CAB2861

REPORT TITLE: PROPOSED CREATION OF AN OPEN MARKET SHARED OWNERSHIP SCHEME FOR WINCHESTER DISTRICT

CABINET

7 DECEMBER 2016

PORTFOLIO HOLDER: CLLR STEPHEN GODFREY (PORTFOLIO HOLDER FOR FINANCE AND CORPORATE POLICY)

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WARD(S): ALL

PURPOSE

To generate financial and non-financial benefits to the residents of the District through creating an Open Market Shared Ownership (OMSO) scheme for the District.

To set aside significant capital funds to allow the Council to invest in purchasing part of properties across the District to diversify the Council’s investment portfolio and to help enable residents to buy their own properties within the District.

To investigate the opportunities this scheme could also have in respect of other housing policy areas.

RECOMMENDATIONS:

That Cabinet:-

i) Approves the concept of the Open Market Shared Ownership Scheme and to pilot this with ten households to begin with to assess demand and the key criteria as well as the financial return to the Council;

ii) Approves the criteria for applications and principles of the Scheme contained in Appendix A of the Report;

iii) Approves for officers to further liaise with relevant mortgage brokers and internal Council department to deliver the scheme;

iv) Recommends to full Council the sum of £4.5m to be included within the Capital Strategy (£1m in 2017-18 and £3.5m in 2018-19).

IMPLICATIONS:

1 COMMUNITY STRATEGY OUTCOME (Detail how this report delivers a Community Strategy outcome(s))

1.1 This Scheme would support the effective and efficient theme through providing a good return on the Council's investment to support wider services.

1.2 There is a link with the wider housing strategy and the link with housing policies around considering a housing company(ies) and other innovative solutions in this policy area.

2 FINANCIAL IMPLICATIONS (to be reviewed by s151 officer)

2.1 The Scheme would require a significant amount of capital investment, though the interest cost of this capital would be being repaid and the Council would have ownership of an asset, though no control over the realisation of the financial element within the asset (unless it wishes to stipulate so). The level of investment would be dictated by Members' appetite for the utilisation of the Scheme. It is suggested that at least 50 households should be included within the Scheme (with restricting the first tranche of funding to 10 households as a pilot scheme) to ensure economies of scale and to deliver enough financial return. This would equate to approximately £4.5m of capital investment.

2.2 Given the ongoing low levels of interest rates and subdued investment returns, this proposal would help diversify the risk the Council holds through its investment portfolio as well as generating returns of circa 3.5-4% rather than the present average rate of return of 0.8**%**. If 50 households were invested in, the annual return would be between £83k and £184k net (see Appendix B).

2.3 There is a risk of capital depreciation, though as this would be a long term investment, it is more likely than not that over a five to ten year period house prices would increase.

2.4 The Council would cover its costs of setup through the commercial borrowing rate and through potential charging for specific work e.g. surveys, legal administration. The household purchasing the property would also be required to pay for the Stamp Duty costs associated with the transaction.

2.5 The cost of the initial documentation and associated legal and accounting framework is estimated to be £3k.

2.6 The Council is finalising the cheme finances in respect of whether Minimum Revenue Provision (MRP) is required to be made as part of the capital financing of this Scheme. The option in the financial analysis include the Scheme with, and without, MRP contributions.

3 LEGAL AND PROCUREMENT IMPLICATIONS (to be reviewed by Monitoring officer)

3.1 The scheme is based upon the HCA (Homes & Communities Agency) leasing scheme which has been in existence for a number of years and has been used for shared ownership schemes like this with housing associations. The Council's Legal Services team would need to review this in detail and ensure that they are comfortable with the legality of the scheme and its working. This Scheme would utilise the powers contained in section 12 of the Local Government Act 2003, and Section 1 of the Localism Act 2011.

3.2 Considerations around State Aid need to be considered. State Aid which is not authorised is unlawful and must be repaid. State Aid only applies where an advantage is given to an "undertaking", but owner-occupiers (who will be the principle recipients of any assistance under the Scheme) will not be "undertakings" so any assistance to the owner-occupiers would not be state aid. To secure this, the Scheme would only be available to fund one property per applicant, and furthermore the proposal would be to charge the cost of borrowing plus an appropriate margin to minimise any State Aid risk.

