Report to the Cabinet

Report reference: C/089/2007-08.
Date of meeting: 17 December 2007.

Epping Forest District Council

Portfolio: **Housing.**

Subject: **Open Market Shared Ownership Scheme.**

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Recommendations:

(1) That the Council pilots an Open Market Shared Ownership Scheme from 2008-09, operated in the way set out in this report, including the following main elements:

(a) Moat to purchase the (head) leasehold of one and two-bedroomed flats on the open market, chosen by housing applicants on the Council's Housing Register approved under the scheme, up to a maximum property purchase price of £190,000;

(b) Moat to simultaneously provide long (sub) leases for 50% of the equity to the applicants, using Moat's existing standard Do-it-Yourself-Shared Ownership (DIYSO) lease;

(c) The applicant's lender (mortgagee) to have the first charge on the applicant's leasehold interest in the property;

(d) Part of Moat's equity purchase to be funded through a private loan, with the amount of loan dependent on the amount of rent that can be charged to repay the interest (see 1(f) below), with Moat's funders to have a floating (first) charge on Moat's leasehold interest in the property (i.e. the headlease);

(e) The remainder of Moat's equity purchase to be funded by an interest-free loan from the Council, secured by a mortgage on Moat's leasehold interest in the property through the Council having a second charge;

(f) Applicants to pay Moat an initial annual rent equivalent to 2.5% of the value of the equity held by Moat, plus buildings insurance and a management fee;

(g) No rent to be received by the Council;

(h) Shared owners to be able to purchase up to three additional tranches of equity shares after 12 months ("staircasing"), subject to a minimum tranche of 10% of the unsold equity, with the price based on the open market value of the property at the time of each tranche purchase;

(i) The risk to the Council's loan to be minimised and mitigated through a legally binding Risk Sharing Agreement with Moat, detailing the terms and the effect of equity sales, including the following key elements:

(i) The proceeds from each tranche of equity sale to be split between

Moat and the Council, with the Council's share (capital receipt) representing the same percentage of the value of the equity sold as the percentage that the original loan represented of Moat's original equity purchase;

(ii) Any net receipts received by Moat from staircasing to be kept by Moat in a ring-fenced, interest-bearing account, and used to help fund further shared equity purchases in the future or, at the Council's discretion, to fund other affordable housing schemes;

(iii) If property values decrease, assuming that the ring fenced account holds a credit balance, Moat to be entitled to draw funds from the ring-fenced account to make up the difference between its capital receipt and Moat's private loan; and

(iv) If no positive balance exists in the ring-fenced account, the account to show a notional negative balance, with incurring interest charges, for a period until any surpluses from future transactions are drawn in by Moat and the account returns to a positive balance;

(j) The capital receipts received by the Council as a result of staircasing to be held and included within the Capital Programme, to fund further loans for shared equity purchases under the Scheme in the future, unless the Cabinet decides otherwise;

(k) Moat's usual income multiples to be used to determine the minimum required income levels to participate in the scheme;

(l) The purchased property must be within Essex;

(m) Moat's marketing, legal and administration costs to met by a one-off fee of £2,500 per purchase, funded from the Council's loan;

(n) Applicants must be registered on the Council's Housing Register and that priority to the Scheme be given in the following order, in both cases prioritised by reference to the Council's Housing Allocations Scheme:

(i) 1st Priority - Council tenants on the Council's Housing Register; and

(ii) 2nd Priority - Non-Council tenants on the Council's Housing Register; and

(o) If the scheme is over-prescribed, that priority be given to those applicants seeking to purchase a one-bedroomed property;

(2) That, under the Pilot Scheme, 6 loans totaling a maximum of £350,000 be provided and that, in order to fund the Pilot Scheme, provision of £350,000 be made within the Housing Capital Programme for 2008-09, part-funded from any capital receipt from the sale of the Council-owned land at Horsecroft, Abbess Roding proposed for a rural housing scheme;

(3) That the Director of Housing and the Director of Corporate Support Services be authorised to agree the detail of the scheme and the necessary legal agreements;

(4) That the Pilot Scheme be reviewed by the Housing Portfolio Holder after six months operation; and

(5) That the Home Ownership Grant Scheme and the Open Market Shared Ownership Scheme be marketed as components of the Council's First Time Buyers Scheme.

