Shared ownership and shared equity: reducing the risks of home-ownership?

Viewpoint
Informing debate

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Shared ownership and shared equity schemes are seen as a way of increasing home-ownership by reducing initial entry costs. However, these policies have been implemented in such a way that the risks to home-owners are also increased, and therefore often do not make home-ownership any more sustainable. Christine Whitehead argues that these products do have the potential to reduce the risks of home-ownership and allow more households to become owner-occupiers in a sustainable manner.

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Key points

- Most shared ownership and shared equity policies have been directed at increasing home-ownership for marginal purchasers rather than making ownership more sustainable. Moreover the ways that they have been implemented, especially in the last few years, have often increased risks.
- Yet partial ownership solutions have the potential for reducing the risks of home-ownership, not only because outgoings are lower and less variable but particularly because the risks associated both with the particular dwelling and with volatility on general house prices are shared either with government or another institution.
- The focus of shared ownership and shared equity products needs to change – away from encouraging people to spend more towards assisting those who are able to pay for their housing over their lifetime but not able to cope with the risks involved.
- There is also a case for providing shallow subsidy to help those further down the market. This is particularly relevant where some of the risks are associated with government decisions or where there are other benefits to the public purse from enabling particular groups to become home owners. Examples here might include supporting shared equity in regeneration projects and in more vulnerable localities, and equity release by older households.
- Key areas for reform include: a simplified, standardised product; re-enabling shared equity on existing homes; more transparent regulation and subsidy; and the development of a better resale market for shared ownership and shared equity products.
- More work is needed to develop and market-test a suitably transparent product that concentrates on risk sharing and sustainability and has the potential for scale.
- The current environment, when many households who can afford to pay for their own home are being put off by concerns about risk, is the ideal time to experiment with a product that could help large numbers of households to manage the risks associated with owning their own home.

Introduction

Shared ownership (SO) and shared equity (SE) products have been a part of UK housing policy for at least three decades. They were originally developed to address issues of affordability in the 1970s when inflation was very rapid and people who could easily afford to buy over their working lifetime were excluded by high payments in the early years of a traditional mortgage. Later they became one of a range of low-cost home-ownership initiatives aimed at extending home ownership, based on expectations that households' incomes would increase so that they could move to 100 per cent purchase within a reasonable time (Allen, P., 1982; Booth and Crook, 1986).

More recently, SO/SE products have been used as a means of providing shallow subsidy to increase home-ownership rates by enabling marginal purchasers to buy as house prices rose faster than incomes and more households were excluded (NAO, 2006).

While there have been many different versions over the years, government policy has concentrated on two core models:

- **shared ownership** where the purchaser buys a proportion of the property with a traditional mortgage, while the other portion is owned by a social landlord who receives rent on this element;
- **shared equity** where the purchaser buys 100 per cent of the property but obtains an equity loan to cover part of the value.

SO has only been available on designated new and rehabilitated properties while originally shared equity loans were available mainly for existing units. This has now changed so even SE loans are also almost entirely for new dwellings. In both cases purchasers may increase or 'staircase' their ownership to 100 per cent. Both schemes reduce initial outgoings and, at least in principle, the deposit required.

A rather different strand of SO/SE, which has been available for even longer, is that which aims to provide affordable housing into perpetuity. The purchaser is allowed to buy only a proportion of the property – keeping the land element, or simply a proportion of the value, in social ownership. This model includes Community Land Trusts and some forms of co-operatives as well as low-cost home-ownership for older people. At the other extreme are short-term schemes that address the problems of unsold properties when the housing market turns down. In the current recession this approach is reflected in HomeBuy Direct (a shared equity product part-funded by the Government and part by the developer), as well as purely market-based schemes put forward by developers (Burgess et al, 2009).

The core policy objective of SO/SE programmes has been to extend owner-occupation to those who otherwise could not achieve it, by overcoming access and affordability problems in early years. This approach increases the risks associated with owner-occupation unless subsidy is enough to offset these risks and/or instruments are modified to address the risks more effectively.

