REPORT TITLE: PARTNERED HOME PURCHASE SCHEME

17 JANUARY 2018

REPORT OF PORTFOLIO HOLDER: Cllr Guy Ashton (Portfolio Holder for Finance)

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WARD(S): ALL

PURPOSE

Formerly referred to as the Open Market Shared Ownership Scheme (OMSO), the Partnered Home Purchase Scheme (PHP) aims to assist local residents onto the property ladder whilst generating income for the Council. This report provides an update on the position of the scheme and seeks approval for proposed changes.

This will enable the scheme to move towards launch in early 2018. The previous report was presented to Cabinet in June (CAB2932, 14 June 2017).

RECOMMENDATIONS:

That Cabinet:

1. Approves the changes to the way the Council recovers SDLT, noting the added risks

2. Approves the change that allows PHP leaseholders to sell or staircase at current market value, as opposed to the higher of current market value or original purchase price

3. Approves the change to annual rent increases from RPI to RPI + 0.5% to bring in line with other schemes operated by the Council

4. Notes the revised financial assumptions

IMPLICATIONS:

1 COUNCIL STRATEGY OUTCOME

1.1 The scheme supports the Council's commitment to delivering quality housing options. Partnered Home Purchase (PHP) is intended to assist local residents onto the property ladder.

1.2 The scheme aligns with the Council's entrepreneurial approach, through generating a new and innovative stream of income.

2 FINANCIAL IMPLICATIONS

2.1 The Council is liable for the payment of Stamp Duty Land Tax (SDLT) on the initial purchase price of each property, and will also incur the additional 3% SDLT surcharge due as a non-residential buyer .

2.2 Officers and external advisers have sought to find ways to recharge the SDLT costs incurred to the PHP leaseholders. As detailed in paragraph 3.1 and 3.2, it is proposed that a 5 year penalty charge is adopted to secure this payment.

2.3 In effect, a 5 year penalty charge requires the leaseholder to pay back the SDLT that the Council has incurred, if they staircase or sell the property within 5 years of purchase. After 5 years has ceased, they will no longer be subject to the penalty charge when selling or staircasing[1]. Leaseholders who sell their property within 5 years will be required to pay back the full amount of SDLT incurred by the Council. Leaseholders who staircase to less than 100% will be required to pay a proportion, based on the percentage of share that they have purchased.

2.4 Adopting a 5 year penalty charge involves some added risk to the Council, as SDLT costs incurred will not be secured indefinitely. The Council is therefore faced with less protection in respect of securing full recovery of the SDLT that it will incur on purchases under the scheme. For example, if a PHP leaseholder chooses to sell the property immediately after the penalty charge has ceased to apply, the Council is at risk of financial loss unless the property has significantly increased in value and the SDLT is therefore recovered by way of capital appreciation.