3.3 Another possible State Aid issue is whether the lenders (who provide the mortgage to the owner-occupiers allowing them to purchase their share) are benefitting from State Aid due to the Council's involvement. Lenders will be "undertakings" for State Aid purposes. The Council is unlikely to agree to the sale of the property if a loss will follow, and provided the scheme is open to all mortgage providers, any benefit which might be forthcoming will be available to all providers, thus minimising any risk of unlawful State Aid.

3.4 On an on-going basis there is a potential new revenue stream, and associated costs, for Legal Services by recovering the Council's legal costs from purchasers and the service completing the work for the respective purchases.

3.5 The procurement of access to the OSMO scheme is through either Capita or ArlingClose (the only two organisations known to provide this scheme). The Council already has a relationship with ArlingClose as the Council's advisors and as this is below £10k it is proposed to go via the ArlingClose scheme to ensure that fits well with the overall Treasury Management Strategy.

3.6 The Council will also ensure all applications comply with counter-fraud requirements through the application process, and these processes will be determined before the launch of the scheme.

4 WORKFORCE IMPLICATIONS

4.1 There could be additional work for Legal Services to complete the respective contractual documentation with households. There will also be additional work for the housing business services and rents team to administer the monthly rental amounts collected from households. It is expected that this additional administration can be contained within existing budgets at the commencement of the Scheme but additional resources, depending on the scale of the Scheme, will be funded through the associated charges to applicants to the Scheme.

4.2 Any overall resourcing costs of this Scheme will be self-funded by the income returned through the scheme via charges and income to the households purchasing through this Scheme.

4.3 The initial pilot of ten households will clarify the administrative burden of providing this Scheme and allow a more accurate basis for any additional resources required to support the Scheme.

5 PROPERTY AND ASSET IMPLICATIONS

5.1 The Council will have a significant financial stake in assets across the District as a result of this Scheme. As highlighted above, there are some resource implications for the Housing Business Services and Rents Team.

5.2 Each household will be required to fund the cost of the full survey of the property in line with the Council's requirements to establish value for money through the property purchase.

6 CONSULTATION AND EQUALITY IMPACT ASSESSMENT

6.1 The Portfolio Holder has been consulted and fully supports the proposed scheme.

7 RISK MANAGEMENT

For those risks shaded grey below, please ensure compliance with the Council's risk appetite http://sharepoint/Intranet/HRHub/InsuranceRisk/Shared%20Documents/Risk%20Appetite%20Statement.pdf for further information)

Risk (Detail specific risk under these headings)	**Mitigation**	**Opportunities**
Property – maintenance	*Would be the responsibility of the homeowner in the contract.* *The Council would expect the right to inspection of the property to ensure that it is adequately maintained.*	
Community Support – lack	*Publicity and*	*Consider option of moving*

Risk (Detail specific risk under these headings)	**Mitigation**	**Opportunities**
of uptake for the scheme *Demand exceeds the supply of Council funding for the scheme*	*communications of the scheme to residents* *Points system to rationalise the number of applications for the Scheme.* *Ability to increase funding to the Scheme if it is considered successful and the financial risk is mitigated*	*to a 50:50% ratio to increase affordability and investment income to the Council*
Timescales – lack of mortgage providers in the market	*Depends upon the current mortgage climate; showing some signs of improvement and currently there are providers of finance to this Scheme*	
Project capacity	*Commence Scheme with a pilot of ten to assess the resource implications on the Council*	*n/a*
*Financial / VfM – housing market drop. 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.*	*As the Council would technically be purchasing the whole property, the Council would have the opportunity to buy the house from the mortgage company and utilise it amongst other assets / potential housing company*	*Ability to financially gain if the housing market rises and put more funding into this scheme or other Council projects to decrease taxpayer funding*
Financial – 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*	
Legal – legality of the scheme	*Documentation based on existing Homes & Communities Agency*	

