

REPORT TITLE: UPDATE ON THE PROGRESS OF THE OPEN MARKET
SHARED OWNERSHIP (OMSO) SCHEME

14 JUNE 2017

REPORT OF PORTFOLIO HOLDER: CLLR GUY ASHTON (PORTFOLIO HOLDER
FOR FINANCE AND CORPORATE POLICY)

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WARD(S): ALL

PURPOSE

To update Cabinet on the progress of the Open Market Shared Ownership (OMSO) scheme since Cabinet approved the concept at its meeting on 7 December 2016.

RECOMMENDATIONS:

That Cabinet:

1. Notes the progress and launch dates of the OSO scheme as set out in the Report.
2. Approve the amendments made since Cabinet approved the original scheme.
3. Delegate authority to the Corporate Director (Professional Services) to administer the scheme as detailed in the Report.
4. Delegate authority to the Corporate Director (Professional Services) in consultation with the Portfolio Holder for Finance to agree terms for the purchase of the property and shared ownership lease.

IMPLICATIONS:

1 COUNCIL STRATEGY OUTCOME

- 1.1 The scheme will support the entrepreneurial approach theme, through providing an income stream for the Council whilst also benefitting local residents.
- 1.2 The scheme also supports the Council's commitment to delivering quality housing options. OMSO provides a means of home ownership.

2 FINANCIAL IMPLICATIONS

- 2.1 The Scheme requires a significant amount of capital investment. The rental payments will cover the interest cost of the capital as well as generate a return to the Council. In addition, the Council would have ownership of an asset, though no control over the realisation of the financial element within the asset. The initial tranche of funding will be restricted to ten households as a pilot scheme.
- 2.2 Appendix A sets out an illustrative example of the capital investment costs and the possible return from a pilot scheme with a mix of different property types. In this example, an initial capital investment of around £1.6m would generate an annual revenue return of £11k in year one rising to £28k in year ten.
- 2.3 Since Cabinet considered the original paper (report CAB2861, 7 December 2016 refers) officers have been advised that the Council will be liable for paying Stamp Duty Land Tax (SDLT) on the initial purchase price and that the 3% surcharge for second home owners will also be due. As it is not practical to pass this on at the date of purchase, it is proposed that, on sale of the property or on "staircasing" (buying out part of the Council's share of the property), the buyer will be required to repay (pro-rata or in full) all the SDLT the Council has incurred. The Council is investigating whether this charge can be secured on the property. In the event that the value of the property has decreased below the original purchase price plus the additional stamp duty surcharge, the Council may be unable to recover the SDLT surcharge.
- 2.4 OMSO homeowners will have the right to increase their percentage of ownership by purchasing some/all of the Council's share (known as "staircasing").
- 2.5 However, if the homeowners wish to sell the property, they will have to obtain the Council's permission to do so.
- 2.6 In both these circumstances, the cost will be the higher of the original purchase price or current market value. This mitigates against the risk of capital depreciation and provides the potential for additional capital returns. OMSO homeowners will only realise capital appreciation on the share of the property that they own less the SDLT they are required to repay.

- 2.7 Although by no means guaranteed, there is a good possibility of the Council being in receipt of capital returns if the long-term trends in the housing market continue.
- 2.8 In the 10 years from March 2007 to February 2017, the average house price in the Winchester District increased from £281,266 to £397,649. This equates to an increase of 41.38% over 10 years or an annualised increase of 3.52%. It should be noted that prices fluctuate over time; the lowest average price in the period was £238,821 in February 2009 and the highest was £401,910 in October 2016.* If the same increase applied over the next 10 years, the Council would make an additional return of £620k on the pilot scheme.

The following graphs* illustrate the change in average price over time and the percentage annual change.

Graph1: Average house prices in Winchester from 2007-2017

Average price: Winchester from March 2007 to February 2017

Key: ● all property types



Graph 1.1: Percentage annual change of house prices in Winchester from 2007-2017

Percentage annual change: Winchester from March 2007 to February 2017

Key: ● all property types



*Source: Land Registry (<http://landregistry.data.gov.uk/app/ukhpi/explore>). Data is based on price paid.

- 2.9 The Council will cover set-up and administration costs through charging the buyer for specific work e.g. legal fees. The extent to which legal work will be sourced internally or externally has not yet been decided and will be confirmed before the commencement of the pilot scheme and assessed during the pilot.

