New foundations

Unlocking the potential for affordable homes

Written by David Rodgers
Foreword by Rt Hon Margaret Beckett MP,
Minister of State for Housing and Planning

the co-operative party

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David Rodgers, January 2009

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The Co-operative Party is the fourth largest political party in Parliament, and the political arm of the Co-operative Movement.

We believe that people will achieve more by working together than they can by working alone. We support the efforts of those who seek success through that co-operative endeavour.

We believe that the only way to create a just and fair society is through power being spread evenly throughout society, and not arbitrarily based on wealth, class, gender or race.

We work to promote co-operatives and all forms of mutual organisation.

We work in partnership with the Labour Party as its sister party to achieve these ends. There are currently 29 Labour Co-operative MPs including ten members of the Government.

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Foreword

This report shows once again how the Co-operative Party makes a valuable and important contribution to finding solutions to the major social and economic challenges of our time.

As the report's author David Rodgers says "The post financial crisis landscape presents all concerned with affordable housing supply with new challenges; challenges that demand new solutions." This document makes an interesting contribution to the debate on those new solutions.

At its heart is the belief that there has never been a more important time for the mutual and co-operative ideal. The application of that ideal to the unique circumstances of our economy and the future housing needs of our country is certainly something that demands our attention.

Rt Hon Margaret Beckett MP
Minister of State for Housing and Planning

Executive summary

Current estimates show that the UK will fall short of its house-building target by more than 150,000 homes this year. The Government has taken action to mitigate the economic blizzard facing Britain, and pledged extra investment in new homes, but the credit crunch has made it increasingly difficult to provide affordable housing either through housing associations or Section 106 agreements. The shortage of affordable homes for rent will be compounded by the inability of less affluent families without substantial savings to secure mortgages, or potentially to sustain them in the face of a possible credit-crunch induced loss of employment and diminution of income. The Co-operative Party has researched a new model of mutual home ownership that can create permanently affordable intermediate market homes, even against the background of the credit crunch.

1. It may be the only way to effectively spend the pledged extra government investment. The business model of most existing housing associations, dependent upon cross-subsidy from selling appreciating housing stock, is no longer viable in the context of the credit crunch.

2. It puts institutional funds back into the real economy. It is an attractive vehicle for institutional investors, such as pension funds; delivering safe, guaranteed yield investments, secured on the value of property co-operatively owned by the residents who live there.

3. It would bring stability to the housing market and the economy. Every "bust" at least since the "Barber boom" in the early 1970s has been precipitated by excessive house-price growth.

Housing associations are facing challenges building homes on existing levels of grant. The fact that the new model would allow mixed tenure means that it could provide a far more effective way of building affordable homes, both for shared ownership and for rent.

The Co-operative Party's new model separates the cost of the land from the purchase price, by taking it out of the marketplace through a Community Land Trust. It ensures affordability through flexible monthly payments that are based on an affordable percentage of income. Any public subsidy is locked in and preserved for future generations through the structure of equity arrangements.

Unlike individual home ownership, where residents have a personal mortgage loan to buy a home, the homes are financed by a corporate loan borrowed by the co-operative. The value of the buildings is divided into shares and when members leave the co-operative, they are entitled to take the equity that they have built up with them. The net value of the shares is calculated by reference to a fair valuation formula set out in the departing member's occupancy agreement or lease, which is the same for all members.

Resident members of the co-operative also finance the management, maintenance, estate services and mortgage costs through the rents they pay to the co-operative, as well as control its budget. The rent is geared to be affordable at 35% of net household income, so the more you earn the more you pay and the more equity shares you own and finance.

The valuation formula in the lease requires resident members to look on property ownership in a new and different way. Rather than viewing a home as a speculative capital investment, the value of which rises and falls in line with unpredictable housing market cycles, it will see a home as a consumer durable, just like a car, or a fridge. This formula will not give mutual home owners high risk speculative house price growth when it may happen again, if ever. However mutual home owners will also be at far less risk of falling into negative equity where their houses are worth less than the outstanding mortgage loan. They will also have the benefit of lower transaction costs when they move into and out of their home.

As Gordon Brown said in his Labour Party conference speech: this time is "a test not just of our judgement but of our values. Today once again we are called to apply our enduring beliefs to completely new conditions." As we seek to rebuild the economy in these difficult times, we believe that there has never been a time in which the mutual and co-operative ideal has been more important.

The latest figures from the National House Building Council predict that combined public and private sector new housing starts in 2008 were as low as 100,000 compared to 200,697 in the previous year[i], the lowest figure since the crash of 1929. The Co-operative Party's new model for mutual home ownership has the capacity to deliver the new homes Britain needs. Without it, Britain faces housing challenges that existing models will find it impossible to tackle effectively.