Risk (Detail specific risk under these headings)	**Mitigation**	**Opportunities**
State aid – lending funds at sub-market rates	*documentation* *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 - WCC would be one of the first Councils in the country to undertake this type of scheme and risk of 'unknown consequences' of the policy	*Formal documentation with independent provider detailing legal and accounting frameworks*	*Opportunity for Council's profile / reputation to be enhanced through providing a new scheme*
Reputation – defaults on the mortgage / Council rental repayments	*Formal contracts put in place with households to allow for recovery of funds.* *Households financially assessed independently before undertaking a mortgage.* *Households would require a market mortgage for 63% of the house price and so would need to pass lenders borrowing limits*	
Other		

8. SUPPORTING INFORMATION:

Background

8.1 The Open Market Shared Ownership scheme (OSMO) is a new scheme offered to local authorities where Councils can own a share of a private property with a household purchasing the rest of the property. This split is down to local determination but a 70:30 (purchaser / Council) split would be the broad expectation.

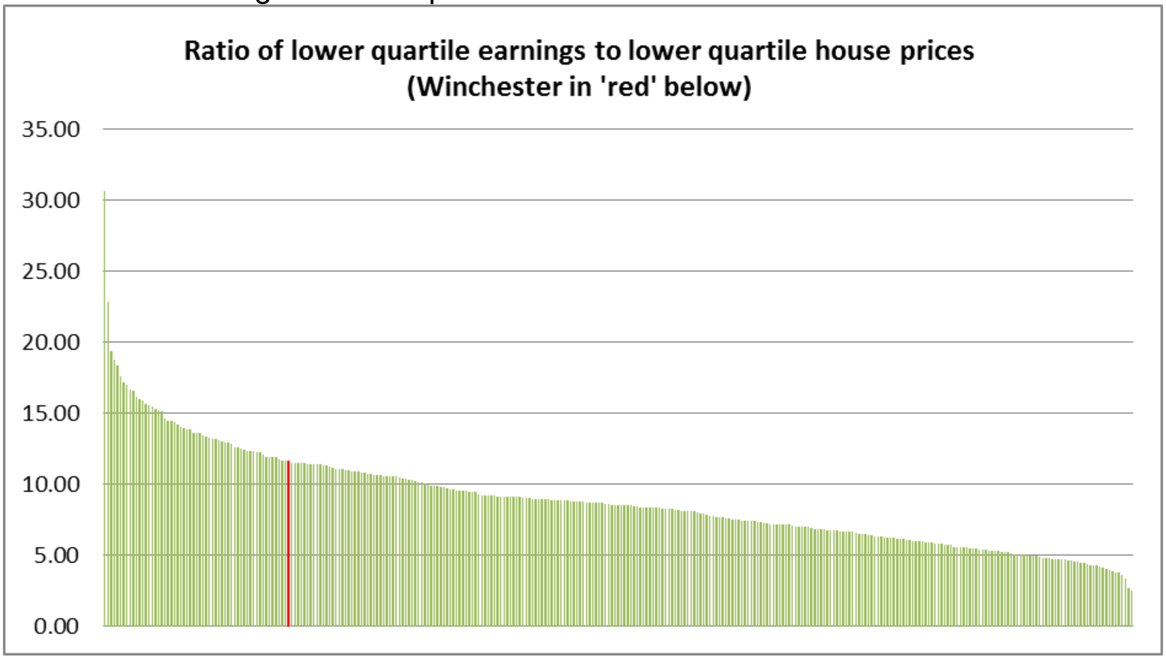
8.2 The Council currently has approximately £60m of investments placed in various financial institutions. As per the Efficiency Plan, the Council is seeking to maximise its income, and this Scheme would provide assistance for the Council to achieve this objective. Through its existing investments the Council already has deposits in building societies, these deposits are backed by the assets (houses) held by those individuals to whom the Building Society have provided loans. At present, overall, the Council receives a return of less than 0.8% on its investment returns. This Scheme would have a return on the interest element of the potential deposits of over 3.5% - 4% which would far surpass current returns. Recent increases in the past weeks on PWLB borrowing rates would put pressure on this Scheme if rental and mortgage rates did not rise accordingly in the future. There is certainly additional risk by undertaking this Scheme. The Council will be exposed to the wider housing market conditions, though this would be a long term investment for the Council with an aim to provide rental yield rather than any short term capital appreciation. Clearly any uplift in house prices would benefit the Council's financial position through additional capital, though capital appreciation is not the prime driver for this scheme.