Introduction:

1. At its meeting in October 2007, the Cabinet considered the effect that increasing house prices within the District have on local people's ability to purchase their own home. Many young people are living with their parents for longer, not through choice, but through necessity. As a result, more people look to the Council to assist them with their housing needs, including those who have a reasonable income and would, in the past, have been able to buy a home on the open market. This has resulted in the number of people on the Council's Housing Register increasing significantly over recent years. There were 3,633 households registered in April 2007, compared to 1,478 in April 2002 (145% increase).

2. To assist Council tenants to get a foot on the housing ladder, the Cabinet agreed to introduce a pilot scheme in 2008-09 to provide tenants with Home Ownership Grants of £34,000 to purchase a property, thereby enabling them to access home ownership, whilst also freeing up a Council property for another household in housing need.

3. Another way that residents can enter home ownership is through new build shared ownership (also referred to as New Build Homebuy). This is where the applicant purchases an equity share in a newly built property (e.g. 50%), and a housing association purchases the remaining share and charges the tenant an associated rent. Overall, due to subsidy (either a developer's subsidy through a Section 106 Agreement and/or social housing grant), the applicant's monthly outgoings are less than if he/she had a mortgage for 100% equity. The shared-owner then has the opportunity to purchase additional tranches of equity from the housing association, eventually up to 100%.

4. At its meeting in October, the Cabinet agreed a target that 30% of all the affordable homes provided on Section 106 developments should be in the form of shared ownership. Indeed, the Council has worked with a number of housing associations in recent years to provide shared ownership on new developments. In the past three years, 27 new shared ownership homes have been completed, compared to 71 general needs social rented homes.

5. However, a problem in Epping Forest for some time has been that, due to the current Essex Structure Plan targets being exceeded a few years ago, and the Council having to wait for the outcome of the East of England Plan before it is in a position to release additional land through the Local Development Framework, there has been a dearth of new development sites in the District - and therefore the amount of affordable homes that can be provided.

6. It is therefore proposed to introduce another low cost home ownership initiative – to complement the previously agreed Home Ownership Grants Scheme - that also does not rely on new housebuilding, and which provides a more flexible opportunity for applicants to enter home ownership. This second initiative is referred to in this report as the Open Market Shared Ownership Scheme. It is further proposed that these two initiatives are referred to, collectively, as the First Time Buyers Scheme.

Open Market Shared Ownership:

Principles:

7. Since Home Ownership Grants would only assist existing Council tenants, the second proposed initiative would also assist non-tenants on the Council's Housing Register. Under this scheme, housing applicants would be able to purchase a one or two-bedroomed property on the open market on a shared ownership basis, in the same way as for a new-build shared ownership scheme described in the Introduction to this report. The benefit of this approach is

that, firstly, it does not rely on new developments coming forward by developers on Section 106 sites (bearing in mind the current dearth) and, secondly, it would provide much greater flexibility to applicants, since instead of being restricted to new-build opportunities that may arise on a specific new development in a specific location, applicants could choose the home they wish to purchase within a prescribed maximum purchase price.

8. The main drawback is that, unlike new-build shared ownership, there would be no developer subsidy being provided from a Section 106 Agreement, which means that the amount of grant would need to be much higher.

9. The proposed scheme is similar to a successful and popular grant-funded scheme operated by the Housing Corporation in the 1990s called "Do-It-Yourself-Shared-Ownership" (DIYSO), which it discontinued in 1999 because the Corporation's priority shifted to increasing the number of new affordable homes actually built by grant (which DIYSO did not). Under the DIYSO scheme, 53 applicants from the Epping Forest District purchased shared ownership properties on the open market during the six-year period 1993-94 to 1998-99.

10. The Housing Corporation appointed Moat Housing Group to operate the DIYSO Scheme across Essex. More recently, the Housing Corporation has appointed Moat as its Homebuy Agent for Essex, which means that it has responsibility to promote and co-ordinate all housing association shared ownership and Homebuy activity across the County; Moat holds a central database of all applicants interested in shared ownership / Homebuy living in Essex and provides their details to other housing associations developing shared ownership.

