Spotlight
Shared Ownership

April 2016

SUMMARY

The Government has allocated an unprecedented £4.1bn to the delivery of shared ownership, opening up new opportunities for development and investment

- Private developers, as well as housing associations, will be able to bid for the grant funding.

- For housebuilders, increasing scale and diversity will create new opportunities to maximise capital receipts from S106 obligations.

- The expansion of shared ownership will open up new opportunities to invest in the income stream from unsold equity shares.

- Demand for shared ownership is potentially substantial and is likely to be greatest where house prices are least affordable, albeit that it is difficult to deliver into the very highest value markets.

- Shared ownership will need to compete with other assisted home ownership programmes, including Starter Homes and Help to Buy. In order to differentiate it from the other options, the greatest demand is likely to be for low initial share sales.

- Expansion of delivery should increase interest from mortgage lenders, creating greater competition and bringing interest rates closer to those for full house purchase.

- Imperfect information and limited opportunities mean that the investment market in the unsold equity shares is currently immature.

- In order to maximise these opportunities, better information is needed on staircasing and delinquency rates so that the real value of the asset can be properly assessed.

- Better information would also help lenders increase their maximum gearing ratios against shared ownership assets, opening up greater financial capacity for housing associations to deploy in building more homes.

WHAT IS SHARED OWNERSHIP?

Shared ownership housing is available to households earning below set income caps: currently these are £90,000 in London and £80,000 for the rest of England.

The occupier of a shared ownership home buys a share of the house with a mortgage at a level they can afford, which may range of 25% to 75% of the full value of the property. This is known as the first tranche sale. The remaining unsold equity is typically held by a housing association and the occupier pays an inflation linked rent on this share, at an initial yield of up to 2.75%. There is the option for the occupier to increase the share of the home that they own, which is known as 'staircasing'.

Downward staircasing, where the landlord buys back additional equity from the occupier, is possible but only intended to be used where households are in financial difficulties and unable to sustain their level of ownership. This is rare and constitutes only in the region of 2% of all instances of staircasing, according to CCHPR 2012 research. It represents a unique option for a mortgage lender to mitigate losses in the event that an occupier can no longer afford loan repayments.

Legally, the occupier of a shared ownership property is a tenant and only becomes an owner when they have fully staircased out. The freehold or leasehold of a shared ownership home has usually been held and managed by a housing association, although all repairs and insurance are the responsibility of the occupier.

Introduction

Shared ownership is one of the Government's key policy interventions aimed at reversing the decline in home ownership. The Autumn Statement promised £4.1bn funding for 135,000 additional shared ownership units over the course of this parliament. At a rate of over £30,000 per home, this is the highest level of funding shared ownership has ever seen and represents a new opportunity for developers, housing associations and investors.

Shared Ownership schemes were first introduced in the 1980s and there are now approximately 175,000 households owned with shared ownership products in England, representing 0.8% of all housing. The proposed expansion aims to increase the number of homes by 77% over the course of this parliament. Starting in 2016, this will require delivery of approximately 35,000 additional shared ownership units each year until 2020, a quintupling of recent delivery rates.

Supply and demand

Past delivery of shared ownership has been supply constrained. The greatest concentrations of shared ownership stock are located in places where there has been a high level of housing delivery over the last 10 to 15 years, including Milton Keynes, South Cambridgeshire, Tower Hamlets and Southwark. This stock has been largely delivered through Section 106.

The indications are that this supply has fallen well short of demand. According to evidence given by the National Housing Federation to the Lyons Review, Housing Associations approve around 85,000 applications for shared ownership each year, but development averaged only 8,000 per annum over the three years to March 2015.

Market capacity

The reduced turnover in the housing market since the credit crunch, as a consequence of reduced mortgage availability and tighter regulation around affordability, has left many people unable to buy their own home. Across England and excluding Help to Buy, there were approximately 360,000 fewer transactions per annum in 2014 and 2015 compared to the five years leading up to 2007.

Over the last two years, shared ownership has delivered additional housing for nearly 3% of the demand not met by the unassisted for-sale market. Help to Buy has filled a further 8% of the gap. The extent to which the gap has been filled by shared ownership does vary widely across the country, reaching over 35% in markets as diverse as Tower Hamlets in London and Wychavon in Worcestershire.

A clear target for the expansion of shared ownership is to unlock this potential demand through a greater availability of home ownership at levels of affordability not currently seen in the market. To date, shared ownership has satisfied more of this potential demand in places where affordability is the biggest barrier to accessing home ownership. This includes Hackney, Horsham and Cambridge, where more than 30% of the gap has been filled.