3 LEGAL AND PROCUREMENT IMPLICATIONS

- 3.1 Since the last report (CAB2861) the issue of state aid has been dealt with and is no longer a concern for the Council.
- 3.2 The Council will be liable to pay a SDLT surcharge of 3 per cent in addition to the regular SDLT payable on the initial purchase price. The regular amount of stamp duty payable by the Council, will be paid by the buyer at the time of purchase. It is proposed that the SDLT surcharge payable by the Council is to be repaid by the buyer if/when they sell the property or (pro-rata) when they staircase. If property prices rise, it is likely that the cost of the surcharge will be covered (in part or fully) by the capital appreciation on the leaseholders share. The mechanism to recover the cost of the SDLT payable by the Council is yet to be established, but the Council is seeking further advice. It is unlikely that the Council would recover the surcharge amount if the shared ownership lease is forfeited or if a mortgagee takes possession pursuant to a default on the mortgage.
- 3.3 To ensure that applications comply with counter-fraud requirements, the Council will ask applicants for photographic proof of identification and any other further documentation required. Applicants that are successful at the first stage of the application process will also undergo rigorous checks when completing their financial assessment.

4 WORKFORCE IMPLICATIONS

- 4.1 One of the purposes of the pilot is to ascertain the impact and cost of this scheme on the Council and to factor this into any further rollout of the scheme. There will be additional work for Legal Services in purchasing the property and granting the shared ownership lease, and additional work will be required in circumstances where the buyer staircases or sells his shared ownership or in dealing with default. The Council is considering whether the legal work will be outsourced to external solicitors, at a financial cost to the Council, that could be charged in full or part to the purchaser.
- 4.2 There will also be additional work for the Housing Business Services and Rents Team, specifically to administer the monthly rental collections from households. The Council will also purchase building insurance and recharge the cost to the buyer. There is an opportunity to charge households on the scheme a fee for the administrative work completed by the Council, although this has not yet been confirmed.
- 4.3 The pilot of ten households will enable the Council to clarify the administrative burden of the scheme and more accurately allocate any additional resources that are required. Officers are discussing who at the Council will take responsibility for the administration of the pilot scheme.

5 PROPERTY AND ASSET IMPLICATIONS

- 5.1 As highlighted in paragraph 4.2 above, there are some resource implications for the Housing Business Services and Rents Team.
- 5.2 The Council is proposing that households in the scheme will be required to fund the full cost of a home buyers survey and are investigating the use of a RICS HomeBuyer survey. It is intended that the Council will use their survey to satisfy its own requirements.
- 5.3 The Council will also recharge the cost of building insurance to households on the scheme.
- 5.4 The Council will own an asset which might appreciate or depreciate in value. The householder is responsible for the maintenance and repair of the property, and the Council will reserve the right to conduct inspections.

6 CONSULTATION AND COMMUNICATION

- 6.1 The Portfolio Holder for Finance has been consulted and supports the progress of the scheme.
- 6.2 The Council plans to launch a register of interest and in the process of preparing a communications plan that will commence after the Cabinet meeting.

7 ENVIRONMENTAL CONSIDERATIONS

- 7.1 OMSO concerns houses that are already in the open market so there are no environmental considerations.

8 EQUALITY IMPACT ASSESSMENT

- 8.1 None

9 RISK MANAGEMENT

Risk (Detail in this column specific risks, under each of these headings)	Mitigation	Opportunities
<i>Property</i> <i>Maintenance/risk that property is not adequately maintained</i>	Maintenance will be the responsibility of the shared ownership owner. Council will reserve the right to inspect the property to ensure it is adequately maintained.	