11. Since Moat is also one of the Council's Preferred RSL Partners, the Director of Housing has been discussing with them how an Open Market Shared Ownership Scheme could operate in Epping Forest, along the lines of the former DIYSO Scheme, with the Council adopting the role of the Housing Corporation as a lender. Moat is unaware of any other local authorities that currently operate such a scheme. Although the Government's Open Market Homebuy Scheme provides interest free loans to applicants for 17.5% or 25% of equity purchased (for only five years in the case of 25%), it is not as affordable as the scheme proposed by the Council and Moat. The Government's scheme is also primarily targeted at a tightly defined group of key workers. Therefore, not only could the operation of the Council's scheme be possibly unique, Moat has expressed an interest in piloting a scheme which, if successful, it could then offer to other local authorities. The scheme that has emerged from these discussions is as follows.

Operation of the Scheme:

12. It is suggested that applicants must be registered on the Council's Housing Register and that priority to the Scheme be given, firstly, to Council tenants and, secondly, to non-Council tenants, in both cases prioritised by reference to the Council's Housing Allocations Scheme. It is also suggested that, if the scheme is over-prescribed, that priority be given to those applicants seeking to purchase a one-bedroomed property, since the associated support from the Council is likely to be less.

13. Moat would purchase the leasehold of a one or two-bedroomed flat in Essex on the open market, selected by one of the Council's housing applicants. According to the Land Registry, for the period October to December 2006, the average price to buy a flat in Epping Forest was £185,631 (primarily 1 and 2 bedroomed). Therefore, it is suggested that the maximum purchase price be set at £190,000 for a 1 bedroom flat, which gives some leeway above the average.

14. Moat would then simultaneously provide a long (sub) lease for 50% of the equity to the applicant. The applicant's equity purchase would be funded, as usual, through a mortgage from a bank or other lender and any cash deposit.

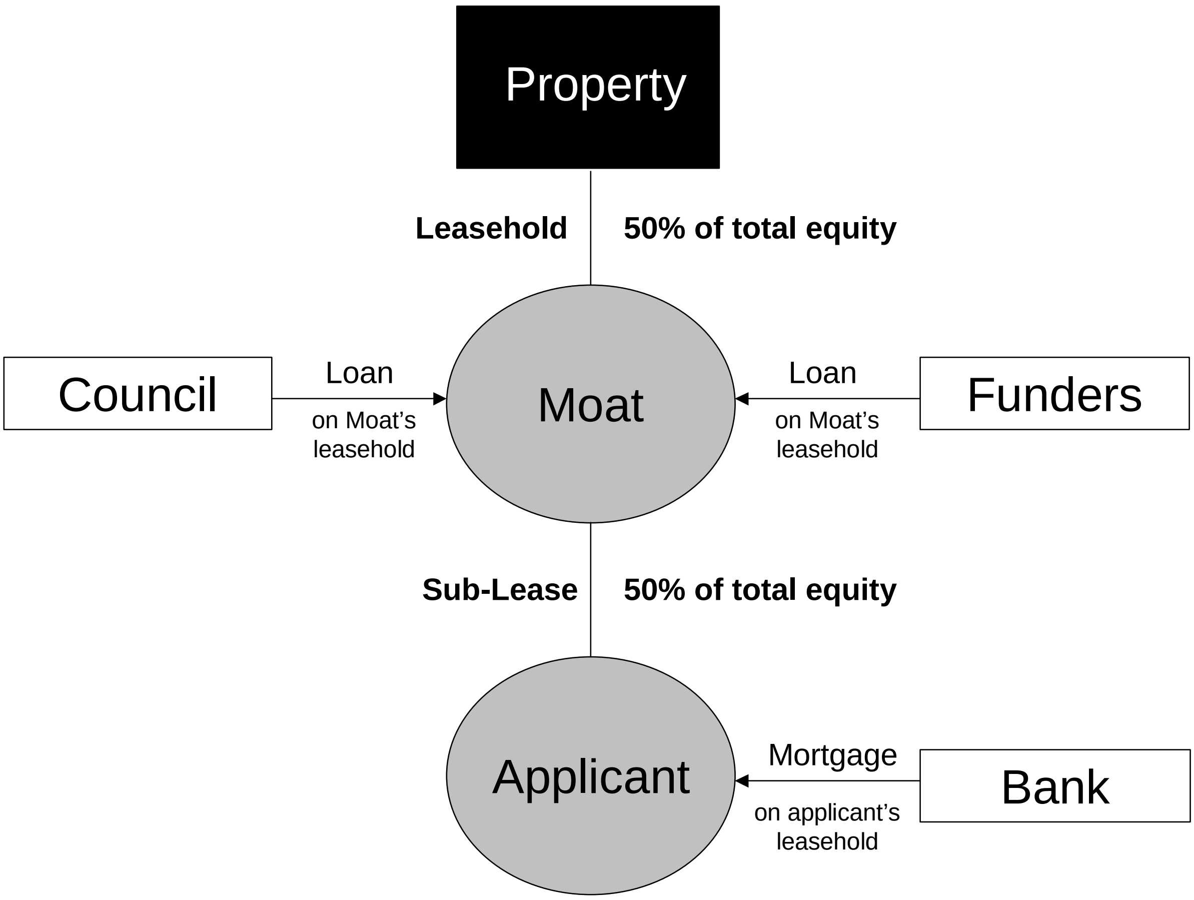
15. There would therefore be two leasehold interests in the property, one held by the

