Firm Foundations: The Future of Housing in Scotland

Attached Paper 1 – Shared Equity

The Future of Shared Equity Seminar – Discussion Summary

In July 2007, the Joseph Rowntree Foundation hosted a seminar on the future of shared equity which was attended by a number of the key stakeholders in this area from a variety of sectors. This note provides a summary of the discussion held; as the event was held under Chatham House rules all comments are non-attributed.

There was general agreement that shared equity should be capable of providing a financial mechanism to fund intermediate housing for many purposes, including to:

- help affordability for first time buyers who are likely to have increased salaries over time, or who are likely to move in the future to a lower house price area;
- help affordability for first time buyers who are unlikely to have more than RPI wage increases;
- enable growing families in shared ownership properties to move to a larger home, for home-owners to move to a higher value area, or for older home-owners to move to higher value supported housing;
- assist home-owners in regeneration areas who cannot afford the costs of the improved housing in the area;
- help close the wealth inequality gap by assisting tenants to invest in their home; and,
- enable older home-owners to remain in their own home for longer.

It was agreed that there needed to be a funding solution, or solutions, without a disproportionate amount of public subsidy. Although government probably sees help to first time buyers as the highest priority, the right product or set of products for that client group might well be capable of helping those with other housing needs as well, perhaps with varying levels of subsidy.
Participants agreed that the new HomeBuy products are not the best solution, as they have not been well received by potential clients. Some of the reasons for this were explored in the discussion and are covered below.

It was noted that the Housing Corporation’s shared equity competition for Open Market HomeBuy was ongoing and might facilitate some innovation in this area. It would not be for several months that new products might emerge in embryonic form from this process. In the Housing Green Paper it was announced that the government is appointing Brian Pomeroy to help it follow up on the Shared Equity Task Force and advise on ways to develop the private sector shared equity market. It was anticipated that he would have access to the competition entries and so would be in a good position to evaluate whether government intervention was necessary for the development of large-volume shared equity products.

Some existing shared equity products – public and voluntary sector The HomeBuy products all involve some element of shared equity. None of these is entirely privately funded. For Open Market HomeBuy, the government has tried to reduce its level of subsidy by getting mortgage lenders to provide an equity loan alongside the mortgage, but the resulting product is unsatisfactory for many consumers as it restricts their choice of mortgage finance and may be seen as relatively expensive compared to other mortgage products. The two lessons from this are that to achieve a substantial volume, any financial product has to be good value for consumers, investors, and for government (if it involves subsidy); and that funding for equity loans is needed from the capital markets rather than from the retail mortgage providers as they cannot readily hedge the risks involved.

The demise of the traditional shared ownership market, including DIYSO, was regretted. In overall home-ownership terms, shared ownership has made a small impact, but it had reached the point in its development where the cost of mortgages, private finance for the RSL and government subsidy (which could be recycled) worked well for all parties.

The HomeBuy shared equity products with an interest rate kicking in after three or five years have not been popular. Financial advisers have probably pointed out that outgoings will increase just at the time that a mortgage interest fixing will mature, which itself could involve increased costs. It was noted that English Partnerships’ First Time Buyer Initiative
also involves an interest rate on the equity loan after three years, which is proving popular. It might be helpful to research why the two very similar products are perceived differently by their potential clients.

Social HomeBuy has not yet been offered by many RSLs or local authorities and so far has not proven popular with tenants. Most social housing tenants cannot afford even a 25 per cent share and the discount arrangements have not seemed fair compared to those under the Right to Buy. Further, of those tenants taking advantage of Social HomeBuy, many have bought their home outright making use of the discount but not the ability to staircase in the future. Some local authorities are offering to share the cost of repairs and maintenance in proportion to the share owned and this should make the scheme more attractive for those tenants who can afford a 25 per cent or 50 per cent stake.

The role of HomeBuy agents was discussed. RSLs are rarely the first port of call for first time buyers or for social tenants of other landlords. Might the role be better linked with general housing advice?

Some RSLs are working with local authorities, particularly in Market Renewal Pathfinder areas, to offer equity loans for relocation or for major works to the home. As these loans are being made without an interest rate, they are currently funded principally by the public sector and will not easily attract private finance.

**Some existing shared equity products – commercial sector**

It was noted that a recent development in this area has been the increased provision shared equity schemes by private housebuilders. Using Section 106 agreements, some developers and housebuilders (developers) are able to offer shared equity for new build housing without any cash subsidy. Each investment is on a small scale, but there are many sites now across the UK where home-owners share equity with a developer. In time developers will probably seek to sell their shared equity agreements to a longer-term investor, but each developer has its own terms, making sales to investors time-consuming and not necessarily good value. It was noted that owning equity shares might give developers more of an incentive to get involved in estate management. However, as these schemes rely effectively on subsidy from the S106 agreements to provide lower cost home ownership properties, they may cause reduced provision of new social rented accommodation.
Some other private sector organisations, such as Asset Trust, are developing their own shared equity products without subsidy. These are currently on a small scale, but the government is hoping that the Housing Corporation’s competition might help such schemes to grow.