<p><i>Suitability – i.e. property needs to be in a reasonable state of repair</i></p> <p><i>Value of property depreciates</i></p>	<p>The Council will purchase building insurance and pass this cost onto the purchaser.</p> <p>Council will use the purchaser's survey.</p> <p>Council will have the right to purchase the property if it is proposed to be sold under the original purchase price or market value and the Council consents to this.</p>	<p>The Council shares in any capital appreciation through the scheme</p>
<p><i>Community Support</i></p> <p><i>Lack of uptake for the scheme</i></p> <p><i>Demand exceeds the supply of Council funding for the scheme</i></p>	<p>Publicity and communications of the scheme to target audience. Register of interest will be set up.</p> <p>Points system to score applicants.</p> <p>Increase funding to the scheme if it is successful and financial risk is mitigated.</p>	<p>Proposed to offer ownership splits ranging from 70:30 – 50:50 (purchaser/Council) to increase affordability and thus uptake.</p>
<p><i>Timescales</i></p> <p><i>Lack of mortgage providers on the market</i></p>	<p>There are a number of providers that have expressed interest/are committed to financing the OMSO scheme.</p>	<p>Opportunity to attract other providers if the pilot stage of the scheme is successful.</p>
<p><i>Project capacity</i></p>	<p>Pilot the scheme with ten applicants to assess resource implications on the Council.</p>	<p>Opportunity to generate new revenue streams through relaying administration costs onto OMSO purchasers.</p>
<p><i>Financial / VfM</i> <i>Housing market drop -</i></p>	<p>Individuals can only sell the property at the either</p>	<p>If house prices rise the Council is likely to make</p>

<p><i>A 20% drop in the housing market could yield a £900k loss for the Council if properties were sold at the bottom of the market.</i></p>	<p>the higher of market value or the purchase price.</p>	<p>financial gains, which will release more funding for the scheme/other council projects.</p>
<p><i>Tenant does not pay rent</i></p>	<p>Treated per the mortgage providers' conditions. In the case that this would happen, the Council would have the opportunity to purchase the property outright, or seek to staircase the level of property purchase to mitigate any bad debt in the short term</p>	
<p><i>Stamp Duty Land Tax surcharge- Council is liable to pay an additional 3% on each property purchased.</i></p>	<p>Recover the amount of the surcharge from the owner of the shared ownership lease if/when the property is sold/they staircase</p>	
<p><i>Tenant does not maintain and repair property</i></p>	<p>The Council will inspect the property and it is being investigated whether it can make undertake works in default and seek to recover the costs from the share ownership owner</p>	
<p><i>Tenant defaults on the mortgage and lender enforces its loan with any shortfall being payable by the Council</i></p>	<p>The Council would have the option to purchase the property (at a potential loss) and then manage this itself</p>	
<p><i>Legal</i></p>		

<p><i>Legality of the scheme</i></p> <p><i>State-aid – lending funds at sub-market rates</i></p> <p><i>SDLT surcharge</i></p>	<p>The Council is utilising its investment powers (As set out in section 12 of the Local Government Act 2003, and section 1 of the Localism Act 2011) to purchase the properties. Documentation is based on existing Homes & Communities Agency documentation. The Council is also being advised by financial advisers Arlingclose.</p> <p>Council will place a premium on its borrowing amounts above the level of Public Works Loans Board rates at the time of the loan to ensure they are in line with market rates.</p> <p>The Council will seek to recover this amount from the shared ownership owner</p>	
<p><i>Innovation</i></p> <p><i>There are risks of the 'unknown' as WCC will be one of the first Councils in the country to undertake this type of scheme</i></p>	<p>Legal and accounting frameworks have been prepared by WCC Officers/ independent advisers</p>	<p>The Council's profile/reputation could be enhanced as a result of the scheme.</p>
<p><i>Reputation</i></p> <p><i>Defaults on rental repayments to the Council and mortgage payments</i></p>	<p>Households financially assessed independently before undertaking a mortgage.</p> <p>Households would require a market mortgage for 50-70% of the house price and so would need to pass lenders borrowing limits</p>	
<p><i>Other</i></p>		

10. SUPPORTING INFORMATION:

10.1 **Background**

10.2 In December 2016 Cabinet approved (report CAB2861 refers) the concept of creating an Open Market Shared Ownership (OMSO) scheme for the Winchester District. Cabinet specifically approved:

- The OMSO scheme will undergo an initial pilot of ten households
- For officers to liaise with the relevant scheme stakeholders/providers.
- The criteria for applications and principles of the scheme
- £4.5m will be invested into the scheme

10.3 **Updated detail of the scheme**

10.4 The scheme works by the Council purchasing a property and leasing a share to the applicant through a 125 year shared ownership lease. The original expectation was that there would be a 70:30 (purchaser/Council) ownership split, with the opportunity to extend this to 50:50. On review, for the pilot stage of the scheme the Council propose to include splits between 50:50 and 70:30 (purchaser/council) to ensure affordability. This decision is supported by the scheme's independent advisers, Arlingclose. The detailed processes of the scheme are to be finally determined in consultation with Arlingclose. In the event that significant amendments are made to the model of the scheme, a report will be brought back to Cabinet for approval.