8.3 There are also some ancillary benefits to the scheme concerning the wider housing aims within the Council's overall Community Strategy. The District, like much of southern England, faces considerable pressure with the affordability of housing. Locally there has been in a significant increase in the number of properties that are privately rented in Winchester, from 14.1% to 21.5%[1].

8.4 The Government has launched a help to buy scheme and are also setting up starter homes. However, these are not appropriate for every homebuyer. First time buyers are finding it increasingly difficult to access the housing market. The Resolution Foundation states that house prices have risen five times faster than wages in the past five years[2] and the Nationwide 'first time buyers gross house price to earnings ratio' for the outer South East has shown the ratio rise from 4.8 to 6.1 in the past three years[3]. The Government's statistics on affordability expressed as the lower quartile ratio of income to prices shows Winchester's ratio as 11.70[4] (see below).

[1] Private sector house condition survey 2014 p28
[2] Preliminary findings from the LGA Housing Commission, July 2016
[3] http://www.nationwide.co.uk/about/house-price-index/download-data#xtab:affordability-benchmarks
[4] https://www.gov.uk/government/statistical-data-sets/live-tables-on-housing-market-and-house-prices

Chart 1.1: Earnings to house price levels



8.5 Research from the Council's housing service is showing that household incomes of around £64k are needed to afford a lower quartile or Starter Home. Average resident earning for workers are around £31k, lower quartile amounts are £14k. Research from the Resolution Foundation has shown the significant decrease in home ownership across the country[5] and the DCLG's home survey report for 2014-15[6] has shown that those first time buyers requiring help from family and friends, or through inheritance has risen from 24% to 37% in the past ten years.

[5] http://www.resolutionfoundation.org/media/blog/home-ownership-struggle-reaches-coronation-street/
[6] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/539256/First_Time_Buyers_and_Potential_Home_Owners_Report.pdf

