

## Equity Sharing with Community Land Trusts: Delivering Sustainable Low Cost Home Ownership by Locking in Value in Perpetuity

### A Building and Social Housing Foundation information paper to the Shared Equity Taskforce

#### Introduction

This paper describes the potential of Community Land Trusts as a vehicle for delivering shared equity products to assist more households into home ownership. The Affordable Rural Housing Commission (ARHC) was set up by DCLG and Defra to identify barriers to the provision of affordable housing and to explore solutions. Chapter Five of the Commission's final report explains the potential of Community Land Trusts (CLTs)

The CLT has the potential to make a significant contribution to the provision of affordable housing in both urban and rural areas, providing a complementary approach to housing associations.

There is a well-established national network of CLTs in the USA which provides low cost home ownership and other services to communities. Washington D.C. is now planning to deliver 1000 homes in partnership with Burlington Community Land Trust. Examples of projects in England and Wales include communities in London, Stonesfield, High Bickington, Rock and St. Minver, Stroud and Powys.

The ARHC's recommendation to the Shared Equity Taskforce:

*"Either through the Shared Equity Task Force or as a discrete study, DCLG, Defra and the Housing Corporation should explore, through piloting and evaluation, whether Community Land Trusts can help add to the delivery of affordable housing in rural areas in a way which offers good value for money and supports the Government's wider objectives of community engagement."*

In addition to case studies in the UK, the Shared Equity Taskforce would benefit from examination of case studies in the United States where the CLT movement has been well established in urban and rural areas for over 20 years.

#### The need for housing

The National Housing Federation (NHF) predicts that house price inflation will continue to outpace growth in earnings and estimates that the average house price in England will be £286,500 in 2011. Research by the University of Cambridge suggests a need for 80,000 new affordable homes each year but provision in 2004/05 was 24,000 homes.

The Government's manifesto commitment to increase home ownership within the population from 70 to 75 per cent is currently hindered by the fact that average house prices are increasingly beyond the reach of households on average earnings. The Government is under pressure to increase public spending to subsidise home ownership but must ensure that subsidy delivers maximum benefit rather than simply propping up an overheated housing market.

#### The potential of Community Land Trusts (CLTs)

- Shared equity products – Holding land in trust and separating it from the open market enables the CLT to assist successive generations with low cost home ownership by repeatedly sharing the uplift in land value between incoming and outgoing households with a resale formula that locks in subsidy in perpetuity.
- Innovative finance for development - Using the value of land to attract private finance to subsidise development thus reducing the call for public subsidy in order to deliver affordable housing.
- Mobility on the equity ladder – Adapting the tenure of a property to suit the changing circumstances of a household. Providing a below market rented home with the revenue stream contributing to an equity loans fund. When the household is ready enabling them to purchase equity to create personal wealth and the incentive to move into home ownership.
- Making best use of public land – Releasing the potential value of land without losing it to the open market by holding it in a trust with a constitution that ensures probity and perpetuity.
- Encouraging active citizenship - Employing participative planning techniques to engage with the community and provide a bottom up approach.
- Capital for renovation – Pooling equity to provide capital to assist home owners with building repairs.

## **The limitations of current subsidy mechanisms for low cost home ownership**

In current low cost home ownership schemes the subsidy that goes into affordable housing is not well preserved:

- House prices rise more rapidly than earnings and as subsidised properties are not separate from the open market, accessibility is rapidly reduced following the initial subsidy
- Shared ownership is increasingly inaccessible and stair-casing provisions lead to the loss of properties and the associated subsidy to the open market

The initial subsidy which is used to help a household get on the housing ladder has less real value upon resale of the property as house prices are rising faster than average earnings. House prices rose by 139 per cent from 1997 to 2005 whilst earnings rose by less than 25 per cent.

The example below uses historical statistics on house price and average annual earnings to demonstrate how the value of subsidy within a low cost home ownership scheme reduces over time.

### **Limitations of current low cost home ownership**

#### **Average house price of approximately £100,000 in 2000**

Low cost home ownership helps a family onto the housing ladder with an equity loan

25 per cent subsidy = £25,000

Property purchased by initial purchaser with a mortgage for £75,000

Assists a household with an income of £21,500 a year (mortgage multiple of 3.5 x income)

#### **Four years later at resale of the property**

**House prices had increased by 80 per cent**

**Wages increased by only 23 per cent**

#### **House price £180,000 in 2004**

25 per cent capital receipt from resale = £45,000

Recycled subsidy now assists a second household to purchase the property at £135,000

Assists a household on **£38,600** (mortgage multiple of 3.5 x income)

The Annual Survey of Hours and Earnings (ASHE 2005) shows that the average gross annual salary is £23,400. In this example the scheme has become less accessible over the four year period.