10.5 In CAB2861 it was proposed that initial rent be set at the prevailing PWLB rates available to the Council plus 1.5%. Following concerns expressed by the Council's advisers regarding affordability, it is now proposed that initial rent be set at PWLB plus 1%. Although the Council's returns will be lower, the proposed rate strikes the balance between returns and affordability, and seeks to ensure adequate take up of the scheme. The initial rate for calculating rent will be set on the day of launch and will remain fixed for 3 months to allow certainty for applicants and brokers. Thereafter it will be reviewed every 3 months with reference to the prevailing PWLB rates. The Council will also reserve the right to review it at any other time in order to mitigate against any significant movements in the PWLB rates.

10.6 The Council will be liable for paying SDLT on the initial purchase of each property and a 3% SDLT surcharge will also be payable. To mitigate the financial implications that the surcharge will have, the Council will require, on sale of the property or on "staircasing" (buying out part of the Council's share), the buyer to repay (pro-rata or in full) all the SDLT it has incurred. If property prices continue historic trends, it is likely the additional cost to the homeowner will be covered by an increase in the property's value over time.

10.7 In addition to SDLT charges, OMSO homeowners will also be subject to financing the following:

- Legal fees (Exact detail to be confirmed)

- Survey
- Building insurance

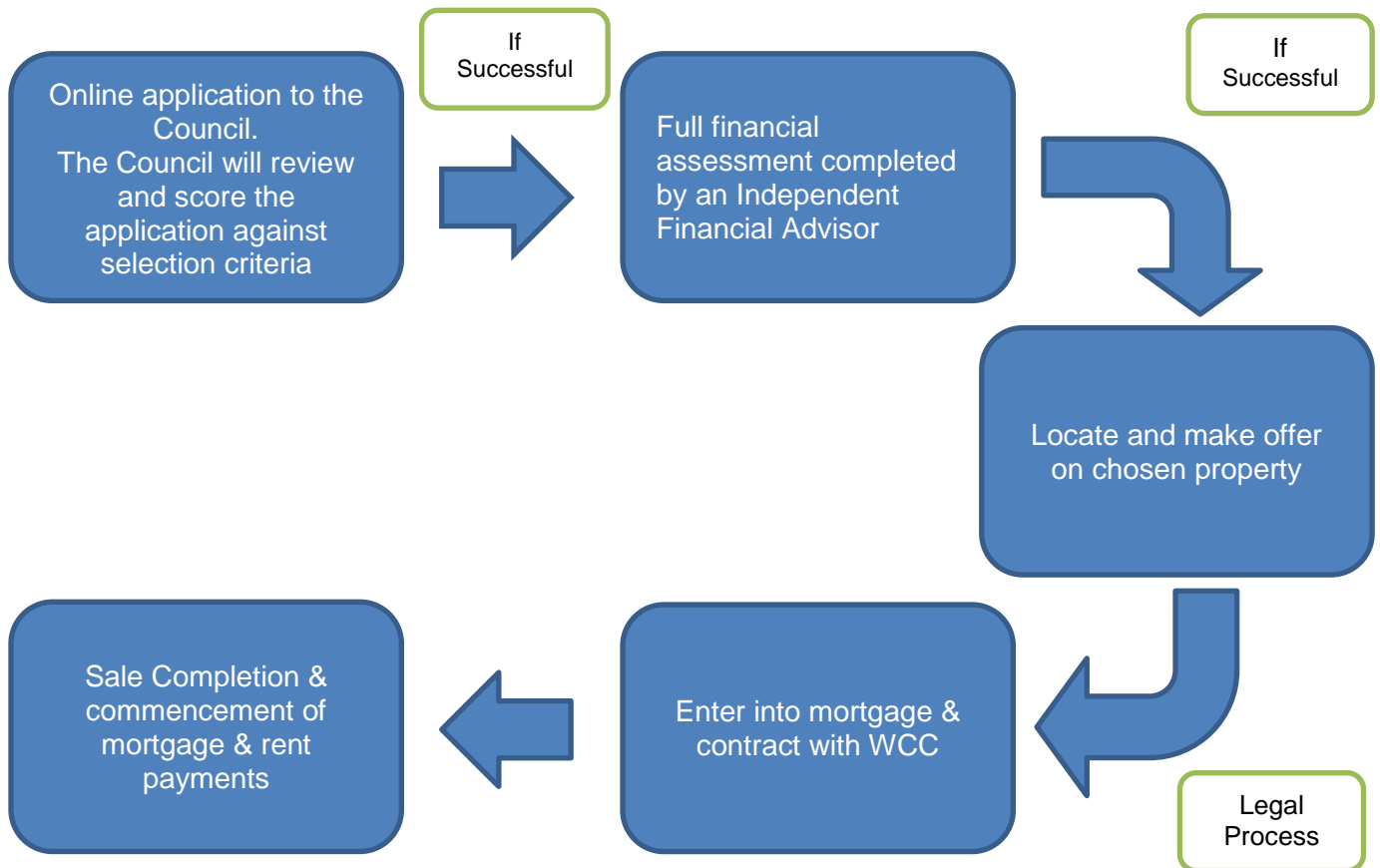
- 10.8 The Council has been advised that there are a number of banks and building societies who have committed to providing mortgages under the OMSO scheme.
- 10.9 As agreed by Cabinet (7 December 2016, CAB2861) applications will be assessed through a points based criteria system. These criteria will determine who is accepted onto the scheme i.e. the applicants with the highest number of points will be accepted onto the scheme.
- 10.10 One of the criteria includes applicants who are employed as a 'key worker'. The Council has worked to create a definition that is broad, so as to include a wide range of workers that are vital to the Winchester District. The definition will be reviewed after the pilot, especially if a large number of 'key workers' apply for the scheme and demand exceeds supply.