applicant and the other held by Moat. Following advice that Moat has received from its solicitors, it is proposed that the scheme is set up using a standard DIYSO lease, which is tried, tested, understood by funders and independent financial advisors, and is already in existence. This means that issues arising from borrowing arrangements for the applicants are unlikely to rise.

16. Part of Moat's (50%) equity purchase would be funded through a private loan from its funders. The applicant would pay Moat an annual rent, initially equivalent to 2.5% per annum of the value of the 50% equity held by Moat, which Moat would use to fund the cost of the private loan required to purchase its share. The amount of private loan that Moat could obtain from its lenders would be directly dependent on the rental income received. The remainder of Moat's equity purchase would be funded by an interest-free loan from the Council. No rent would be payable to the Council.

17. The applicant's mortgagee would have the first legal charge on the applicant's leasehold interest in the property. It would be a requirement of Moat's funders (and indeed any housing association's funder) that they have the first legal charge on Moat's leasehold interest in the property, which would be through a floating charge across Moat's property portfolio. The Council's loan would be secured by a mortgage on Moat's leasehold interest, which would be the second legal charge.

18. The following graphic illustrates the arrangement:



19. Moat's marketing, legal and administration costs would be met by a one-off fee of £2,500, provided from the Council's contribution. Applicants would have to pay Moat a building insurance charge of £7.77 per month and a management fee of £17.00 per month.

20. Based on the above, and the maximum purchase price of £190,000, the shares would be as follows (lower purchase prices would result in different % shares, with lower financial contributions by Moat and the Council, and lower rents to the applicants):

Party	Cost (£)	Share (%)
Applicant	£95,000	50.0%
Moat	£39,583	20.8%
EFDC	£57,917	29.2%

21. The following table compares (for illustration purposes) the monthly outgoings for applicants, compared to if they had to purchase 100% equity:

Approx. monthly mortgage repayment (*)	£583.38
Monthly rent (2.5% of unsold equity)	£197.92
Management charge (p/m)	£17.00
Buildings insurance (p/m)	£7.77
Approx. total monthly outgoings	£806.07
Mortgage for 100% equity	£1,174.54
Difference per month	£368.47
% difference per month	31%

(*) = 5.5% over 25 years

22. Using current income multiples of 3.5 X joint incomes and 4 X single incomes, the minimum required income levels to meet the costs and to participate in the scheme would be:

- Single Income - £26,400 per annum; and
- Joint Income - £29,815 per annum

Staircasing:

23. The shared-owner would be able to purchase additional tranches of equity from Moat after 12 months, up to the full 100% equity (referred to as "staircasing"). They would be able to increase their ownership in separate stages, or in one stage to 100%. The minimum share they could purchase must be at least 10% of the unsold equity and they would only be able to staircase a maximum of three times.