In areas of high housing values, local authorities now struggle to allocate shared ownership properties to households from priority groups on the housing register as the open market appraisal of property value takes no account of local area median incomes. With each resale the property value increases faster than wage rises and becomes less accessible.

A household in East Hampshire would need to pay at least £760 per month to cover the rent and mortgage (5.5 % APR) for only a 25 per cent share of a three bed terraced house valued at £210,000 on the open market. Source: Swaythling Housing Society, 2006.

Shared ownership models delivered through Registered Social Landlords include the provision for households to staircase to full ownership which results in a capital receipt which is recycled to assist another household. However, the sale of one home does not necessarily fund a similar property or assist a household on equivalent income for the reasons mentioned above and because house prices are not static between sales and the pot covers a region with different housing markets.

## **How do CLTs tackle these issues?**

CLTs employ restrictive covenants which capture land value in perpetuity by preventing sale of the property on the open market. The CLT benefits from any increases in the value of the property in line with the open market and it passes the benefit on to successive generations. The subsidy which goes into a property is locked into the property and increases in value with each resale.

Resale data from Burlington CLT in the USA shows that as the value of initial subsidy grows, it has been able to help households on increasingly lower percentages of Area Median Income (AMI) with each resale over the past 20 years.

### Shared Equity with a CLT

An initial subsidy enables the first household to purchase at an affordable price. The model is able to continue to deliver benefit by capping the resale value as compared to the open market value. On resale the household cannot realise the full open market value of the property due to the restrictive covenant and so increases in value are preserved. The subsidy remains with the property as a proportion of the open market value and as a result also grows in value. The resale formula shares any uplift in equity between the incoming and outgoing households. The outgoing household receives capital as an incentive to help them move on to home ownership. The cost of purchase is then reduced for the incoming household. The cycle is repeated with each resale.

The example below shows how the CLT equity sharing formula could provide a significant deposit to help a household into full home ownership but by sharing the uplift in equity also helps the next household by subsidising the cost of purchase. The formula is flexible and can be adjusted to suit local circumstances or objectives.

#### **CLT Resale Formula**

Open Market Value at initial purchase = £100,000  
Initial purchaser requires 25 per cent subsidy to purchase = £25,000  
Initial purchaser obtains a mortgage for £75,000

At resale, the open market value = £180,000  
The increase in open market value = £80,000  
The CLT resale formula repays the initial purchaser's mortgage of £75,000 and gives them 25 per cent of the uplift in value = **£20,000**

The remaining equity stays with the property and allows the next household to purchase the property at a resale price of **£95,000**

**£20,000 (25% X £80,000) + £75,000 (household one's mortgage) = a resale price of £95,000**

**The original subsidy delivers ongoing benefit**

The typical deposit for a first time buyer is now £23,967; and the average house price in the UK in January 2006 is £188,191. The CLT provides security of tenure and when the household is ready to move on, the opportunity to benefit from the uplift in equity by providing a deposit for home ownership.

#### **Private finance for CLTs**

The subsidy that enables the initial purchase could take the form of public subsidy as with American CLTs which benefit from municipal funding or lines of credit through a revolving fund. The value of the assets within a CLT can also be used to attract private finance.

Various financial models have been proposed by organisations such as CDS Cooperatives and Community Finance Solutions. Each model has its own merits and would appeal to different markets and it is therefore recommended that all models are explored in more detail by the Taskforce. The following explanation is a generic description of potential solutions to access private finance.

The value of land could be used to attract patient capital operating along similar lines to the HomeBuy scheme, whereby, a household obtains a personal mortgage at the level that they are able to afford and the remaining balance is met with an equity loan obtained by the CLT to enable the purchase to go ahead. The amount of the required CLT equity loan could be reduced by negotiating land at a reduced price or nil value in the case of public land, Section 106 agreements or other donation so that it becomes a form of subsidy. Innovative approaches that reduce the cost of development such as modern methods of construction could represent a further subsidy available to support local households.

CLTs have also employed ethical bonds with a guaranteed return in order attract local investment for development and have benefited from pro bono assistance during the development process. Cross-subsidy is being used on larger developments with the sales of some properties on the open market used to subsidise the development of CLT properties. On larger sites, a proportion of properties could be developed for commercial use to create a revenue stream which supports the servicing of loans and administration of the CLT.