Commercial reversion schemes, without subsidy, are available for older people who want to stay in their own home but need to release equity. These schemes provide an indication of the likely commercial cost of shared equity products.

**Developing a market in equity share loans**

Mortgage lenders and RSLs trying to innovate with equity mortgage loans have hit regulatory constraints. The FSA would need to be closely involved in the further development of a market in equity share loans.

It was agreed that a standardisation of terms is needed for equity share deals so that an investor market in equity share loans can be developed. This would achieve the best/lowest price commercially for the consumer, and could be subsidised if this was unaffordable to meet some housing needs. However, there have been no discussions among private sector equity share providers to consider whether a standardised approach would be in everyone’s best interest.

There was agreement that on the supply side, large scale funding would be available from pension funds and life insurance companies if there was a sufficient volume of equity share loans for securitisation, at the right price. This would probably involve a layered structure of bonds, offered at different prices, to reflect different levels of risk. The nearer one could get to a six-year bond, the more appetite there is likely to be, so long as the bonds are priced to provide investors with returns similar to that which they can achieve elsewhere in Europe. To facilitate development of an appropriate bond structure, it might be helpful to research the length of time owners who have benefited from an equity share arrangement have stayed in their property, before moving on. It was acknowledged that this information is not easy to get hold of for past shared ownership cases, but the London RSLs have been tracking staircasing and sales since 2001 and the Housing Corporation will be capturing the information on a national level for the new HomeBuy products.
A key question is how to get the volume of equity loans, on standard terms and conditions, to get the market started. It was suggested that at least £500 million of equity loans, on standard terms and conditions, would be needed before securitisation could be arranged.

The structured bonds issued for the securitisation of the equity loans would, at the right price, attract pension funds and life insurance companies into this market. Investors in an active equity loan market would not want to manage the portfolio of loans; they would expect an intermediary organisation to do that. That intermediary organisation, or a separate lending company, could originate equity loans in large volumes on standard terms, to facilitate securitisation. Mortgage lenders, developers and RSLs could then become marketing arms for the lending company rather than investing the capital in equity loans themselves.

In time, an active securitisation market in equity loans would reduce the price of equity loans for home-owners. This is because current investors such as developers would know that they could sell on their portfolio, so long as each loan was on the standard terms, or they could arrange loans from a centralised provider. They would no longer have to price in the cost of holding the investment or of the negotiations required in selling it on.

To get the market started and to underpin securitisation, some equity investment would be needed. Now is not a good time to attract such institutional investment as the UK housing market is probably close to its peak and there is worrying news from the US about recent investor experiences relating to sub-prime mortgages. The equity investment would almost certainly need to have government backing of some kind. Although it was suggested that RSLs might be willing to contribute grant from earlier Homebuy schemes, as they could benefit themselves from an active equity loan market, the government backing would not need to be grant. It could provide equity, matching the terms of the private sector, or it might give some form of secondary support such as that provided by Fannie Mae in the USA.

An equity loan market would provide an alternative investment opportunity for buy-to-let investors. Instead of tying up their capital in one property and having the risks of management, they could invest in the residential property bonds issued for securitisation. These bonds would be secured on a large portfolio of equity loans and would be actively
traded, so enabling the investors to sell without having to worry about the sale of an individual property.

**A different approach**

A totally different approach is being developed by CDS Co-operatives who are developing a scheme for tenants that has many of the characteristics and benefits of home-ownership but with less risk for residents. This involves a Community Land Trust, with subsidy to enable an intermediate rent, and a mutual housing organisation to manage the houses, raise the funds and administer a unitised share scheme for residents. This avoids the costs of buying and selling for residents. It therefore provides a new form of tenure that increases the range of housing choices available and it provides a strong focus on community engagement and local accountability.

With the CDS scheme, all residents have to pay a deposit when they move in. They are charged rent and service charges, based on what they can afford, calculated as 35 per cent of their net income. As incomes rise, residents pay more. The rent covers management, a sinking fund contribution for major repairs, and finally a contribution to the mutual’s mortgage, divided into units. Hence, those on higher incomes buy more units. When residents leave, they take 90% per cent of the value of the units they have paid for.

**Conclusions**

Despite a constructive debate, there was no one solution that emerged as the way forward for funding intermediate housing needs. A number of small-scale initiatives that are currently being undertaken were discussed, but the participants saw no obvious way to gear up to high volume financial products without a co-ordinated approach, involving a number of organisations including government. JRF will now consider whether it should become involved in identifying what needs to be done to move this forward.

Authored by Rachel Terry
August 2007