**Sedgefield Borough Council**

**Coalfield Housing Market Renewal Study**

**Options for the provision of financial assistance**

Annex 3

33994

Spring 2005

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# SEDGEFIELD BOROUGH COUNCIL

# COALFIELD HOUSING MARKET RENEWAL

# OPTIONS FOR THE PROVISION OF FINANCIAL ASSISTANCE TO PROPERTY OWNERS

**May 2005**

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# 1 INTRODUCTION

1.1 Sedgefield Borough Council (SBC) is exploring options for replacement of housing in the three small settlements of Chilton West, Dean Bank and Ferryhill, as part of the Coalfield Housing Market Renewal Study.

1.2 Clearly, renewal options generated must be practical, affordable and acceptable to key stakeholders: particularly residents in the communities affected and Sedgefield Borough Council.

1.3 There are numerous strands of development of a suitable regeneration strategy, this paper focuses on the issue of housing support packages for those residents displaced as a consequence of agreed interventions. Following consultation, the agreed range of support packages will need to be costed and incorporated into the preferred option for the three settlements.

1.4 The offer of suitable packages is likely to prove instrumental in gaining community acceptance to the overall programme. SBC will need to ensure packages are appropriate and justifiable in terms of value for money.

1.5 Existing home ownership models (outright purchase or Low Cost Home Ownership - LCHO) do not always work in low value areas where there is inevitably a concentration of low income households. Regeneration areas are inevitably linked to low value areas and on-going sustainability requires new models to bridge the gaps between costs and value and meet client side affordability criteria (i.e. affordability to residents).

1.6 This report sets out brief details of some models that are suitable for the provision of financial assistance to owner-occupiers affected by regeneration schemes, as in use within the sector.

## 2 CURRENT MARKET PRACTICE

### 2.1 Sedgefield BC current assistance policy

2.1.1 The Council's current range of assistance packages are likely to require enhancement in order to meet the needs of residents affected by the market renewal activity.

2.1.2 The policy of allocating owners required to move a mixture of 50% interest free equity loans and 50% grant, subject to a comparatively modest overall limit on assistance, is likely to require revision or supplement.

### 2.2 Low Cost Home Ownership (LCHO)

2.2.1 The standard RSL low cost home ownership model provides a route to part ownership for those displaced households that cannot afford outright purchase.

2.2.2 The RSL providing the replacement dwelling requires a capital grant to fund the proportion of equity not to be purchased by the part owner. A rental is paid on the equity retained by the RSL, typically ranging from 2.5% to 4% of value. The share of equity sold to the part owner would be equivalent to the compensation paid to the owner on acquisition (via a CPO or voluntary basis).

2.2.3 The part owner may "staircase" to purchase the remainder of the equity, typically in minimum tranches of 10% at a time, and at the then current market value. There is no obligation on the part owner to purchase more equity.

2.2.4 The RSL achieves a return on investment via the rental and may enjoy significant capital gains on the retained equity, if subject to later 'staircasing'. The part owner is responsible for all repairs and maintenance costs.

2.2.5 This option would only be viable for displaced owner-occupiers with some income due to the obligation to pay rent.

2.2.6 A typical example would be as follows:

| **Conventional LCHO Model** | | |
|---|---|---|
| | | **£** |
| a | Market value | 120,000 |
| b | Capital cost to RSL | 100,000 |
| c | Equity sold (compensation) @ 50% | (60,000) |
| d | Grant paid to RSL (20% of cost) | (20,000) |
| e | Balance of cost (funded from loan) | 20,000 |
| | | |
| f | Rental charge (per week) @ 3% | 34.62 |

2.2.7 Clearly the compensation, and hence equity sold, may be lower than £60,000. In the above model for each £10,000 reduction the rental would need to increase by £17.30 per week. In addition, the part owner would need to budget for maintenance and other ownership related costs (insurance, etc), although these costs ought to be broadly similar to the displaced owner's current out-goings.