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i Source: Building Magazine 9 January 2009.

Introduction

The financial crisis that has engulfed the global financial markets will have long term effects on how the UK housing market works. It will impact on the supply and demand for housing, including housing that is affordable to those who do not qualify for state subsidised rented housing and those who cannot buy a home on the housing market.

Before the crisis, in order to meet the demand for housing, the Government set a target of adding a net 246,000 additional new homes to housing supply each year between now and 2016. The latest figures from the National House Building Council predict that combined public and private sector new housing starts in 2008 were as low as 100,000 compared to 200,697 in the previous year[ii], the lowest figure in peacetime since the crash of 1929. Even before this fall in output, every home built in the UK at pre-crisis rates of construction would have had to last 1,200 years before it would be replaced.[iii]

The global financial crisis has sent shockwaves through the world economy, shockwaves which affect us all. It marks a tectonic shift in the way financial markets operate. These include the mortgage markets that supply loans for house purchase and the provision of affordable housing. In the wake of the financial tsunami that has engulfed the global financial markets the UK faces a major challenge to its ability to build new homes to meet demand. One thing is certain. That is that the landscape in which housing is supplied and managed will never quite be the same again.

Maintaining and increasing the supply of affordable housing is a matter of social justice that concerns us all. But, in the wake of the global financial crisis, it is also an essential stimulant for the construction sector of the economy and crucial for maintaining skills and capacity in the house building industry. Increasing housing supply and achieving the government's housing supply targets is also essential if we are to avoid another cycle of unsustainable house price rises and the economic risks that inflated house prices create. This housing policy paper explains the unique contribution that a new co-operative form of mutual home ownership can make to meet these challenges.

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ii Source: Building Magazine 9 January 2009.

iii Source: Kate Barker, Review of Housing Supply, HM Treasury December 2003 page 8.

The global financial crisis

The global financial shockwaves began with irresponsible lending of home loans to high risk borrowers in the United States, many of whom could not afford to repay them. These 'sub-prime loans' funded by easily available credit fuelled high house price inflation; higher house prices that were used to secure ever increasing debt.

These high risk sub-prime loans were bundled together with other home loans and converted into paper 'asset-backed securities' that were traded on the international financial markets; traders often earning millions of dollars in bonuses for trading them at a profit. The problem was that, within these bundled-up asset-backed securities, nobody knew where the bad 'toxic' loans were. By the time it became known that high-risk, sub-prime loans had been bundled up and sold on the international financial markets, defaults by borrowers who could not afford to repay their loans had started to escalate and the value of the homes in the US against which they were secured fell dramatically. Nobody could tell which banks held the toxic asset-backed securities. In compliance with agreed international accounting rules, banks started to write down the value of the asset-backed securities they had invested in leading to huge losses for the banking sector. Banks became unwilling to lend to each other because nobody knew where the risks to liquidity of the banks lay and the shockwaves of the crisis spread around the globe.

Of course, the underlying causes of the crisis were more complex than that. High-risk lending to people who could not afford to repay what they borrowed was driven by the surplus of dollars available in other countries like China, Japan and the Gulf oil states with which the US economy ran a huge trade deficit. These dollars created high foreign currency reserves which could not be spent in the countries themselves. The return of these dollars to the US through the international currency markets made credit in the US readily available and cheap, which fuelled the inflation of house prices.[iv]

The losses are huge. The Bank of England's estimate in November 2008 is that the loss to the global financial system is in the order of £1,800 billion, to which must be added the $50 billion lost in the alleged Madoff fraud.

iv For an analysis of the wider background to the crisis see: 'The financial crisis: burst bubble, frayed model' by Robert Wade, Professor of political economy at the London School of Economics at http://www.opendemocracy.net/node/34666/pdf

The UK Government's response to the crisis

In response to the crisis, the Labour Government of Prime Minister Gordon Brown and Chancellor Alistair Darling led the world in acting decisively to maintain the stability of the UK banking system.

As the Prime Minister has said, Britain is much better placed than many to weather the global turmoil created by this crisis. Although there has been some irresponsible lending into the housing market by UK lenders (estimated at 8 or 9% of total mortgage lending, notably from Northern Rock, with its flawed business model of borrowing short term on the international wholesale funding markets and lending up to five times salary and 125% of property values, and Bradford and Bingley's self-certified mortgages), we have not had the USA's 'Ninja' loans ('No Income No Job') that were based on the assumption that repayment could be financed, even by households with no income, from rising house prices. Nor do we have the level of national debt that the USA has had; the government here having been more prudent in the operation of fiscal rules. Also we do not have the crude surplus of housing that is now plaguing the housing market in the US, as the Prime Minister correctly identified during his September 2008 visit to New York and Washington. Similarly, because of the past ten years of sound management of the economy, employment remains high and unemployment low although the risk of global recession now threatens this success.