Chart 1.2: Resolution Foundation summary of home ownership

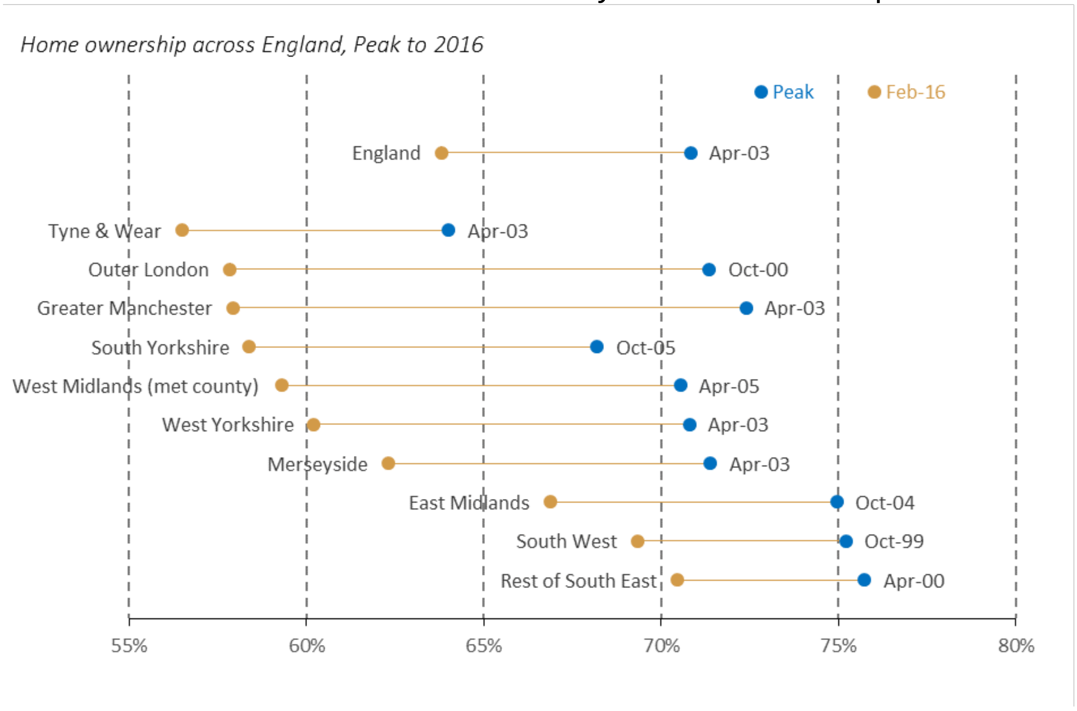
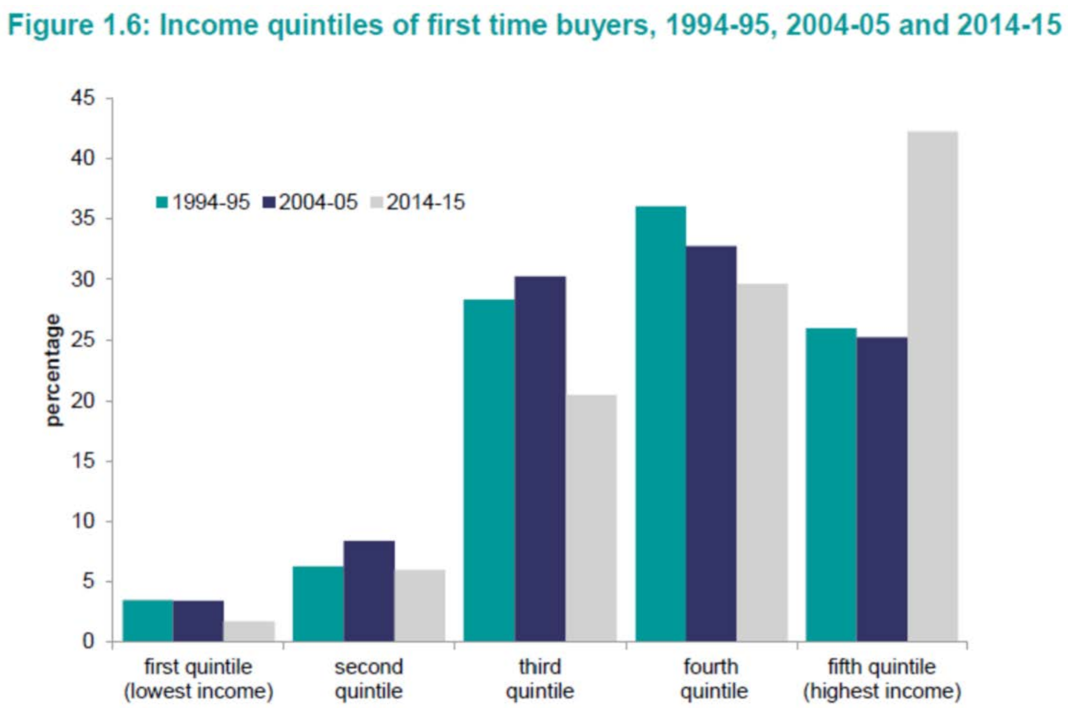


Chart 1.3: Income quintiles of first time buyers



8.6 Allied to some local residents having difficulties in entering the housing market, the Council also needs to ensure that it can offer an attractive package of benefits to attract staff to work at WCC (and may wish to expand this in wider public services that support the district as a whole). Utilising the OSMO scheme could assist in retention and attraction of key staff within the public sector.

How the scheme could work

8.7 The OSMO scheme works through the Council owning the whole property with the purchaser having a charge of up to 70% of the property. The purchaser would be able to buy any property in the District up to a maximum value set out by the Council. The purchaser would likely to be required to provide a 10% deposit, with a mortgage on 90% of their share (so a deposit of 7% of the house value and a mortgage for 63%). The Council would effectively own the remaining 30% of the property and it is proposed would charge a rent to the purchaser on this element to cover the costs of borrowing.