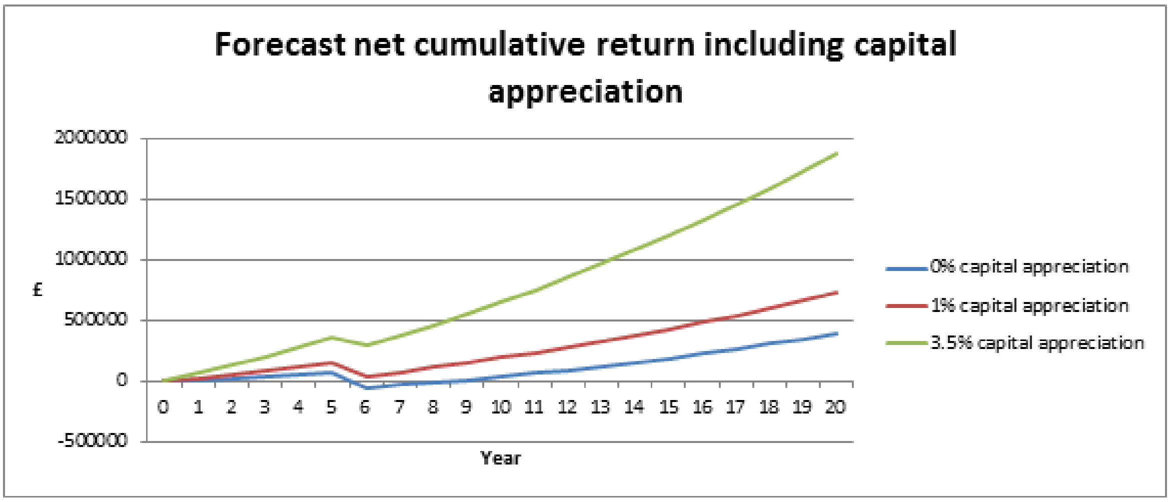
2.5 Assuming an initial investment of £1,643,000 (£1.5m plus SDLT) in the pilot and no capital appreciation, and assuming all homebuyers staircase to 100%, the "breakeven" year after the penalty charge period would be year 9. In year 6, for example, the Council would make a total net loss of £55,000 in this scenario (versus a total net surplus of £84,000 if it were able to fully recover SDLT). It should be noted however that a 1% per annum increase in value would result in no year making a net loss.

[1] 'Staircasing' is known as the process in which leaseholders can increase their percentage of ownership by purchasing some/all of the Council's share

2.6 If property prices increased annually in line with the average increase of the previous 10 years (3.5%) and with RPI at 2% annually, there would be a net surplus in year 6 of £289,000. This would rise to £1,872,000 in year 20 versus £388,000 with no capital appreciation. It should be noted however that there is no guarantee house prices will increase in value and that there may be years where asset prices fall in value.

2.7 The graph below illustrates the impact each year if all homeowners staircase and compares 0% capital appreciation, 1% capital appreciation, and 3.5% capital appreciation. Further details including assumptions are provided in Appendix A.

Graph 1: Forecast net cumulative return including capital appreciation



2.8 Leaseholders on the scheme are likely to need to obtain a mortgage for their share of the property, and will pay rent to the Council on the remaining share. As reported in CAB2932, the Council initially intended to increase rent annually by RPI only. However, normal practice within shared ownership is to increase annual rent by RPI + a range of 0.5% up to a maximum of 2%. Current shared ownership schemes within the City Council include a rent increase of RPI + 0.5%. With this in mind it is proposed that the PHP scheme is amended in line with this, and annual rent is increased by RPI + 0.5%; this ensures consistency across the Council and provides some mitigation against SDLT losses were owners to staircase early.

2.9 As reported in both CAB2861 and CAB2932, it was originally intended that staircasing and sale of properties was to be at the higher of original purchase price or current market value. Based on advice received from external financial and legal advisers, it is now proposed that staircasing and sale is at current market value only. The reasons for this change are detailed in paragraphs 11.8 to 11.12. The change also incorporates situations where leaseholders staircase to less than 100% ownership. This exposes the Council to additional financial risk, as in the event of a falling market, the

Council could realise a financial loss. For example, if values fell by 10% and a homebuyer increased their share in a property that originally cost £400,000 from 50% to 75%, the Council would incur a £10,000 capital loss. This would, however, be reliant upon the homebuyer having sufficient access to funds.

3 LEGAL AND PROCUREMENT IMPLICATIONS

3.1 As reported in CAB2932, the Council is liable for the payment of Stamp Duty Land Tax (SDLT) on the initial purchase price of each property, and, being a non-residential buyer, will also incur the additional 3% SDLT surcharge. Having sought legal advice, it has been established that there are no exemptions from either of these charges for local authorities.

3.2 It was previously reported in CAB2932 that the Council planned to recharge its SDLT costs to the scheme's leaseholders either pro-rata when staircasing or on the sale of the property. Council officers alongside external advisers have considered ways to secure the recovery of the SDLT charges incurred, to mitigate the financial loss to the Council, whilst still ensuring that the scheme's model remains viable.