In order to gain maximum benefit from the uplift of land value associated with planning consent, CLTs aim to negotiate nil or reduced price land either through Section 106 agreement or by donation of public or private land.

### **Defining a CLT community**

A CLT community need not be defined geographically but could be interest, faith or culturally based. CLTs in America have pooled assets across large areas and various settlements for the benefit of individuals. Members have equal influence in decision making with regard to management of the CLT. CLTs could be used to deliver at a local level or on a larger scale through a network similar to HomeBuy agents. Any home which is publicly funded could become an asset of a CLT as condition of funding so that the asset brings benefit to successive generations. In areas of high demand for affordable housing, CLTs could be used to protect against losses through Right to Buy.

A CLT is not a 'one size fits all' approach but a label for a wide range of innovative approaches to deliver affordable housing by holding land in trust in perpetuity.

### **Finance for individual households**

There is evidence of support for mortgages to households purchasing through the CLT model; and for corporate CLT mortgages. In the USA, CLTs work closely with lenders to remedy cases of mortgage default. As a last resort when remedial action fails, mortgagee in possession allows sale on open market.

- Triodos Bank provided finance to Stonesfield CLT
- Ecology Building Society provided finance to Stonesfield CLT.
- RBS NatWest has supported communities in Scotland.
- Principality Building Society is negotiating finance with three pilot CLTs in Wales.

### **Legal models**

Leasehold enfranchisement affects long leases (over 21 years) and enables lessees to purchase the freehold of their property. As an alternative to long leases, CLTs can employ other ownership models in order to avert the threat of leasehold enfranchisement. Trowers and Hamlins solicitors have worked with the Housing Corporation, CDS Cooperatives and Community Finance Solutions in order to ensure perpetuity by developing legal models that work within the current legislative framework.

Three approaches are outlined in no particular order of preference:

A household could purchase a property and own the freehold with the shortfall in purchase price met by a CLT providing an equity mortgage with clear recitals as to the purpose of the CLT to avert leasehold enfranchisement and the equity loan creating an interest in the property for the CLT.

The property could be registered with the Land Registry under co-ownership law with both CLT and occupants as co-owners. Under co-ownership law, the CLT could be paid a 'compensation' for non-occupancy by the residents in order to cover costs of administration.

CDS Cooperatives has designed an alternative cooperative approach known as the Mutual Home Ownership Society. A corporate mortgage is obtained to cover the entire housing development which is then unitised with shares purchased through monthly payments by individual households and based on their household income. Clear recitals as to the purpose of the CLT are employed to avert leasehold enfranchisement and the households are granted a right to occupy through a lease and on departure they would exchange their shares for capital which could help them onto the housing ladder.

The exclusion of assets from the open market in perpetuity is fundamental to the CLT's ability to deliver affordable housing to successive generations. Recitals which ensure that the purchaser clearly understands the CLT's intention to provide affordable housing in perpetuity are coupled with restrictive covenants to underpin this objective.

### **Adapting to the changing needs of a household – up and down the equity ladder**

As a CLT holds an asset in trust on behalf of and for the benefit of the community it can adapt the use of the asset to match the needs of the community. This might apply to the tenure of the property, for example, a family may move into their home and rent the property initially but as their circumstances allow, the tenure could be adapted to allow them to purchase an interest in the property. If the household wishes to move into full home ownership, the CLT can help to provide the deposit as demonstrated in the above examples.

The Mutual Home Ownership Society allows households to purchase units of equity based on their household income and so they are able to move up and down the equity ladder to reflect their financial

circumstances and as they are purchasing or selling shares this is possible without incurring the costs normally associated with home purchase.

### **Technical Support for Communities**

There is rapidly growing interest in the CLT model and a clear appetite for new and innovative approaches to provide affordable housing which encourage active citizenship and real choice for communities.

Many communities are currently held back by the lack of available finances which are necessary to engage expert advice and conduct feasibility studies. As the CLT model is still below the radar of mainstream policy and so it requires an enlightened local authority or RSL to put resources into feasibility studies and to work closely with communities to enable them to develop appropriate solutions with the CLT model.

The government should seriously consider funding a programme which provides technical support to communities with regard to CLT feasibility, legal issues, acquiring land, development and planning.

This could be developed along similar lines to the Community Land Unit and the Highlands Small Communities Housing Trust in Scotland which both provide advice to communities on a wide range of issues including land acquisition, development and management of assets.

Communities in Scotland also benefit from changes in legislation which support community land acquisition and the Scottish Land Fund supported by the Big Lottery which provides grants to assist in community acquisition of land.