8.8 The Council would need to consider how it would select individuals to be eligible for the scheme. There are a variety of criteria to consider and these can be weighted accordingly. However, utilising the Community Strategy would suggest some of the following to be key criteria:

- Local residents
- Assisting first time buyers
- Those households who work in the district
- Reduce pressure on the housing allocations list

8.9 The Council would also need to ensure that the application was valid with some outside checking of the application. The Council would also need to ensure that the applicant can afford a mortgage and it would be most appropriate to go outside to an independent advisor for this work as this is not a skill available in-house and it could be obtained at nil cost to WCC.

8.10 The Council would also need to consider how much funding, which would be capital, which it wishes to apply to this scheme. A 30% share of a £300k property would be £90k. For the scheme to address a reasonable number of households, there would need to be a least 50 properties involved i.e. £4.5m of investment.

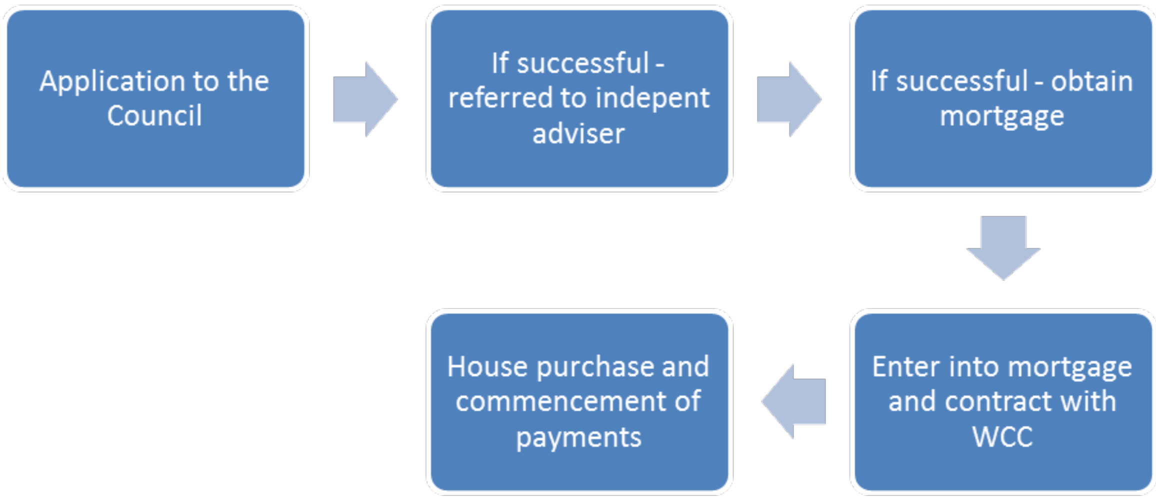
8.11 The Council would also need to agree an upper limit on the property price. It is suggested that this would be £450,000, so as to be of most policy benefit to those on the lower to middle spectrum of the property market within the District. It is also proposed to only make this Scheme available to those households where the property they are purchasing is their only property, to avoid potential issues with state aid.

8.12 The homeowners would have the opportunity to ‘staircase’ their element of the property up and so repay the Council’s element at any point. This would then realise monies back to the Council to pay off debt, funding the capital programme or re-invest in the OSMO scheme.

8.13 The Council would also be exposed to the market forces and so have the opportunity for capital appreciation on their element of the property, but also capital depreciation and so loss if the homeowner wished to sell at a lower price than they bought the property for. The Council would however be in a strong position to buy the property itself first for a variety of purposes.