3.3 Two main options for the recovery of SDLT were identified, namely recovery through a penalty charge on the lease or a second charge on the property. The Council has received both external legal and financial advice that a second charge would not be viable as it does not comply with mortgage lenders' conditions, and thus they would be unwilling to finance the scheme.

3.4 In light of the external legal and financial advice received, to take the scheme forward it is proposed that the Council includes a penalty charge covenant in the lease which requires leaseholders who wish to staircase or sell the property within 5 years of purchase to repay (either proportionately or in full) the SDLT that the Council has incurred. This amount of time is proposed based on advice received from financial advisors, Arlingclose, that mortgage lenders will not accept a penalty charge of longer than 5 years. A recharge of the SDLT incurred by the Council would not therefore be secured in perpetuity as originally envisioned.

3.5 Adopting a five year penalty charge has implications, as the Council will not be able to secure the recovery of the SDLT it has incurred after the 5 years has passed. The Council risks incurring a net overall loss if a leaseholder sells the property after the penalty charge has ceased and before rental income and/or capital appreciation has offset SDLT costs.

4 WORKFORCE IMPLICATIONS

4.1 For the duration of the pilot, legal work in purchasing the property including the granting of the shared ownership lease will be outsourced to external solicitors Penningtons but will also require some limited input from legal.

4.2 The Housing Business Services and Rents team will be required to administer the monthly rental collections from households.

4.3 The New Homes Team will administer the pilot scheme once it has launched. There will be additional work involved in assessing applications, dealing with enquiries and ensuring a smooth process from start to completion.

4.4 The pilot will enable the Council to ascertain the administrative burden of the scheme and assess how administration is best carried out if the scheme is to expand in the future.

5 PROPERTY AND ASSET IMPLICATIONS

5.1 A RICS HomeBuyer report will be produced in joint names between the Council and the leaseholder of the prospective property. The leaseholder will be required to fund the full cost of the survey. The Council will use this survey to satisfy its own requirements.

5.2 The properties in the scheme may appreciate or depreciate in value. The leaseholder is responsible for the maintenance and repair of the property, and the Council will reserve the right to conduct inspections.

5.3 The Council will recharge the cost of buildings insurance to leaseholders on the scheme.

6 CONSULTATION AND COMMUNICATION

6.1 Financial advisers Arlingclose have liaised with mortgage providers that have committed to providing lending to those who take part in the scheme.

6.2 The Council’s legal and financial advisers in relation to PHP support the decisions requiring approval in this report.

7 ENVIRONMENTAL CONSIDERATIONS

7.1 PHP involves properties that are already built so there is no guarantee of them being energy efficient or having environmental credentials.

8 EQUALITY IMPACT ASSESSMENT

8.1 None required - The scheme is available to all subject to financial thresholds and criteria

9 RISK MANAGEMENT

Risk	**Mitigation**	**Opportunities**
Property *Property depreciates in value*	 Council will have the right to purchase the property if it is proposed to be sold under the original	 The Council shares in any capital appreciation through the scheme

	purchase price or market value and the Council consents to this.	
Suitability – i.e. property needs to be in a reasonable state of repair	RICS HomeBuyer report to be produced in joint names. This will satisfy the Council's requirements.	
Maintenance/risk that property is not adequately maintained	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. The Council will purchase building insurance and pass this cost onto the purchaser.	
Community Support *Lack of uptake for the scheme*	 Pilot will inform this and the any reasons as to why there was lack of uptake.	
Demand exceeds the supply of Council funding for the scheme	Points system to score applicants. Increase funding to the scheme if it is successful and financial risk is mitigated.	
Timescales *Lack of mortgage providers on the market*	 There are a number of providers that have expressed interest/are committed to financing the scheme.	 Opportunity to attract other providers if the pilot stage of the scheme is successful.
Project capacity *Resource implications*	 Pilot the scheme with ten applicants to assess resource implications on	