The bold fiscal measures announced by the Chancellor in his 24 November 2008 pre-budget report are designed to stimulate the economy and prevent a long and deep recession. These measures are welcome, particularly bringing forward capital spending commitments to increase the supply of affordable rented homes and support for home owners. If anyone doubts the desirability and wisdom of such action they should heed the words of George Soros, the speculative investor who came out of retirement to deal with the effects of the global financial crisis. Speaking on the Today programme on Radio 4, he said that the crisis in the World's financial markets was like "a cardiac arrest, the impact of which has not yet been fully felt". Doing nothing is not an option if a severe and lasting recession is to be avoided.

The actions taken by the government to maintain stability are aimed at restoring confidence in the financial markets and preventing a long and severe recession; a recession which, had it been allowed to deepen for a want of decisive government action to stabilise the banking system and stimulate the economy, could have led to more job losses than the loss of confidence in the financial and consumer markets will inevitably create.

The UK housing market in the post financial crisis world

The tectonic shift that has occurred in the global financial markets means that the housing landscape in the UK will never be quite the same again. This impact will be long-term and will create significant change in the way the mortgage and housing markets work. The new chief executive of RBoS Nat West, Simon Hester, has been appointed to de-risk the bank's balance sheet and because he is reputed to be able "to look at the challenges objectively without any attachment to what went before".[v]

The major outcome will be a new risk-averse, resilient and more regulated approach to lending in which:

- Banks and other retail lenders re-learn the old established canons of managing lending risk. This means the return by financial institutions to prudent lending rules such as:
  - lend primarily what you can attract in deposits because wholesale sources of finance for mortgage lending will be in short supply and expensive;
  - know your counterparty to the transaction and be assured of their capacity to repay debt;
  - know the nature, location and true value of the asset that secures that repayment obligation;
  - don't inflate asset values by aggressive marketing and risky lending;
  - only lend up to 80% of the assessed value of the asset used as security for the loan (gone are the days of 100% mortgage loans);
  - ensure continuous compliance with financial gearing and other debt covenants to reduce the risk of default.
- Retail lenders will retrench into their traditional role of lending to buyers on the open market who have a deposit and do not require a loan to value ratio of more than 80% (75% if you want a tracker mortgage deal).
- Loans for first-time buyers with 10% deposits are going to be in short supply and at premium interest rate margins. Lenders will price the additional risk of higher loan to value ratios which, with the added burden for borrowers of arranging and funding mortgage guarantee premiums,

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v Financial Times, 14 October 2008 page 2.

will be much more costly than in the past. The requirement for a minimum deposit of 15% to 20% will be the norm.

- There will be fewer lenders and mortgage products in the market. (The number of mortgage products available in the UK dropped by more than 75% in the last 12 months as a direct result of lenders being more prudent in their business activities).[vi]
- Mortgage providers will be required by new regulations to maintain higher capital liquidity ratios to loans (their Margin of Liquid Assets), which will restrict lending and increase mortgage costs.
- Commercial retail mortgage lenders will eschew complexity and cherry pick the best most secure borrowers because funds will be in short supply: the losses written off by the banks having taken cash out of the markets.
- House prices and affordability will be driven by increases or decreases in average earnings, not by speculative capital gains driven by easy credit.
- Housing construction starts will dramatically reduce and developers will seek to renegotiate Section 106 affordable housing obligations which will become unaffordable for them to deliver; we are already seeing work on housing sites stop and sites being mothballed.

Does this mean that the British love affair with individual home ownership is at an end? No, it does not. Predictions in the midst of this crisis are hard, but the aspiration to own a home will remain high. Analysts predict that the housing market will slowly recover and, unless more homes are built, that prices will begin to rise again relative to earnings.[vii] While more prudent and sustainable lending rules coupled with tighter regulation and restrictions on available retail mortgage finance will restrain house price growth, it is not clear whether this will do enough to prevent a similar housing bubble developing in the future. As property and residential land continues to remain primarily in the hands of developers and individual owners, we will always risk similar speculative growth in times of economic prosperity. The government's acceptance of the report of Sir James Crosby that mortgage-backed securities should be covered by government guarantees[viii] will help to stimulate mortgage lending, but will not bring back the billions lost in the financial crisis; billions that are no longer available to lend. And we must ask whether we would want to return to pre-crisis lending?