In more affordable markets, the evidence of take-up is much lower: up to 15% in parts of Leicestershire and only 5% in parts of Nottinghamshire, Staffordshire and areas of the north. These reference points suggest that there is potential capacity to absorb at least 60,000 additional shared ownership units per annum in current market conditions.

Whilst there is some level of demand for shared ownership everywhere, demand for the greatest volume of new units is in markets where affordability is most stretched and demand is highest, as shown in the map. This is largely in the South of England, although it is difficult to make shared ownership affordable to people below the income caps

FIGURE 1

Shared ownership supply and staircasing volumes

Source: Savills using HCA SDR and TSA RSR with data before 2008-09 from 'Understanding the second-hand market for shared ownership properties' by Anna Clarke and Andrew Heywood, 2012, Cambridge Centre for Housing & Planning Research, University of Cambridge in many high value parts of London without selling very small initial shares and reducing the rent on the remainder below the standard 2.75%. This makes it difficult to deliver financially viable shared ownership homes in the very highest value markets.

Mortgages

One limiting factor for take-up of shared ownership may be mortgage availability for prospective purchasers. To date, lenders have had little reason to develop attractive products for this small, niche market.

As with all lending on new homes and particularly flats, most lenders are reluctant to lend at more than 75% loan to value. However, at or below this level, there is a small pool of lenders charging mortgage interest rates that are similar to those available for standard house purchase.

For higher loan to value products (85% to 90%), the few banks that will lend charge significantly higher interest rates, with margins reaching 4.5% over base rate, compared to only 2.6% for the average first-time buyer.

Who will build?

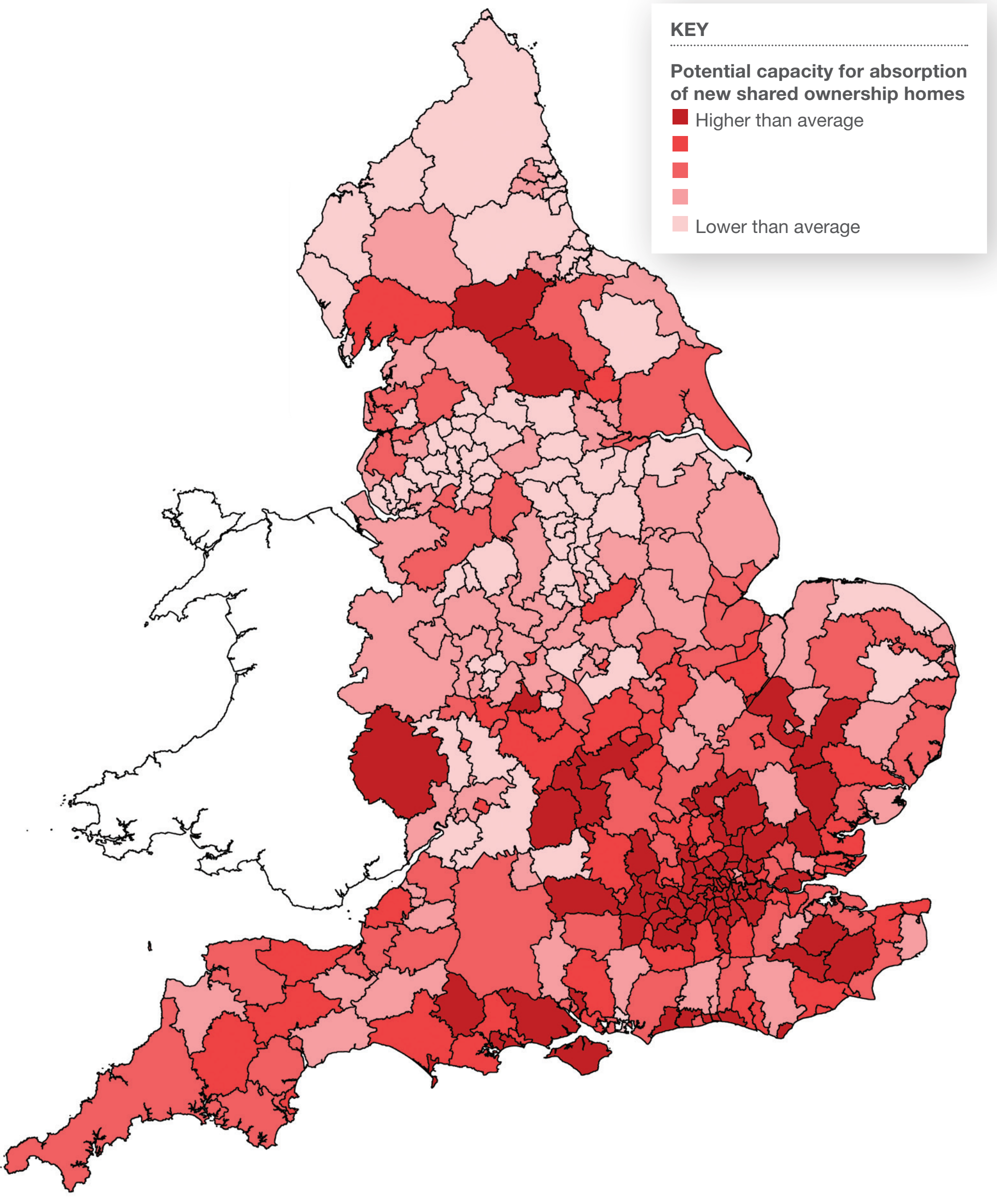
Shared Ownership will in the future effectively be the only tenure for which Homes and Communities Agency (HCA) grant funding will be available. Private developers will be able to apply for the grant, although the Office for Budget Responsibility has said that it expects housing associations to receive 90% of the available funding.