24. The price for the tranches would be linked to the open market value of the property at the time of the additional equity purchase. The proceeds from each tranche purchase would be split between Moat and the Council, with the Council's share (a capital receipt) representing the same percentage of the value of the equity sold as the percentage that the original loan represented of Moat's original equity purchase. For example:

Original purchase price	£190,000
Council loan	£57,000
% Council loan of original price	30%
% Council loan of Moat's equity	60%
Current value	£209,000
Additional equity to be purchased by Applicant	20%
Price of additional equity	£41,800
Council's share (60%)	£25,080
Moat's share (40%)	£16,720

25. Therefore over time, provided property prices increase, the Council would recoup its

initial loan, as well as receiving an additional amount linked to the increase in the value of Moat's equity. It is proposed that the capital receipts received by the Council as a result of staircasing would be held by the Council and used to fund further loans in the future, in the same way. Similarly, any net receipts received by Moat from staircasing (after repaying its private loan) would be kept by Moat in an interest bearing account, ring-fenced, and used to supplement further equity purchases by Moat (or, at the discretion of the Council, to fund other affordable housing schemes). The position if property prices decrease, is explained later in the report.

26. It should be noted that the scheme could also be provided for larger properties (e.g. 2 bedroom houses or 3 bedroom flats/houses); Moat has run a number of models on different bases. However, this would increase the amount of loan required from the Council, resulting in either a greater capital requirement or less applicants being assisted. Similarly, the scheme could operate with different initial share purchased by applicants than 50%; again, different models have been produced by Moat. However, larger shares would increase the applicant's monthly outgoings and lower shares would again increase the amount of loan required from the Council.

Risk and Risk-Sharing:

27. The main risks for members to consider are in relation to the position if:

(a) the value of the property(ies) for which the Council has provided loans - at the time a shared-owner wishes to purchase additional equity - is less than the value at the time the Council originally provided the loan;

(b) if the shared owner defaults on their mortgage; or

(c) if Moat was to go into liquidation.

In the first two cases, Moat would be at the same risk as the Council.

28. Since the applicant and Moat will each have their own leasehold interest in the property, the applicant's lender will not be able to call upon the equity held by Moat to repay its mortgage in the event of there being insufficient equity to repay the applicant's mortgage, or if the property has to be re-possessed. In either event, any loss on the applicant's equity would have to be borne by the applicant, and not Moat (or the Council).

29. Since the proposed scheme is one in which the Council and Moat will work in partnership, it is proposed that the risk to the two organisations will be shared. The Council's loan will be protected by way of a mortgage on Moat's leasehold interest in the property and through a legally binding Risk Sharing Agreement, which will detail the terms and the effect of equity sales. It is proposed that this would operate as follows:

> (i) When Moat sells tranches of equity to applicants, the capital receipts apportioned to the Council (in the way set out earlier in the report) will be paid by Moat to the Council under the terms of the Risk Sharing Agreement.
>
> (ii) If the receipts from the sale are higher than the original amount invested, they will be used by Moat and the Council as set out earlier in the report.
>
> (iii) If property values decrease, Moat will be entitled to draw funds from the ring-fenced account that it sets up (referred to earlier in the report) to make up the difference between the receipt and Moat's original investment. This assumes that the ring fenced account holds a credit balance.
>
> (iv) If no such positive balance exists, eg, if values have decreased on the very first transaction, the ring fenced account will show a notional negative balance, with

incurring interest charges, for a period until any surpluses from future transactions are drawn in and the account returns to a positive balance.

(v) In the highly unlikely event that Moat went into liquidation, the Council's loan would be protected by the Council's charge on the property. Only under this circumstance would the effect of Moat's funders having the first charge come into effect, in which case they will seek to recover the value of their whole loan portfolio with Moat, from across the value of all of Moat's properties. However, it should be noted that no housing associations have gone into liquidation to date, and if such an event occurred, the Housing Corporation, as the regulator, would take action to protect the interests of the Association's tenants, either through the injection of money or through requiring a transfer of assets to another housing association.

30. From the Council's point of view, members must appreciate that if a property's price reduces, the Council's receipt from equity sales will be less than the original loan it provided. This would mean that less capital resources will be available to re-invest in further loans for the scheme in the future. However, it should also be noted that, under this scenario, property prices for loans that the Council gave to Moat to assist other applicants in the future would also be less.

31. Members' attention is also drawn to the fact that economists' current predictions on house prices vary. However, it is quite possible that property prices will not increase in the near future, and may well even reduce, which is a risk that needs to be taken into account.