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vi Financial Times, 18 April 2008, report on the Financial Times website.

vii See 'Affordability Still Matters' National Affordable Housing and Planning Unit, July 2008.

viii 'Mortgage finance: interim analysis', Sir James Crosby, HM Treasury November 2008, reported in the Financial Times 25 November page 5.

What is patently clear, however, is that there will be many tens of thousands of households in communities up and down the country who do not qualify as priority households for access to subsidised rented housing but who also cannot afford to buy on the open market. They will be caught in the gap between affordable rent and ownership. In the aftermath of this crisis, ensuring that these new and emerging households have access to a decent home they can afford is a major political and electoral challenge. Increasing the supply of homes is also a major challenge to ensure that volatility in the housing market does not drive problems in the rest of the UK economy.

The gap will be harder to fill from the bottom by increasing the supply of affordable subsidised housing for rent. While everything possible should be done to maintain the supply of affordable housing for rent, the capacity to increase supply will be adversely affected by the recessionary impact of the global financial crisis. With falling tax revenues, higher government borrowing and increasing welfare costs, it will be hard for governments to increase capital housing budgets over the long term. In the UK, the capacity of housing associations to build new homes has also been adversely affected. The effects are:

- The majority of housing associations that made bids for social housing grant from the government's three-year 2008 – 2011, £8.4 billion, National Affordable Housing Programme based their bids for grant on the assumption that they would be able to cross subsidise social rented housing from shared ownership sales and, in some cases, from open market sales. The financial crisis's impact on house prices and mortgage availability means that cross-subsidy from sales is no longer achievable. Housing associations will need to restructure their delivery programmes. They will either not be able to deliver the homes they planned to build or will need more grant to do so; a restructuring of delivery that will place a new emphasis on homes for rent.[ix] Either way, the number of affordable homes built will be less than originally planned.
- Most housing associations are well placed to weather the downturn, and are financially robust, well managed and well governed.[x] Some housing associations may encounter financial viability and liquidity problems because of increased lending costs and commitments to developments where income from sales will not be realisable or where the commercial

ix Source: circular letter to housing association chief executives from David Orr, chief executive of the National Housing Federation 8 October 2008.

x Source: National Housing Federation Credit Crunch Update October 2008.

finance required has been withdrawn or is now only available at increased interest rate margins. Impairment accounting rules, which require unsold homes and land banks to be written down to their lower current market value, will also impact on housing associations' income and expenditure accounts and balance sheets, limiting future borrowing capacity.

- The Government has helped 110,000 households to buy a home through shared ownership and shared equity schemes since 1997, but its current HomeBuy programme managed by housing associations will be harder for consumers to use as a route to home ownership because of the scarcity of retail mortgage finance and the demand from lower risk borrowers. Many individual borrowers who might have used HomeBuy will now be seen as sub-prime borrowers. Some lenders have already withdrawn from offering mortgages on HomeBuy products.

An innovative and sustainable approach to meeting the need for new homes

The post-financial crisis landscape presents all concerned with affordable housing supply with new challenges: new challenges that demand new solutions. The shortage of retail mortgage finance and lower outputs from the National Affordable Housing Programme are likely to be long-term features of the post crisis world.

The impact of the crisis on the supply of housing generally, and affordable housing in particular, is likely to be acute unless there are new creative political solutions to stimulate housing supply. Because of excess of demand over supply of housing in the UK, demand will remain high. This should mean that the UK housing market will not fall to the extent of the house price drop in the US and will be quicker to stabilise and recover. Unless supply increases to meet demand, there is a real risk that, at some time in the future, the high levels that house prices reached relative to earnings in 2007 will be reached again and the risk of another housing market crash will be repeated.

The big political challenge that Britain now faces is how to achieve the new homes target the Government has set. This can only be done if additional finance from institutional sources is brought to bear on the task of increasing the supply of affordable new homes. The source of this finance can be our pension funds and our life assurance investments redirected by opportunities to invest in homes needed by the people of

Britain. In the wake of the crisis, pension funds, in particular, are going to look at diversifying investments and achieving a closer match between their liabilities and return on assets.[xi]

This is also not just a housing supply issue. Bringing in new sources of finance to meet housing demand is also essential if we are to maintain construction skills and prevent a deep and long recession in the construction and house building sector of the economy.

It is in meeting this challenge of accessing new sources of finance to maintain housing supply and stimulate construction activity that the co-operative movement has a unique capacity to innovate and make a difference in partnership with the Government. It can do this by creating a new form of 'Mutual Home Ownership', the development of which will be an attractive investment for life and pension fund investors; a debt investment secured on the value of property co-operatively owned by the residents who live there. This will be a less risky use of these funds than investing them in shares, asset-backed securities, derivatives and default risk hedge funds on the global financial markets.