A key worker is defined as:

A public sector employee working in the Winchester District, in a permanent or fixed-term position for a period of at least two years.

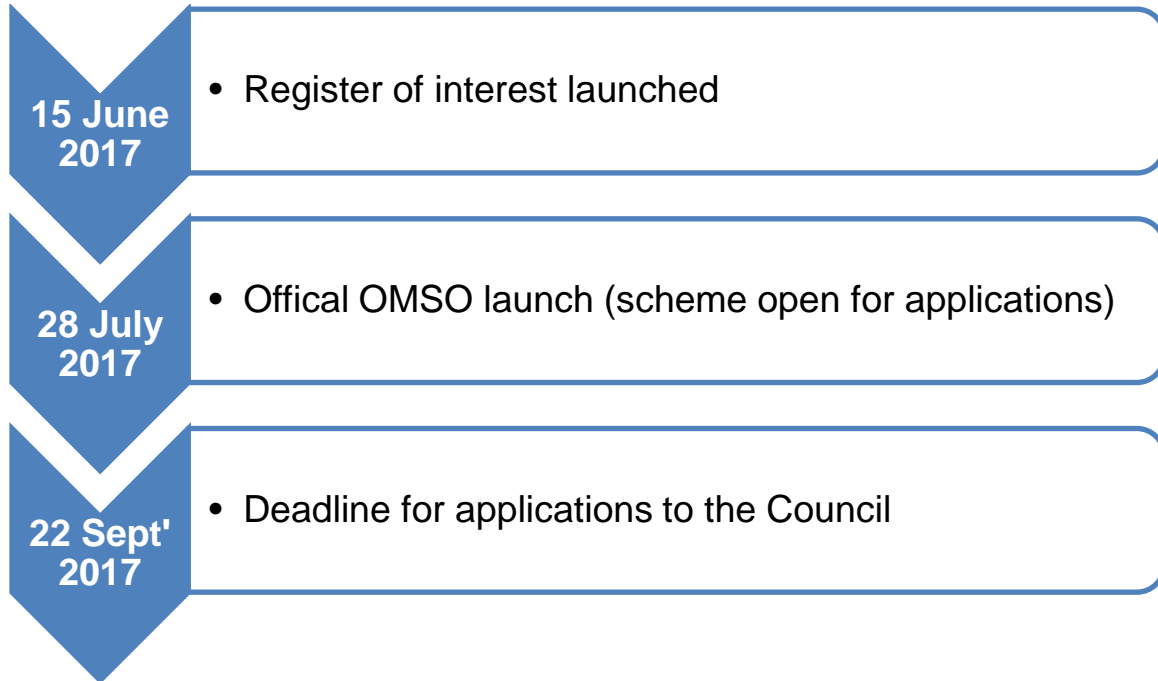
- 10.11 The Council will launch a register of interest to raise awareness and generate interest before the scheme is officially launched. Interested parties will then be notified about additional information, further press releases and once the scheme is open for applications. The register will also help the Council to establish the volume of applications that the scheme is likely to attract.
- 10.12 The target audience for the OMSO scheme are those who meet the application selection criteria. As agreed by Cabinet in December (CAB2861 refers), groups who receive priority are local residents, those employed inside the district boundary in a permanent role, first time buyers and key workers. The full application criteria can be found in Appendix C.
- 10.13 The Council is currently in the process of assembling a communications plan for the scheme. This will incorporate a range of communication methods including website posts, social media adverts and leaflets. The Council is also exploring opportunities to facilitate a launch event for the scheme. This will raise the profile of the scheme and generate further interest. It will also benefit parties who are interested in applying.