The diversity of subsidised home ownership products that will be available (Help to Buy, Starter Homes, shared ownership) means that there is a challenge for developers to differentiate the products from one another. Done badly, the target markets for each product could overlap, reducing the overall pool of buyers for the new homes being delivered across the whole site, slowing total delivery. This potentially creates an incentive for the developer of a large site to retain control of shared ownership sales to ensure that different products are effectively differentiated from one another.

If housebuilders and developers retain control of first tranche sales, they will both want to pass on the management responsibility and secure a capital return for the unsold equity.

FIGURE 2

There is demand for shared ownership across the country, but the volume of demand varies by location



Source: Savills using DCLG data

▼ Milton Keynes

Whilst housing associations are likely to remain best placed to take on management of new shared ownership units, the unsold equity will go to the highest bidder, which may be a housing association or a private sector investor.

Investment

The return from investment in shared ownership comes in two forms: rental income and capital repayments on staircasing. The standard rental income is set at a 2.75% yield on the unsold equity and is inflation linked. The initial yield is often reduced in an effort to make shared ownership affordable to households below the income caps in the highest value parts of the country. Whilst the initial yield is low, this is a net yield with no costs or voids to deduct.

The lack of data on staircasing and the absence of definitive information on delinquency (occupier default on rent or mortgage payments) means that investment decisions have to be made with an imperfect understanding of the performance of the asset. Anecdotal evidence of the experiences of housing associations in managing shared ownership stock suggest that delinquency rates are very low.

Whilst there is data from the HCA on 100% staircasing, there is no comprehensive data on partial staircasing. A survey of housing associations carried out by the Cambridge Centre for Housing and Planning Research (CCHPR) in 2012, found that only 14% of all instances of staircasing were partial (i.e. to less than 100%). This is likely to stem from the costs involved and administrative requirements, with staircasing tending to be 'back to back' with a house sale.

The fact the income from shared ownership has rarely been sold by housing associations is testament to the quality of the asset. The HCA Global Accounts for 2014 show the sector received income of £146m from staircasing activity and £775m from first tranche sales. Heylo Housing is one of the few private sector investors seeking opportunities to increase exposure to this asset class, but the growing opportunity as development volumes increase is likely to attract new entrants.

Finance

The lack of clarity around the performance of shared ownership as an asset class also hampers the extent to which housing associations can gear against their stock. Banks are prepared to lend up to 80% of the market value of social housing, but the proportion of shared ownership stock that they are willing to accept as security is limited. Staircasing means that the shared ownership pool is a wasting asset and therefore lenders rarely accept more than 10-15% shared ownership within a portfolio as part of new lending.

The increasing amount of shared ownership within housing associations' portfolio of assets will therefore not be proportionately matched by an increase in borrowing capacity, but clarity around the performance of the asset may help. The attractiveness of the unsold equity as an investment will also be limited without greater transparency.

£775m
Income for housing associations from first tranche sales in 2014

HEYLO HOUSING

Heylo is a private limited company and has acquired over 500 shared ownership properties across 25 local authorities since it was launched in 2014. In the summer of 2015, Heylo and Bellway agreed a contract under Heylo's Home Reach model to deliver 1,000 new shared ownership homes over a three-year period.

Under the 'Home Reach' contract, the developer will build and sell initial shares of new shared ownership homes, simultaneously selling the unsold equity to Heylo at a pre-agreed price. This delivers 70% to 90% of the full open market value of the new home to the developer, depending on the size of the initial share purchase.

The Heylo/Bellway deal is the first of its kind, but Heylo expects to agree a series of similar contracts with national and regional housebuilders.

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