So how will this work? The key is the use of publicly owned land (and other land that can be acquired at nil or reduced cost) and the separation of the land value from the value of the homes that are built on it so that residents pay for the cost of building their homes, not the land. The land is held as a community owned asset for the benefit and wellbeing of a defined local community by a Community Land Trust (CLT).

The Government has recently acted to provide a legal definition of a CLT which states that:

A Community Land Trust is a corporate body which:

1. is established for the express purpose of furthering the social, economic and environmental interests of a local community by acquiring and managing land and other assets in order:
   - to provide a benefit to the local community
   - to ensure that the assets are not sold or developed except in a manner which the trust's members think benefits the local community

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xi See Financial Times report "Pension funds urged to restructure investments " page 6, October 11/October 12 2008.

2. is established under arrangements which are expressly designed to ensure that:
   - any profits from its activities will be used to benefit the local community (otherwise than by being paid directly to members)
   - individuals who live or work in the specified area have the opportunity to become members of the trust (whether or not others can also become members)
   - the members of a trust control it.

This means that a CLT must ensure that the land assets it holds must not be sold or developed other than in a manner which the members of the local democratically controlled CLT considers benefits the local community. The land can come from surplus public sector owned land, exception sites in rural areas and sites where planning consent for housing use allows the local community, through the CLT, to capture the uplift in value when change of use is granted.

The homes built on the CLT owned land will be owned by their residents through a residents' mutual society that is a co-operative housing society. It is only a co-operative housing society (what in law is defined as a 'co-operative housing association') that can create this type of mutual resident ownership. In it, the residents who live there and whose rents service the debt mutually own the affordable housing assets and risks. This is because:

- In UK housing law, only a fully mutual co-operative housing association grants contractual tenancies/leases that give it the capacity to create the mutual ownership, equity sharing scheme we propose.
- It is essential that the risks of borrowing and servicing debt rests with the residents who live in the homes and whose rents service that debt repayment risk. This is particularly the case in the post financial crisis world.
- It will only be acceptable to citizens to take the responsibility for servicing the cost of the investment to build their homes if they are in control of the corporate debt and the management and maintenance of their homes and neighbourhood.

Political support for these new forms of ownership and investment is vital if we are to succeed in using them to maintain affordable housing supply. It is also essential to enable land to be acquired by Community Land Trusts for this form of affordable housing development. We urge all political parties to support us and the Labour Government in this endeavour.

Unlike individual home ownership, where residents have a personal mortgage loan to buy a home, the mortgage is a corporate loan borrowed by the co-operative to finance the cost of building its members' homes on the land provided by the CLT. The value of the homes, but not the land, is financed by the co-operative's corporate mortgage loan. The value of the buildings financed by the loan is divided into equity shares with a base value of £1,000 each. Resident members of the co-operative finance the management, maintenance, estate services and mortgage costs through the rents they pay to the co-operative. They also control their mutual ownership co-operative's budget. The rent is geared to be affordable at 35% of net household income, so the more you earn the more you pay and the more equity shares you own and finance.

This is the fundamental co-operative principle of equity. (It also matches exactly the way pension funds are built-up through contributions: the more you earn the more you pay into the pension fund). When you leave the co-operative, you will be entitled to take with you the net value of the equity shares you have financed during your time as a resident member of the co-operative. The net value of the shares when members leave is calculated by reference to a fair valuation formula set out in the departing member's occupancy agreement or lease, which is the same for all members.

We call this 'Mutual Home Ownership'. It is a type of housing co-operative devised by CDS Co-operatives, a registered social landlord based in London that is the largest co-operative development and service agency in London and the South of England with over 30 years experience of developing and servicing resident controlled housing co-operatives. More information about how Mutual Home Ownership works can be found in 'A Consumers' Guide to Mutual Home Ownership: your questions answered' on CDS Co-operatives' website at www.cds.coop.

The valuation formula in the lease requires resident members to look on property ownership in a new and different way than individual, open market home ownership. Rather than viewing a home as a speculative capital investment, the value of which rises and falls in line with unpredictable housing market cycles, it will see a home as a consumer durable, just like a car, a fridge or a washing machine. It will not be a speculative investment which residents buy hoping for a windfall capital gain when they sell it because they expect shortage of housing supply and cheap credit to inflate its value. As this latest financial crisis shows, the market value of homes can be severely affected by global economic factors that have nothing to do with the cost or the supply and demand for homes in the UK.