Other issues:

32. *Legal Issues* - The detailed legal issues relating to the scheme and the risk sharing agreement will need to be considered further by officers.

33. *Rent Increases* - Rent increases will be aligned with the Retail Price Index of the previous October, November or December. Moat's Board approves the increase each year.

34. *Repairs and Maintenance* – As with all shared ownership schemes, the applicant/occupant would be responsible for repairs and the maintenance to the purchased property.

35. *Resales* - The lease with the applicant would have a nomination clause that, upon resale, would give Moat two months to find a buyer (nominated by the Council) for the shared owner's share in the property. This would retain the property to help future applicants enter shared ownership and recycle the Council's investment in the property, without having to contribute any further grant.

Funding the Scheme:

36. The success of the scheme (mainly dependent on the level of take-up) cannot be predicted at this stage. Therefore, it is suggested that, like the Home Ownership Grants Scheme, the Open Market Shared Ownership Scheme be piloted over a 12-month period during 2008-09, with a review by the Housing Portfolio Holder after 6 months operation. To make the pilot scheme worthwhile, it is suggested that budget provision of £350,000 is made in 2008-09, which would fund 6 loans for equity purchases, and probably leave some surplus budget.

37. There is currently no provision within the Council's Capital Programme to fund this initiative and there is limited scope to divert funding from other projects in the Capital Programme. Therefore, for the scheme to proceed, it would be necessary to increase the Council's Capital Programme, funded from capital receipts. It is currently predicted that the balance of usable capital receipts will have fallen from £27.6m to £20.3m over the life of the current programme. It should be noted that the Council is currently benefiting from the

revenue income generated by the investment of these balances. The full year effect of funding £350,000 of additional expenditure from receipts would be to reduce investment income by approximately £20,900 per annum, which would have an impact on either the level of the Council Tax or the level of other services that could be provided.

38. However, in order to reduce the impact of the scheme on the Council's available capital funding, it is proposed that any capital receipt (estimated at £187,000) from the sale of the Council-owned land at Horsecroft, Abbess Roding for a rural housing scheme (referred to elsewhere on this Cabinet agenda) be used to part-fund the Open Market Shared Ownership Scheme.

39. However it should be noted that, as the Council's loans are repaid (through the equity sales to occupants), additional local residents will benefit from the scheme and that, if property prices increase, the scheme will generate surpluses that can also be re-invested.

Statement in Support of Recommended Action:

40. House prices within the District continue to increase, resulting in an increasing number of local people being unable to purchase their own home. The proposed Scheme is innovative and would assist 6 applicants on the Council's Housing Register to enter home ownership. If house prices increase, the Council's investment in the Open Market Shared Ownership Scheme would increase proportionately and would be recouped when shared-owners purchase additional equity shares up to 100% (staircasing). The receipts could then be re-invested in further equity purchases to assist other applicants. A risk sharing agreement would minimise and mitigate the Council's risk, especially if property prices decrease.

Other Options for Action:

41. Other than the recommended option, the main options are:

(i) Not to operate the proposed Scheme;

(ii) Reduce or increase the overall capital provision, to assist more or less people under the scheme;

(iii) Operate the Scheme with a different percentage of initial equity purchase or by allowing applicants to purchase larger properties (which would increase the funding required from the Council);

(iv) Have a different arrangement between the Council and Moat; or

(v) Reduce or increase the amount of initial rent charged from 2.5% (which would also affect the funding required from the Council).

Consultation undertaken:

42. Moat has been consulted on the proposed Open Market Shared Ownership Scheme and supports the proposals.

Resource implications:

Budget provision: £350,000 additional provision within the Capital Programme.
Personnel: Nil.
Land: Nil.

Council Plan/BVPP reference: Meeting Housing Need.
Relevant statutory powers: The community wellbeing powers contained paragraphs (b)

and (c), Section 2(1) of the Local Government Act 2000. One of the visions of the Community Strategy is for Epping Forest to be a district that has safe, decent and attractive housing that meets the needs of those who want to live in the District and Objective 2 relating to the vision is to make affordable housing available, in rural and urban locations, for people who want to live in the District.

Background papers: Housing Policy File – “First Time Buyers Scheme”.
Environmental/Human Rights Act/Crime and Disorder Act Implications: None.
Key Decision Reference (if required): Key Decision.