## 2.3 Variants on basic LCHO model

2.3.1 The main variant on the above conventional LCHO RSL model involves finding options to defer the rental element, which may not be affordable for the part owner, particularly if the current property is mortgage free and where this new out-going would represent an unaffordable burden.

2.3.2 Deferral of rental would be possible if the RSL providing the new property is prepared to forego this income (used to meet interest payments on debt) either by: anticipation of future capital gains on the retained equity, in return for an increased share of capital gains on the sold equity, or some combination of both elements. The exact balance of the above options to defer rental would depend upon the characteristics of each case, but it is likely that the part owner would need to be prepared to sacrifice some or all of their future equity gain in return for a rent-free share in a new property. This approach can also be used to meet (defer) maintenance costs.

2.3.3 It should be noted that in this example the RSL would have to finance annual interest payments as and when they fall due and therefore rental deferral would require cross-subsidy from other sources until such time as capital gains are realised, which may not be for many years. It would be reasonable to expect RSLs actively engaged in the regeneration, and developing a number of other new properties for sale or rental on conventional terms, to offer a proportion of new LCHO units developed for occupation on a deferred rental basis. It would not be reasonable to expect an RSL to offer this option on a large scale without such opportunities to generate income to support overall cash flow and help meet interest payments in the early years. Capital gains are also uncertain as to both value and timing; this route would therefore present increased risk to RSL partners.

## 2.4 Homeswap

2.4.1 The 'Homeswap' model, pioneered by the Salford / Rochdale HMRA Pathfinder, involves provision of an interest free equity loan to bridge the gap between equity acquired in a new property by the displaced owner occupier (i.e. compensation received for the property acquired for the regeneration scheme) and the value of the new home provided. A legal charge is placed against the property equivalent to the equity loan.

2.4.2 The basic model involves amortisation (i.e. writing down and eventually writing off) of the equity loan over a period of years, typically ten years. The aim here is to encourage residents to remain in occupation in order to help stabilise the community and promote achievement of wider regeneration objectives. If the property is sold then the remaining equity loan is repaid, but without interest. The 'write-off' aspect is discretionary and the model is likely to be attractive to residents even if the equity loan is not written off but eventually repaid on sale.

2.4.3 This option is attractive to home-owners and should be an effective mechanism for ensuring overall scheme objectives are met. However, 'write-off' of the equity loan is expensive and would require substantial subsidy. Using the figures in the above example, an equity loan of £60,000 would be needed and may be written off (£120,000 value of new provision less £60,000 compensation for the property acquired for regeneration). Of this sum, £40,000 would represent actual expenditure written off (£100,000 construction cost less £60,000) rather than market value gain foregone.

## 2.5 Homebuy

2.5.1 Homebuy involves the displaced owner-occupier using compensation to purchase a 75% equity share in an existing property purchased on the open market. The individual identifies the property that he or she wishes to purchase. An RSL provides an interest free loan for the 25% balance of equity, funded by a Housing Corporation grant.

2.5.2 Only existing properties can be acquired with the scheme, exactly 25% of the equity must be purchased by the part owner, and the RSL partner must obtain a grant allocation from the Housing Corporation. However, despite this rigid framework, the scheme can be attractive and more affordable to owners as no rental or interest is paid on the 25% equity share retained by the RSL. On eventual sale the part owner pays 25% of the sale proceeds to the RSL and the RSL recycles the proceeds into a further project.

## 2.6 Enhanced Homebuy / Interest bearing equity loans

2.6.1 Variations on the standard Homebuy model include:

- allowing Homebuy on new build properties if the RSL is able to find an alternative funding source to Social Housing Grant (e.g. use of cash backed reserves or debt);

- advancing a 25% interest-bearing equity mortgage in addition to the 25% interest-free equity loan. This model would require the part owner to fund just 50% of the acquisition cost via a conventional mortgage loan (or CPO / other compensation received). The model, developed by the Joseph Rowntree Foundation, can significantly increase the purchasing power of displaced owners. If the equity loans are provided by the same lender they can be merged into a single loan with a low interest charge. This model can both minimise grant requirement and stretch affordability (e.g. the grant required can be less than half of that for a conventional Homebuy property).