Chart 1: OMSO Process



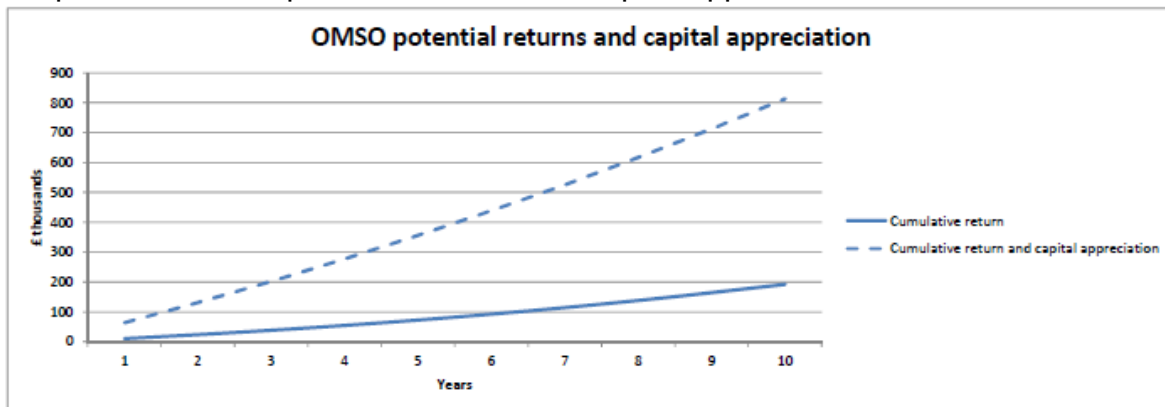
- 10.14 Subject to the successful completion of the financial assessment, the applicant will have six months to locate a property and have their offer accepted by the vendor.

Chart 1.1: Timescales for launch of Pilot



10.15 The financial figures have been updated (see financial implications) to reflect the latest PWLB rates. The rate of return in year one is anticipated to be 0.7% and, assuming RPI at 3% per annum and no staircasing, 1.7% by year ten. Based on these, the annualised rate of return over ten years would be **1.1%** (1.0% if RPI were 2% per annum) though this assumes no capital appreciation and no staircasing. Capital appreciation (based on the past ten years of data for Winchester District, though property price will fluctuate over the coming ten years) could provide a further 38% return on capital invested. However, any increase would only be crystallised on a homeowner purchasing part, or all, of the Council’s share of the property, or on the sale of the property. Appendix A has further details.

Graph 1:3 – OMSO potential returns and capital appreciation



10.16 **Legal process**

First Purchase

- 10.17 Once an applicant has been approved onto the Scheme and completed a satisfactory financial assessment, they can then locate a property. The applicant will negotiate the terms of the purchase, including the purchase price with the seller or the agent of the property. They will have a total of six months to locate and make an offer on a property. When the value has been agreed, they will notify the Council. The Council will then undertake a valuation of the property. There are three types of valuation and the Council propose to undertake a mid range valuation, being a RICS Homebuyers survey. This will provide information to the Council to ensure that the proposed purchase is a suitable investment for the Council to make. The fee for this will be paid by the proposed shared ownership owner.
- 10.18 Once agreed, the Council will purchase the property, with all costs being paid by the buyer (with the exception of the Stamp Duty Land Tax surcharge as detailed in paragraph 3.2) and will simultaneously grant the shared ownership lease to the buyer.