8.14 The Council would also have the opportunity to charge rent on the 30% share. The Council would seek to get at least its borrowing costs with an appropriate margin to mitigate any State Aid lending issues. On a property worth £350k, this would mean the household paying approximately £850-950 pcm in mortgage payments (depending on the mortgage obtained) with payment on the Council rent (at PWLB interest only rate plus 1.5%) element of approximately £320. This would equate a total cost to the household of around the £1,220pcm level. Rental prices on properties around the £350k mark in the district are approximately £1200 - £1300. Therefore the household would not have any significant financial benefit on a monthly basis but would have a share of their own property.

Chart 1.4: Potential Flowchart



Financial examples

8.15 Assuming that the Council assisted with 50 properties (20 at £250k, 20 at £350k and 10 at £450k), the ongoing gross return on rental income would £212k p.a. There would be borrowing costs or the loss of internal investment returns that would reduce this figure by between £28k and £129k. This would mean that there would be a net yield between £83k and £184k each year. If the Council was required to put aside MRP each year, this would reduce the financial benefit to revenue by between £50-60k p.a. but would increase the capital receipt at the end of the transaction by the same amount.

8.16 Below are two potential scenarios for the schemes assuming that both meet the Council criteria in Appendix A and there is sufficient Council finance available:

1. Mr X wants to buy a one bedroom property in the city centre valued at approx. £215k.

   With a £15k deposit he can acquire a mortgage costing him £650 per month. Additionally he would pay rent of £220 per month to the Council for its 30% share in the property. This total monthly cost of £870 compares to an average cost of £900 to rent this type of property.

2. Mrs Y wants to buy a two bedroom property in a village just outside the city of Winchester, it is valued at approx. £315k.

   With a £22k deposit she can obtain a mortgage costing £940 per month. She would also pay £325 monthly rent to the Council for its 30% share of the property. The total cost of £1,265 is less than the average rent of £1,350 for am equivalent property.

8 Conclusion

8.1 Members are recommended to support the creation of this OSMO scheme and the criteria for applications in Appendix A.

9 OTHER OPTIONS CONSIDERED AND REJECTED

1) Longer term treasury management investments

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:-

None

Other Background Documents:-

http://www.winchester.gov.uk/housing/private-housing-empty-properties/private-sector-house-condition-survey/

Preliminary findings from the LGA Housing Commission, July 2016

http://www.nationwide.co.uk/about/house-price-index/download-data#xtab:affordability-benchmarks

https://www.gov.uk/government/statistical-data-sets/live-tables-on-housing-market-and-house-prices

http://www.resolutionfoundation.org/media/blog/home-ownership-struggle-reaches-coronation-street/

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/539256/First_Time_Buyers_and_Potential_Home_Owners_Report.pdf

APPENDICES:

Appendix A: Draft criteria for applications

Appendix B: Summary financial implications

Appendix A: Application criteria

A points based system to assist the Council in delivering its objectives within the Community Strategy and applies to at least one of the applicants.

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 (n.b. subject to definition by the City Council)	2
First time buyer	2

The key principles of the scheme would be:

- Only available on properties under £450,000
- The property must be the only property owned by the applicant(s)
- That this cannot be used to purchase properties under Right to Buy
- That the household would be required to provide 70% of the property funds and the Council 30% with an option to a 50% - 50% ratio as part of the scheme design

Appendix B – Comparison of net income from the Scheme with and without MRP contributions

Comparison (in both cases assumes sale at same value as purchase.

No MRP - assumes borrowing on maturity basis over 25 years and sale and reduction of CFR to zero at end of 25 years

	Yr 0	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10
Net revenue £000	28	86	146	82	87	91	95	100	105	109	114

MRP - annuity over 50 years; assumes borrowing on annuity basis over same period and sale and reduction of CFR to zero at end of 25 years

	Yr 0	Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7	Yr 8	Yr 9	Yr 10
Net revenue £000	25	59	93	26	29	33	37	41	46	50	54
Difference	(3)	(28)	(53)	(57)	(57)	(58)	(58)	(59)	(59)	(59)	(60)

		No MRP		**MRP**		**Difference**
		£000		**£000**		**£000**
TOTAL revenue over 25 years		3,396		1,882		(1,514)
Remaining Capital Receipt at 25 years				1,717		1,717
Total		**3,396**		**3,599**		**203**