	the Council.	
Financial / VfM *Housing market drops - 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.*	 The Council has the opportunity to purchase properties and make alternative use of them/dispose of them when the market has recovered through a housing company. This would not however be the case were the leaseholder to staircase and increase their share of the property.	 If house prices rise the Council is likely to make financial gains
Tenant does not pay rent	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	
Stamp Duty Land Tax – leaseholder will only be required to repay the Council's SDLT if they staircase or sell within 5 years of purchase		If property prices rise, SDLT could be recovered through capital appreciation
Tenant defaults on the mortgage and lender enforces its loan with any shortfall being payable by the Council	The Council would have the option to purchase the property (at a potential loss) and then manage this itself	
Leaseholders are able to staircase at current market value, which subjects the Council to financial risk in the event of a falling market	Scenario planning indicates this is unlikely for all purchasers in the pilot alongside a five year falling market. Housing company purchase option	

	would seek to recoup any loss through on-going rent	
Legal *Legality of the scheme* *State-aid – lending funds at sub-market rates*	 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. 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.	
Innovation *There are risks of the 'unknown' as WCC will be one of the first Councils in the country to undertake this type of scheme*	 Legal and accounting frameworks have been prepared by WCC Officers/ independent advisers	
Reputation	Additional complexity through SDLT repayment and risk of administration delays mitigated through testing of application processes.	Potential enhancement through supporting investment in local area
Other *Defaults on rental repayments to the Council and mortgage payments*	 Households financially assessed independently before undertaking a mortgage. Households would require a market mortgage for 50-	

	70% of the house price and so would need to pass lenders' borrowing limits	

10 SUPPORTING INFORMATION:

10.1 **Background**

10.2 In December 2016 Cabinet approved the concept of creating an Open Market Shared Ownership Scheme for the Winchester District. Cabinet specifically approved:

- The scheme will initially be piloted with ten households
- For officers to liaise with the relevant scheme stakeholders/providers.
- The criteria for applications and principles of the scheme
- £4.5m could be invested into the scheme subject to review of the pilot

10.3 **Updates to the scheme since the last report CAB2932**

10.4 In June 2017 a report (CAB2932) provided an update on the progress of the scheme and was brought back to Cabinet. Since this last report there have been a number of changes to the scheme.

10.5 The scheme was formerly called OMSO (Open Market Shared Ownership), but in consultation with the Portfolio Holder for Finance it has since changed to Partnered Home Purchase (PHP).

10.6 The workings of the scheme have been considered further. It has been decided that for the duration of the pilot scheme the legal work, relating to each property purchased will the simultaneous grant of a shared ownership lease, will be outsourced to external solicitors Penningtons.

10.7 The Council requires a survey to be undertaken on each property to ensure that the proposed purchase is a suitable investment for the Council to make. Officers have investigated the use of a RICS HomeBuyer Report, which can be produced in joint names between the Council and the prospective purchaser. This level of report will serve to satisfy the Council's requirements. The PHP leaseholder will be required to fund the full cost of the survey.

10.8 Once Leaseholders have bought the initial share of their home, they are able to obtain further shares by staircasing. The minimum share they are required to buy upon staircasing is an additional 10% of the property. Shares can be purchased outright or as a further advance on the mortgage. Leaseholders are able to staircase until they reach 100% ownership, and at this point they will acquire the freehold of the property and cease to pay any further rent to the Council. As highlighted in paragraph 10.16, it is proposed that leaseholders are able to staircase based on current market value.

10.9 **Fundamental changes to the scheme**

10.10 As well as the changes highlighted above, since CAB2932 there have been some key changes to the model of the scheme.

