

Briefing by the CML

Section 106 planning agreements and low cost home ownership lending



Introduction

1. This note has been prepared to help local authorities and housing associations understand the issues that arise for lenders when section 106 (s106) agreements or other planning controls are used that contain restrictive or variation clauses.
2. These issues are historic rather than being particularly associated with worsening market conditions. However with current lending constraints and housing market uncertainty it is even more important that where possible we remove barriers to lending on low cost home ownership (LCHO). Raising awareness of the need for simplification and consistency of s106 agreements is one element of the work the Council of Mortgage Lenders (the CML) is undertaking to improve the current situation.

S106 template agreement

3. In 2006 the CML worked with the Department for Communities and Local Government (CLG) (then ODPM) to support the development of a template s106 agreement together with guidance designed to address the issues lender were finding. It is clear that despite the existence of the template agreement and work done at the time to raise awareness of it, it is not routinely or consistently used by local authorities.
4. The existing template agreement and guidance can be found on the CLG website [Model planning obligation \(section 106\) agreement - Planning, building and the environment - Communities and Local Government](#) and is currently being updated by the Law Society.

Key message for local authorities and development partners

5. A key message is that a local authority should where possible use the template s106 agreement. However where an authority is considering a restrictive or variation clause on a development, particularly on rural exception sites, they should note the general guidelines below and discuss this with lenders to assess what the impact of this will be on the availability of lending for low cost home ownership (LCHO) products whose terms are determined by the s106 agreement.
6. Housing associations who own LCHO properties with restrictive terms may find this has a detrimental impact on their ability to borrow. The impact on commercial wholesale lending to housing associations is not covered in detail in this paper but is worth highlighting.

S106 agreements used by local authorities

7. The number of mortgages on properties with s.106 agreements or other restrictive covenants is very small compared with the overall size of the market. Many different approaches are adopted by local authorities and the lack of a standard agreement being used means that being involved in lending on LCHO, for those small number of lenders active in that market, has become increasingly time consuming and resource intensive.
8. In spite of this there is an awareness that local circumstances and specific conditions attached to development such as restrictions on land use, mean that in some cases there will be a need for some variation. However it is essential, if we are to continue to sustain and support this lending market, that we reduce unnecessary variation, make better and more consistent use of the template agreement and highlight clearly in each case where a s106 must contain a variation from the template agreement.

Impact on lending for LCHO

9. The rest of this briefing note deals with the specific issues for lenders when considering applications for a mortgage on LCHO properties covered by a s106 agreement. Restrictive clauses such as those set out below have the impact of effectively denying the lender in possession adequate ability to realise their security and therefore undermine a fundamental requirement of mortgage lending. If a lender has to take a property into possession, it is required to get the best price for the property and sell at the earliest opportunity. If only a very limited number of people are able to buy the property and no suitable buyer is available, the lender will not be able to sell and the borrower's debt will continue to increase. The result is likely to be a diminished appetite to lend with the property as security and/or lower loan-to-value lending.
10. Restrictions currently seen in section 106 agreements which cause difficulty for mortgage lending include:
 - A condition on sites that housing will be affordable in perpetuity and/or where perpetuity is achieved by restricting valuation of staircasing and disposal;
 - Occupancy controls and nomination rights restricting the current and future use of the LCHO properties; and
 - Where future property sales are restricted to a multiple of local or regional incomes.
11. Previous discussion and joint working on reducing barriers to LCHO lending have resulted in agreement to deal with the specific issue of perpetuity and occupancy controls through use of a cascade mechanism. This involves offering the property to a very local market and gradually widening the net until the property can eventually be sold on the open market. Alternatively, the local authority or housing association could buy the property back in this situation. This is successful so long as there is a clear process for the mechanism within agreed timescales and as highlighted already in this paper it is important that early discussions include lenders.
12. Sometimes restrictive covenants only come to light very late in the sale process which can cause problems for the borrower. Borrowers should be made aware of any restrictive covenant early in the process so that this can be taken into consideration when applying for a mortgage.

Shared ownership leases and guidance

13. If the arrangement is a shared ownership one the lender will always want a Mortgagee Protection Clause (MPC). The MPC in a shared ownership lease was designed to cover the lender's loss should it have to take possession of the property on default. This and other issues relating to shared ownership leases are dealt with in the joint CML and NHF publication 'Shared Ownership: Joint Guidance for England'. As with section 106 agreements it is essential also that shared ownership leases are not varied unduly and follow the model fundamental clauses referred to in the joint guidance.

In conclusion

14. This note on s106 and lender issues is one element of a body of work the CML is leading on to highlight and lobby for improvement to LCHO products for lenders who are already active in this market but also to promote opportunities for potential lenders on LCHO.

Further contact

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