## 2.7 Step Ladder mortgage

2.7.1 A product marketed by Bradford and Bingley Building Society which involves:

- 100% loan (subject to income);
- 30% of the loan interest free (for ten years);
- remaining 70% interest free for three years, then conversion to a repayment mortgage at a slightly higher interest rate;
- lender takes a share of equity appreciation when realised:
    - first 2% in full;
    - 30% of next 10%.

## 2.8 Revenue top-up to loan repayment

2.8.1 Funded via a reduced interest rate in order to avoid tax liabilities, this is a simple form of non-repayable subsidy. Payments would normally reduce over time, as income is assumed to rise. The advantage of this model is that the up front PSBR costs of subsidy is more affordable than capital subsidy. Also, payments would cease when the recipient sells and moves, which may provide better value for money for public expenditure. However, an administrative infrastructure is needed to channel subsidy into loan repayments, which makes this option less attractive for smaller scale regeneration projects.

## 2.9 Option Renting

2.9.1 Similar in concept to an Islamic home finance method, this is a mechanism to facilitate an individual to acquire an interest in a property while occupying it as tenants and paying rent.

2.9.2 An RSL or Special Purpose Vehicle owns the property and receives a deposit from the occupier. The occupier pays a cost rent that reflects the level of deposit made. The occupier has a pre-agreed contractual right to buy on an agreed, normally discounted, basis which reflects the value of the deposit.

2.9.3 Rental attracts more generous Housing Benefit entitlements than mortgage payments which makes this model more suitable for those in low paid employment or at risk of unemployment

## 2.10 Right to buy repurchase

2.10.1 A useful model for regeneration schemes involving refurbishment of former local authority owned properties where owners can no longer afford the burden of owner occupation.

2.10.2 The property is repurchased from the owner on the basis of the net present value of the future cash flow (net rent) to be derived form the property post rehabilitation, probably representing a discount to open market value.

2.10.3 In return for foregoing some capital on acquisition, the former owner reverts to a secure or assured tenancy paying an affordable rent. The owner would need to prove eligibility for social housing on the RSL's / local authority's normal allocation criteria.

## 2.11 Equity release / equity loans

2.11.1 There is a well developed market in equity release / equity loan products which can be appropriate for households where renovation schemes are proposed and require funding, particularly where these lead to an increase in value.

2.11.2 Such products normally involve sale of equity to an insurance company in return for a lump sum or income. Interest can be deferred, although this can result in rapid erosion of equity.

## 3 COSTS, RESOURCES AND POWERS

3.1 The suitability of the various options outlined will of course vary depending upon the exact nature of interventions, the current tenure mix, prevailing market values and the cost of re-provision.

3.2 Some schemes, e.g. Homeswap are attractive to residents but expensive to operate.

3.3 Repayable equity loans may be expensive in the short to medium term, bit offer the near certain prospect of full repayment in future years.

3.4 Schemes operated in conjunction with RSLs are likely to be particularly attractive. In effect, there is an opportunity to lever some of the balance sheet capacity of the RSL to bridge the gap between the advance and repayment of equity linked loans. As part of a mixed package that provides the RSL with more 'profitable' scheme development, it should be possible to obtain co-operation from a financially strong RSL. However, it should be noted that some schemes will also require a source of capital grant or subsidy (e.g. Homebuy).

3.5 Legal powers (e.g. re: local authority funding) for engagement in provision of displacement packages would need to be established, but new powers granted to local authorities under the Regulatory Reform Order and Housing Act 1996 provide considerable scope to support and fund action either via RSLs or direct.

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