Staircasing

- 10.19 The buyer will have the opportunity to purchase additional shares of the property and may ultimately purchase up to 100 percent. At this point, the Council would then realise its investment in the property. The value of any additional share purchased will be calculated at the time of the purchase, but, with the caveat that the Council will not be required to sell any additional share at less than higher of the original purchase price or current market value. When staircasing or selling the property, the householder will only realise capital appreciation on the share of the property that they own, minus the SDLT that they are required to pay.
- 10.20 When selling the property, it can only be sold for the higher of either the property purchase price or the market value. The Council would not want to interfere with the ability for the property to be sold by the homeowner, but would require that no sale is made within the first year of the scheme to protect the Council's initial investment and costs associated with the scheme. To sell the property, the homeowner would need to gain the Council's consent.

10.21 **Other matters for consideration**

Default on mortgage

- 10.22 If buyer defaults on the mortgage, the mortgagee will enter into possession and may be able to sell the property without any restrictive covenants imposed by WCC (depending upon terms of share ownership lease). The shared ownership lease as drafted makes provision for WCC to make up any shortfall they incur in a mortgagee in possession sale.

Non payment of rent

- 10.23 The Council may have a right to forfeit the lease depending upon the terms of the shared ownership lease and the mortgagee's rights. This will be considered further.

Buyer fails to maintain the property

- 10.24 If the buyer fails to maintain the property, the Council may be required to undertake repairs to it, in order to maintain the value of its investment. The Council will reserve the right to undertake inspection of the property at any time in order to ensure it is being maintained to a reasonable standard.
- 10.25 For the period of time in which the property is subject to the shared ownership lease (up to 125 years), it is intended that the Council will not sell the asset, unless the leaseholder requests to do so.

11. OTHER OPTIONS CONSIDERED AND REJECTED

Longer term treasury management investments

- 11.1 The Treasury Management (TM) policy could be amended to make longer period investments rather than invest in the OSMO scheme. This policy change will be considered anyway as part of the TM policy for 2017/18 but to achieve returns of PWLB rates plus a margin would be very difficult in the current financial climate and would indicate a major change to increasing investment policy risk.

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

CAB2861- Proposed creation of an Open Market Shared Ownership Scheme for Winchester District - 7 December 2016.

Other Background Documents:-

<http://landregistry.data.gov.uk/app/ukhpi/explore>

APPENDICES:

Appendix A – OMSO pilot financial implications

Appendix B – Draft Terms & Conditions

Appendix C – Application criteria

OMSO pilot financial implications**Assumptions**

Property mix: (2 of each type)	<i>SDLT per property (including 3% surcharge)</i>
£200,000	£7,500
£250,000	£10,000
£300,000	£14,000
£350,000	£18,000
£400,000	£22,000

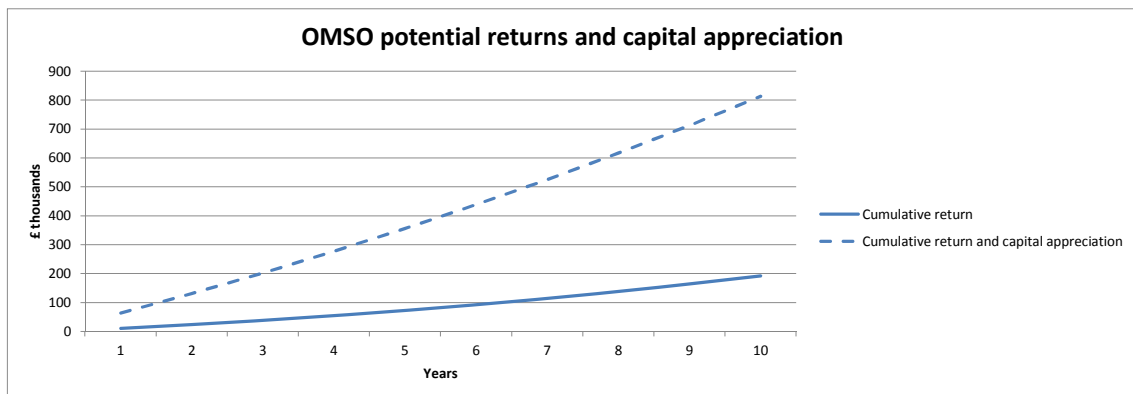
Total outlay to WCC: £1,643,000

Total applicant share: £1,500,000

PWLB:	2.72% (25 yr certainty rate - maturity)	
Rent at outset:	PWLB + 1%	<i>Increased by RPI annually</i>
RPI:	3.00%	
Capital appreciation:	3.52%	<i>Annualised increase from March 2007 to February 2017</i>

Notes

- Any capital appreciation is only crystallised when the owner buys some or all of WCC's share.
- When staircasing or selling the property, the owner will need to pay WCC the *higher of* the property's original value or the current value as well as repaying the SDLT incurred by WCC (on a pro-rata basis).
- Actual returns will depend on various factors such as property mix, actual RPI, and staircasing.