10.11 **i) SDLT recovery**

10.12 As detailed in paragraphs two and three, the Council is subject to additional risk as a result of changes to the way that SDLT is recovered. Originally it was envisaged that the Council would recover all the SDLT charges that it incurs on completion of the purchase of each property.

10.13 This however is no longer viable as to achieve such recovery the Council would have to place a second charge on the properties within the scheme. Financial advisers Arlingclose have advised that mortgage lenders will not accept a second charge as it does not comply with their conditions.

10.14 On this basis, it is proposed that a penalty charge running for a period of five years is adopted. This will require leaseholders staircasing or selling the property within 5 years of purchase to repay the SDLT (either a proportion or in full) that the Council has incurred. This subjects the Council to additional risk as it will have less protection in respect of recovering the SDLT that it has incurred. If a leaseholder decides to sell or staircase after the five year penalty charge has ceased, the Council is at risk of not being able to recover all the SDLT it has incurred.

10.15 **ii) Staircasing and sale of properties**

10.16 As reported in CAB2861 and CAB2932, it was originally intended that leaseholders who wish to staircase or sell their property would be required to do so at the higher of original purchase price or current market value. It is now proposed that leaseholders are able to sell or staircase at current market value only.

10.17 This change exposes the Council to additional financial risk in the event of a falling property market. This risk would however be mitigated in a circumstance where a leaseholder wishes to sell , as the Council would be able to exercise a right of pre-emption and purchase the leaseholder’s share itself.

10.18 **iii) Annual rent increases**

10.19 As detailed in paragraph 2.7, it is proposed that annual rent in the scheme is uplifted by RPI + 0.5%, as opposed to RPI only. This change brings the PHP scheme into line with other City Council shared ownership schemes, ensuring consistency. The change also provides some mitigation against SDLT losses in scenarios where leaseholders staircase or sell the property before the ‘breakeven’ period.

11 <u>OTHER OPTIONS CONSIDERED AND REJECTED</u>

11.1 **SDLT recovery**

11.2 Two options for the recovery of the SDLT that the Council will incur were considered. The preference is to adopt a 5 year penalty charge, as opposed to a second charge that would run for an indefinite amount of time.

11.3 The option of imposing a second charge was rejected based on advice received from financial advisers Arlingclose. Arlingclose advised that mortgage lenders would not accept a second charge as it does not comply with their lending conditions. If this option was chosen the scheme would no longer be feasible given that mortgage lenders would be unlikely to finance mortgages under the scheme. In order to take the scheme forward it is therefore proposed to adopt a penalty charge running for a period of 5 years.

11.4 Penalty charges running for a period longer than 5 years were also considered. These were deemed to be unsuitable based on advice received from Arlingclose, that mortgage lenders will not accept penalty charges running for longer than 5 years.

11.5 **Annual rent increases**

11.6 The Council intends to increase annual rent on properties by RPI + 0.5%. Other options were also considered in respect of this. It was originally intended to increase rent annually by RPI only. However, this is not normal practice within other shared ownership schemes. Increasing rent by RPI + 0.5% also provides some mitigation against any SDLT losses as a result of leaseholders staircasing early. The option of increasing annual rent by RPI only was therefore rejected.

11.7 Increasing annual rent in excess of RPI + 0.5% was also considered. In other shared ownership schemes rent increases generally range from RPI + 0.5% up to a maximum of 2%. This option was rejected to ensure consistency with current City Council shared ownership schemes that include annual rent increases of RPI + 0.5%.

11.8 **Staircasing and sale of properties**

11.9 It is proposed that the Council allows PHP leaseholders to sell or staircase at current market value only.

11.10 The other option considered was to require leaseholders who wish to sell or staircase to do so at the higher of current market value or original purchase price. This would protect the Council from financial loss in the event of a falling property market.