In mutual home ownership the home's value is driven by the cost of providing it and the cost of maintaining it. The resident who has the right to use it consumes its value over its normal useful life. A car or a house has a certain lifetime of usefulness. A car is built to last, at most, about ten years; a house seventy. Each year in use, part of the value of the car or the house is consumed by the user. Even if it is well maintained by the user, it will need to be replaced or rebuilt at the end of its useful life. Its true value at any time (rather than its speculative value) is:

- the cost of building the house (adjusted to average earnings which is the principal driver of housing costs and affordability),
- less:
  - the value of the years of the useful life of the house consumed by the user; and
  - the balance of the outstanding mortgage loan yet to be repaid.

This formula will not give mutual home owners high risk speculative house price growth when it may happen again, if ever. However, mutual home owners will also not be at risk of falling into negative equity where their houses are worth less than the outstanding mortgage loan. They will also not have difficulty in selling their equity shares, providing, of course that their co-operative housing community is well managed and maintained (which is why it is so vital that the resident members are in control of it). And, if mutual home owners fall on hard times and their income reduces, they can sell some of their equity shares to other members willing to buy them. If that is not possible or they lose their income entirely, they can freeze their equity and convert to a rental tenancy, with the rent eligible for housing benefit assistance (which will enable the co-operative to continue to pay the mortgage even if a resident cannot).

This type of corporate mortgage also has the advantage that it can be collateralised with loans to similar co-operatives to reduce the default risk and converted into co-operative housing investment bonds that will be an attractive investment for pension funds and life assurance companies. This collateralisation and conversion into investment bonds can be done by a financial intermediary, like the Co-operative Housing Finance Society Ltd (CHFS Ltd) which was established in 1997 to provide twelve month mortgage interest guarantees to lenders for non-equity rental housing co-operatives. CHFS Ltd is also a mutual co-operative society which borrower co-operatives and pension and life fund investors can become members of; so it is likely to continue in the sensible traditions of other mutual financial organisations because borrowers and investors will be in control of it. It will also be regulated by the FSA.

The co-operative's corporate mortgage loan can also be structured to take out the inflation and interest rate fluctuation risk, to the benefit of investors and borrowers. This can be done by using an innovative mortgage instrument that was successfully used by Canadian housing co-operatives in the late 1980s and 1990s to raise over $Can 500 million in mortgage loans. It is called a 'tilted index linked mortgage' (TILM). It is an elegant mortgage that builds in resilience for both borrower and investor and it is tried and tested.

The base financial model for Mutual Home Ownership (MHO) and the economic assumptions it contains are currently being 'stress tested' by academics at Birmingham University's Business School's Centre for Urban and Regional Studies (CURS). The initial view of the academics at CURS is that: "*the [MHO] model makes a valuable and unique contribution to the development of future affordable housing. Other low cost home ownership schemes have proved limited in their attractiveness to purchasers, inflexible for those within the tenure and fail to address affordability concerns for future residents. This model is attractive with regard to all these concerns...*". [xii]

Mutual Home Ownership developments could also be mixed tenure. There is no reason, other than the availability of the normal subsidy provided for a rented home, why a resident in a Mutual Home Ownership development could not start on a standard rented tenancy with the right to buy equity shares as and when their income permitted them to do so. They would not be second class citizens either. They would have the right to participate in the democratic governance of their home just as any other member of the mutual. The 'Right to Buy Equity' would not mean that the home would become unaffordable for future generations of occupants or that it would move to the open housing market. The trading of equity shares within the mutual when a member leaves means that some outgoing member's shares can be sold to other resident members whose incomes have risen, allowing a smaller portfolio of shares to be transferred with the right to occupy a home to a new member on a lower income. This, together with treating

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xii Letter from CURS to CDS Co-operatives 25 November 2008.

housing assets as a consumer durable, creates a cycle of permanent affordability from one generation to the next.

There will be some areas of the country where the value of the land alone will not be enough to bring the cost of entry into Mutual Home Ownership within the range of affordability for those on modest incomes. In these areas, limited capital subsidies from the new Homes and Communities Agency may also be required. But the subsidy, whether through land or capital from the HCA, is not a permanent one-off subsidy for those lucky enough, on day one, to move into a Mutual Home Ownership home. There is an expectation, which residents must actively accept, that as their incomes rise over time they will buy more equity shares in the mutual when they can afford to do so. MHO is a dynamic tenure. As an MHO community becomes wealthier, as can reasonably be expected in a stable sustainable community, initial capital subsidy is released over time as members' incomes rise and they buy more equity shares. This means that capital subsidy is, in effect, an equity loan that is returned with asset growth, if any, at the date it is sold. Our view is that as this capital subsidy is released, it should be used by the Community Land Trust to provide more affordable homes although it could be returned to government as a redeemed equity loan. It provides a permanent right to occupy at an affordable price but not a permanent subsidy.