Appendix B: Draft Terms & Conditions

1. General Eligibility

- 1.1. You must be accepted onto the OMSO scheme in order to participate.
- 1.2. You or anyone else buying with you must not currently own another property in the UK or abroad.
- 1.3. If you or the other person buying with you is a social housing tenant they must surrender their tenancy at the time of completion.
- 1.4. You cannot be in arrears with rent, service charge or mortgage payments or any other loan repayments within the last 12 months.
- 1.5. You must complete a full financial assessment with [•] within the time scales required.
- 1.6. Winchester City Council reserves the right to withdraw their offer for OMSO at any time for any reason. Winchester City Council will not be liable for any losses or costs that you have incurred.
- 1.7. You need to inform us of any changes in your financial or household circumstances throughout the process.

2. Buying your new home

- 2.1. You must buy a share of between 50% and 70% however you will be required to buy the highest share you can afford.
- 2.2. Your new home must:
 - 2.2.1. have 1 or more bedrooms
 - 2.2.2. be below £450,000 in value
- 2.3. The property must be within the price and size limits agreed by Winchester City Council and our financial advisors.
- 2.4. Your new home must be located within the Winchester District.

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- 2.5. The property must be:
- 2.5.1. acceptable for mortgage purposes
 - 2.5.2. in a reasonable state of repair
 - 2.5.3. considered habitable with a sound roof
 - 2.5.4. purchased with full vacant possession.
- 2.6. You will be responsible for providing a RICS homebuyer report (including a valuation), and the costs associated with obtaining the report.
- 2.7. In the event that the purchase of your new home falls through, for any reason, Winchester will not be responsible for covering or refunding any costs that you may have incurred.
- 2.8. A new 125-year Shared Ownership lease will be issued on the property that you purchase. The rent on the share that you don't own will be calculated at PWLB + 1% (borrowing rates to be confirmed) p.a. with annual increases in accordance with the terms of the lease. The initial rate on which rent is calculated will be fixed for a period of 3 months from the launch date of the scheme and will be reviewed with reference to PWLB rates every 3 months thereafter. Winchester City Council reserves the right to review the initial rate at any other time it so chooses.
- 2.9. As a Shared Owner of your property you will solely responsible for full maintenance and upkeep in accordance with the repair responsibilities in the lease.
- 2.10. Winchester City Council will charge for building insurance and for the cost of any services provided by the Council.
- 2.11. If your purchase is to include fixtures and fittings which come at an additional cost to the agreed sale price, this must be agreed by Winchester.
- 2.12. Once your offer on your property has been accepted you will be required to pay a £500, non-refundable, reservation deposit. This sum will be deducted from your final payment on completion, and is otherwise non-refundable.
- 2.13. Properties that are excluded from the OMSO scheme include:
- 2.13.1. Studio apartments
 - 2.13.2. Commercial or part commercial properties. This includes live/work units.
 - 2.13.3. Properties on sale at auction.
 - 2.13.4. Plots of land on which to build, including self-build schemes.
 - 2.13.5. Properties that have previously suffered from structural movement or subsidence.
 - 2.13.6. Retirement housing.
 - 2.13.7. Listed buildings.
 - 2.13.8. Leasehold houses.

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- 2.13.9. Unusual construction builds, this includes mobile homes, caravans or houseboats.
- 2.13.10. Leasehold properties that come with a Share of the freehold.
- 2.13.11. Properties that Winchester City Council deem unsuitable
- 2.13.12. Properties over the value of £450,000
- 2.13.13. Properties under Right to Buy

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Appendix C: Application criteria

Criteria	Points
Local residents for five years or more as a resident of the district (from the age of 18)	2
Local residents for ten years or more as a resident of the district (from the age of 18)	3 (i.e. an additional point to the above)
Applicant(s) works inside the district boundary in a permanent role	2
Applicant(s) employed as key-worker (as defined in paragraph 10.10)	2
First time buyer	2

The key principles of the scheme:

- Only available on properties under £450,000
- The property must be the only property owned by the applicant(s)
- Scheme cannot be used to purchase properties under Right To Buy
- The household is required to purchase between a 70-50% share of the property and the Council subsequently between 30-50%