
- three lenders per builder for anyone using SUCs,

we can get some idea of the size of company likely to be able to operate via a SUC.

If we then assume that NewBuy sales represent 15% of a company's total annual sales, then all these assumptions suggest a company would need total annual sales in excess of about 2,000 per year. This implies only the largest dozen or so companies will wish to operate SUCs. However the decision to use a SUC or MUC will ultimately rest with each home builder/lender relationship and it is quite possible that even larger companies may prefer to participate via MUCs.

Another very important issue arising from MUCs is the sharing of risk. A MUC will operate as a pool of 3.5% contributions plus 5.5% sovereign guarantees from Government (i.e. 9% in total). Any lender repossession losses will have to be funded out of this pool. Therefore all the builders in a MUC will have to pay towards any losses (through their 3.5% deposits), even those arising from properties sold by other builders in the cell. Of course the lenders will apply their usual high-LTV underwriting and credit scoring criteria to all the borrowers in each cell, so this should offer considerable protection against repossessions occurring. However it is conceivable that the buyers from a particular builder might lead to concentrated losses which, as noted above, would have to be shared by all the builders in that MUC. Any participating home builder's total liability would be capped at the company's 3.5% contributions to the cell. We do not believe this shared risk presents a major problem because borrowers will all be vetted by lenders. However it is important that companies contemplating participating in the scheme are aware of this pooling of risks.

Please note that an individual builder's contributions to the pool of funds in a MUC will be the first to be eroded by claims arising on properties they have sold, so it is beyond those resources that the risk is mutualised as between all remaining funds in the pool.

LEGAL DOCUMENTS

There are a number of key legal documents for the scheme.

- Government Guarantee (between Government and HBF Insurance PCC)
- Insurance Policy (between home builder, lender and HBF Insurance PCC)

A key document whereby a PCC company cell insures the lender in respect of the loans made to customers of the builder

- Framework Agreement (between lender, home builder, HBF Insurance PCC and JLT)

Also a key document for home builders, creates builder and lender obligations to fund the PCC company and provide 95% LTV mortgages respectively

- Services Agreement (between home builder and JLT)

Agreement for the services provided by JLT to administer the scheme and details of JLT's fees

- PCC Management Agreement (between HBF Insurance PCC and JLT)

Agreement for the provision of the management services required to operate and establish the PCC company

- Single and Multi-user Cell Agreements (between HBF Insurance PCC and home builder)

Establishes the home builder's entitlement to assets of the cell of the PCC

- Bank Charge (between HBF Insurance PCC and lender)

Gives lender control over the 3.5% deposits

Legal firm Clyde & Co has been appointed to advise HBF on the drafting of these contracts and any advice can be relied upon by HBF members. However companies may wish to obtain their own legal advice.

ELIGIBILITY

The Government has amended the definition of eligible properties, as noted in a previous HBF Briefing, to cover properties which are being sold as residential properties for the first time or for the first time in the current form. This will now extend to all new homes (houses and flats), as well as all conversions, refurbishments and renovations up to a price cap of £500,000 (though we understand some lenders have their own price caps which may be lower than £500,000). Home builders participating in NewBuy must make the scheme available on all properties (up to £500,000) and all sites – i.e. the scheme cannot be offered selectively.

Other eligibility criteria will include:

- Available to UK citizens and those with a right to remain indefinitely in the country;
- Full ownership only (i.e. not shared equity or shared ownership);
- Primary home (i.e. excluding second homes, investors and buy-to-let landlords);
- Capital repayment mortgages only.

Home builders will only be able to offer a very restricted number of incentives. They will not be able to offer any financial incentives, such as deposit paid, legal fees paid or stamp duty paid. They will be able to offer a straight discount, but the mortgage LTV will then be based on the net price. Free carpets and curtains will be permitted as an incentive. We are currently seeking clarification about taking properties in Part Exchange, or offering white goods not included in the standard specification as incentives.

WHAT TO DO NEXT

JLT and HBF are organising a Teach-in on NewBuy at 10.30am on 5th March in London. If you wish to attend, please contact: Diana_Gallagher@JLTGROUP.COM or telephone Diana at 0207 558 3980.

Any home builder wishing to participate in the scheme via the HBF insurance company must first obtain the approval of the Guernsey regulator, and in the case of non-HBF members the prior approval of HBF before approaching JLT. JLT has advised that companies can apply now for Guernsey approval. However the decision about applying is not as straight forward as we would hope.

Because the minimum cell size, capital relief, State Aid requirements, lenders' requirements, etc are still under discussion, we cannot yet reach a definite conclusion about the use of SUCs and MUCs. Also, as indicated above, the method of allocating regulatory and costs to each cell has not yet been finalized, so we cannot yet tell you the up-front and annual costs per cell.

On the other hand, JLT is anxious to receive early applications because it is worried that a flood of late applications to JLT and the Guernsey regulator may cause processing delays.

HBF member companies wishing to participate can now make an 'in principle' application to the Guernsey regulator for an initial application fee of £1,420, payable to the Guernsey Financial Services Commission. To obtain a home builder application pack please contact: Jane_Collenette@JLTGROUP.COM. This fee will cover the first cell. A further fee of £1,420 will then be payable for any additional cells. However before applying please read the section on Single-user Cells and Multi-user Cells above. Also, if a company makes an application, the £1,420 fee is not refundable if the company subsequently decides not to participate in the scheme. However this £1,420 fee is the total cost of obtaining this initial regulatory approval and does not commit a company to proceeding with the scheme or commit you to any further costs.

Non-HBF members should first contact HBF at info@hbf.co.uk.

We have tried to provide as much relevant information as possible in this Briefing. However should you have any further questions about the scheme, please contact John Stewart at john.stewart@hbf.co.uk. We will attempt to give you an answer, but please keep in mind that a lot of detail has yet to be resolved.

Stewart Baseley
HBF Executive Chairman