It is this capacity to release equity over-time into the market that has sparked interest in our Mutual Home Ownership proposals in the United States as a potential housing market rescue vehicle. In many neighbourhoods in the US, homes repossessed by the banks are boarded up while their former residents are homeless. The banks could put these empty homes into a local Community Land Trust which would hold them as an equity investment on behalf of the bank. There are over 180 CLTs in the United States and the US House of Representatives defined the legal nature of a CLT in 1992.[xiii] Homeless households could move in and buy equity shares in these homes, buying as many shares as they could finance from 35% of their net income. This would immediately generate a return for the banks. As a neighbourhood stabilises and becomes wealthier more equity shares would be purchased by residents releasing more equity to the bank. President Barack Obama may well be interested in looking at mutual and co-operative solutions too. Community and mutual ownership could

xiii See H11966 Congressional Record – House, 5 October 1992, amendment to Sec 233 of the Cranston-Gonzales National Affordable Housing Act (42 U.S.C 12773), USA House of Representatives.

also be used for mortgage rescue in the UK and as a means of bringing into use unsold homes, although the crisis here is not as acute as in the US. However, our principal aim in putting forward these proposals is to maintain activity in the house building sector of the UK economy and the supply of affordable homes to meet demand.

The benefits of these arrangements to increase the supply of affordable housing in the wake of the global financial crisis are:

For investors:

- The investment is ethical and is a low risk debt investment, not an equity investment in unstable markets.
- Using the TILM, the repayment stream can be structured to guarantee a fixed yield, equal to government gilts, over and above the underlying rate of inflation.
- Because of the co-operative ownership structure, the investment will be secured on the open vacant possession market value of the asset.
- Because the investor will have a charge over the land held by the CLT as well as the built housing asset, the loan to asset ratio will be comfortable – on average not more than 60% of the loan to asset value ratio.
- The loans will be substantial corporate loans, rather than a portfolio of high risk loans to individual shared ownership purchasers who are now, by definition in the new post-crisis financial market 'sub-prime' borrowers.
- The loans will be to a corporate entity that can demonstrate robust long term cashflows because of demand for its housing and sound management that is accountable to the residents who have the mutual obligation to service the debt.
- A 12-month interest payment guarantee will be available to the lender from the Co-operative Housing Finance Society Ltd (CHFS).
- The asset and the repayment obligations will be professionally managed by a competent professional managing agent like CDS Co-operatives or another co-operative housing service agency accredited as competent to do so and acceptable to the investor and residents alike.
- CHFS will monitor the borrower housing co-operative's compliance with financial covenants, such as income to interest rate gearing, and will have the power to act to prevent default should a default risk occur, without affecting the investor's rights.
- The performance of the co-operative will also be scrutinised by the locally accountable Community Land Trust.

The opportunity to invest in this scheme should be attractive to life assurance and pension funds that, after the financial crisis, will be looking to diversify some of their investments from equity to secure debt vehicles. Because of the way the mortgage repayment profile is structured, it guarantees an annual real yield investment, secured on quality housing assets for which there is a high demand. Co-operative Mutual Home Ownership is, in effect, a 'Rent with Equity' form of tenure.

The advantages for residents are:

- Access to a decent affordable home in an increasingly difficult housing market and access to mortgage loans to build and provide that home.
- Control over their homes and housing environment.
- Some interest, through ownership of equity shares, in the use value of their home (although Mutual Home Ownership arrangements treat housing assets as consumer durables rather than as a high risk speculative capital investment).
- Loan repayment obligations can be structured to take-out the interest rate risk in a way that matches the investor's need for a guaranteed yield.
- Residents will not face a repossession risk in the event of job loss, ill health or disability because they can reduce their equity share or convert their tenancy to a non-equity tenancy and their monthly payments will be eligible for housing benefit.
- The costs of buying into the co-operative and selling shares will be limited because the home is not bought or sold, it remains in the ownership of the co-operative; it is the right of occupancy and the equity shares that are sold at a price driven by the valuation formula in the member's tenancy/lease agreement.
- Environmentally sustainable elements of design and construction can be financed over the whole of the corporate mortgage loan, rather than just the occupation of the first resident, reducing energy costs and carbon emissions. (Combined heat and power plants and solar panels can be divided into equity shares just as easily as members homes can; and it doesn't matter whose south-facing roof the solar panel sits on because the roofs are owned in equity shares by all the members).
- The ability to use the net residual value of equity shares towards a deposit on a house if and when the member needs to move and can afford to do so.
- Residents will be active citizens in a sustainable community that they democratically govern and control.