11.11 This option was however rejected, based on advice received from external legal and financial advisers. The Council was advised that requiring leaseholders to sell or staircase at the higher of original purchase price or current market value would involve a fundamental change to the standard shared ownership lease which mortgage lenders are familiar with. Making a fundamental change to the standard model lease is problematic for mortgage lenders, and will therefore impact their willingness to provide mortgages under the scheme.

11.12 Requiring leaseholders who wish to sell or staircase in a falling market at higher than market value, to protect the Council's initial outlay, could also subject the Council to reputational risk, as this could prevent the leaseholder from being able to sell or staircase due to financial constraints.

11.13 **Conclusion**

11.14 If Cabinet accepts the recommendations made in the report the scheme will move forward with an aim to launch in early 2018.

BACKGROUND DOCUMENTS:-

Previous Committee Reports:-

CAB2861 – Proposed Creation of an Open Market Shared Ownership Scheme for Winchester District – 7 December 2016

CAB2932 – Update on the progress of the Open Market Shared Ownership (OMSO) Scheme – 14 June 2017

Other Background Documents:-

APPENDICES:

Appendix A – Financial Forecasts.

Partnered Home Purchase Scheme - Financial forecasts and assumptions

An illustration is provided below detailing the impact of imposing a deferred charge for 3 years versus full recovery of Stamp Duty and Land Tax (SDLT) incurred by the Council.

The impact of capital appreciation at 1% per annum and 3.5% per annum (the average annual change in Winchester district between 2007 and 2017) is also illustrated. It should be noted that additional capital receipts may only be used for capital purposes though this in itself can have future revenue benefits by reducing the amount the Council needs to borrow for major projects.

For ease of presentation and comparability, it is assumed that all householders staircase fully at once.

The assumptions below are subject to variation and so actual returns will differ. For example, if annual inflation were 3% the total return at year 20 in the deferred charge model would increase by £156,000 and would decrease by £138,000 if annual inflation were only 1%.

It is also important to note that in the event house prices fall and a purchaser chooses to staircase, the Council risks making a capital loss. For example, if values fell by 10% and a homebuyer increased their share in a property that originally cost £400,000 from 50% to 75%, the Council would incur a £10,000 capital loss. This would, however, be reliant upon the homebuyer having sufficient access to funds.

Assumptions

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

Total cost to WCC:	*£1,643,000*
Total applicant share:	*£1,500,000*

PWLB (variable):	2.70%	*25 yr certainty rate (maturity) as at 05/12/2017*
Premium:	1.00%	
Initial Rent (PWLB + 1.0%):	3.70%	
Inflation:	2.00%	*Rent increased by RPI annually - assumed 2%*
Addition to annual rent:	0.50%	
Annual rent increase:	2.50%	*Inflation plus 0.5%*

All values are at today's prices

The following table demonstrates the impact at each year if all homebuyers were to staircase to 100% in that year and assumes there will no capital appreciation.

	SDLT costs not refunded after deferred charge period of 5 year; rent increased by RPI+0.5%		***Original assumptions - SDLT repaid in full on pro-rata on staircasing; rent increased by RPI only***	
Capital appreciation PA:	**0.00%**		**0.00%**	
Staircase year	**Total cumulative return**	**Annualised rate of return**	**Total cumulative return**	**Annualised rate of return**
Year 4	£53,020.62	0.80%	£51,305.24	0.77%
Year 5	£69,921.23	0.84%	£67,019.23	0.80%
Year 6	-£54,646.61	-0.56%	£83,934.71	0.83%
Year 7	-£34,644.63	-0.30%	£102,075.73	0.86%
Year 8	-£13,033.57	-0.10%	£121,466.78	0.90%
Year 9	£10,226.79	0.07%	£142,132.88	0.93%
Year 10	£35,177.69	0.21%	£164,099.52	0.96%
Year 20	£387,508.50	1.06%	£461,284.02	1.24%

BREAKEVEN YEAR:	**9**	n/a

This graph illustrates the impact of capital appreciation on the overall net return were all homebuyers to staircase to 100% in any one year.