For Government and society:

- An innovative way of increasing affordable housing supply that contributes to achieving the Government's targets of 246,000 new homes in England each year.
- A supply of community owned housing that remains affordable from one generation of residents to the next.
- A form of land and home ownership that will promote stability in the housing market.
- Avoiding or minimising recession through stimulating the construction and associated manufacturing and service sectors of the economy.
- Bringing underutilised public sector land assets into productive use.
- It is a new form of housing tenure that can also be developed in Scotland, Wales and Northern Ireland.
- Providing a new, resilient, low risk form of investment for the nation's pension savers and life assurance companies.
- Promoting sustainable communities, encouraging active citizenship and democratic participation.

Complex? No. Different forms of co-operative and mutual ownership are well established across the globe and are no more complex than other forms of shared equity ownership. Different? Yes. It is a different way of owning a stake in your home that is designed to be economically, socially and environmentally sustainable. Together the Government and the Co-operative Movement can really make a difference.

Next steps

CLTs and co-operative Mutual Home Ownership projects can be developed within the existing legislative and administrative arrangements but will be made easier if the Government supports the initiative with the following enabling actions:

- Excluding all homes built on land owned by CLTs from the leasehold enfranchisement provisions of the Leasehold Reform Act 1967.
- Amending the Commonhold Act 2000 to enable co-operatives to register as Commonhold Associations and develop Co-operative Commonhold housing schemes on land owned by a CLT; Commonhold being a more appropriate democratic form of tenure for Mutual Home Ownership than feudal landlord and tenant property law.

- Establish a start-up fund and revolving technical assistance loan fund to stimulate the development of CLTs and Mutual Home Ownership projects.
- Ensure that HM Treasury and the Financial Services Authority work with CHFS and the co-operative housing sector to create collateralised debt structures and create a regulated bond market that is attractive to pension fund and life assurance investors.
- Ensure that the new registration and regulatory regime to be introduced by the new Tenant Services Authority is sympathetic to and encourages the formation, registration and intelligent risk based regulation of CLTs and Co-operative Mutual Home Ownership Societies.
- Ensure that the new Homes and Communities Agency's capital funding and delivery regime is structured to provide capital subsidy for CLTs and Mutual Home Ownership where the provision of nil or low cost land alone is not sufficient to achieve initial affordability levels required to meet demand in local communities.
- Issue supplementary planning guidance to local planning authorities to the effect that Local Development Frameworks should include reference to the development of CLTs and Co-operative Mutual Home Ownership as a means of increasing affordable housing supply and creating a presumption in favour of change of land use being granted to residential where the uplift in land value is to be captured for the benefit of the community by a CLT.
- Encourage the Homes and Communities Agency and interested local authorities to proceed with the demonstration projects, such as the proposed pilot project at Cashes Green in Stroud.
- Issue a new General Consent to Dispose of publicly owned land for CLT/ Co-operative Mutual Home Ownership schemes which recognises that, in order to achieve Local Strategic Plan housing targets and wellbeing outcomes in Local Area Agreements using CLT and Co-operative Mutual Home Ownership, the best price reasonably obtainable for public land assets may be a nominal £1.[xiv]

xiv See the erudite analysis of the land valuation issue in Stephen Hill FRICS's "General Theory of Best Consideration: affordable housing advice notes 1.1 to 1.3" available from the library on CDS Co-operatives' website at www.cds.coop

About the author

David trained as a science teacher but began his career in co-operative housing in 1972, while a student, as a voluntary committee member pioneering the early development of housing co-operatives. He began working in housing, setting up and supporting housing co-operatives in 1974. Since 1979 he has been Executive Director of CDS Co-operatives, now the largest secondary housing co-operative in England managing 3,000 homes.

David is Vice Chair of the Board of Governors of the Co-operative College and former chair of its audit committee. He is founder secretary of the Co-operative Housing Finance Society Ltd which provides mortgage interest guarantees to housing co-operatives. He is the UK's representative on the Housing Board of the International Co-operative Alliance. Recognised internationally as an expert on community ownership and resident control, he has spoken at conferences in Austria, Brazil, Canada, Estonia, Germany, Spain and South Africa. He acts as administrator of the All Party Parliamentary Group on Housing Co-operatives and served for six years as the co-op housing sector representative on the national council of the National Housing Federation.

His publications include 'New Mutualism – the third estate' (Co-operative Party 1999), 'Co-operative Housing – realising the potential' (UK Co-operative Council 1998) and the 'Modular Management Agreement for Tenant Management Co-operatives' (HMSO 1994).

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