The objective of this *Viewpoint* is to examine the question of whether SO and SE can act as a means of reducing and sharing risks, not just for new purchasers but also for more established owner-occupiers. It looks at the principles involved and the extent to which current products available in England are aimed at reducing risks. Finally, it asks questions about the potential for developing products that might better reduce these risks.

Background

The capacity to pay for housing depends upon household income – and its stability and predictability – on the one hand, and the costs of housing on the other. A third party (i.e. government) may intervene both to require minimum standards and to set affordability criteria. The first increases the cost of housing, especially to poorer households, generating greater problems of affordability and risk. The second increases the numbers of households in need of some assistance. Thus income distribution is likely to be the major determinant of housing consumption – mediated by regulation, finance and subsidy to determine outcomes.

To clarify further, there will be a set of people on higher incomes who can pay for adequate housing themselves and can both achieve minimum standards and meet affordability criteria. Even this group may still benefit from risk sharing and risk transfer products because of the specific attributes of housing and home-ownership.

Below this level of income, there are households who, while they cannot meet the socially determined criteria at any given moment, would be able to do so given their lifetime incomes and circumstances. To enable them to do so requires financial instruments to be put in place to allow them to adjust their expenditure in line with income over time. Such households will be more open to risk at those stages of life when they are consuming more than their current income easily allows.

Finally, there is the group who cannot afford adequate housing if they are to be able to purchase the other essentials of life. This group requires subsidy if they are not to live in overcrowded and/or substandard conditions. Alternatively they will not be able to afford other necessities of life. The lower the affordability bar and the higher the standard of housing required, the larger the number in this group. To the extent that households remain stretched, the greater is the cost to them of bearing the risks associated with volatility and housing consumption and investment.

The distribution of income in England is particularly uneven so the proportion of households in the lower two groups is relatively high. Moreover, wealth distribution is even more imbalanced which means many cannot rely on parental assistance or other support to help them achieve an adequate home. Both realities mean that risks and vulnerability are higher for these groups.

Limiting the Government's commitment to provide housing support (apart from lowering standards and/or accepting worse levels of affordability) entails identifying those who can manage alone; those for whom adjusting housing finance instruments can reduce risk and help match income and expenditure over time; and limiting direct assistance to those who cannot manage for themselves.

The JRF Housing Market Taskforce's agenda is specifically about volatility in the housing market and in the economy more widely. However, there are also important risks associated with the nature of the housing asset – particularly its scale and its specificity – which mean that all households investing in housing may benefit from risk sharing and diversification products. SO and SE can help address both these types of risk (Caplin et al, 1997; 2003).

Volatility in house prices, interest rates and employment generate uncertainties about both the household's capacity and willingness to pay for housing. In the face of uncertainty particularly with uneven, 'lumpy' expenditure people will normally be risk averse and will therefore under-consume to reduce risk (Whitehead and Yates, 2010). So the more volatile the market the more households will feel unable to commit to the level of expenditure required to achieve adequate standards. Risk therefore means either better risk-management instruments or more subsidy, or both.

The opposite situation may occur if there are expectations that house prices will rise more rapidly than the cost of capital and alternative investments, leading to increased demand for housing because of expectations of future real capital gains. This process may feed on itself, generating a house price bubble when decision-makers underestimate the risks involved.

In this context, it may be argued that vulnerable households should be protected from their own 'exuberance' because they are inadequately informed about possible outcomes and less able to cope if their expectations prove incorrect. More generally there is a case for creating instruments (mostly in the form of some type of insurance and risk transfer) that mitigate the adverse effects for those who suffer as a result of volatility. That risk may be specific to the individual (such as sudden illness) or systemic (increased unemployment across the economy or higher interest rates because of poor management of the economy).

Individual and housing asset risk are part of any household's decision about the home in which they live – whether or not there is general market volatility. People do not make decisions in the certain knowledge of future possibilities. And because housing decisions are lumpy, irregular and large scale, there are issues about how to reduce these risks for more vulnerable households and to mitigate adverse effects that come, for example, from unexpected illness or from house price reductions.

The normal approach to dealing with the possibility of individual circumstances changing, as long as the probability can be estimated and the risks are independent, is through insurance. Mortgage Payment Protection Insurance (MPPI) was developed to address these types of risk with respect to loss of income arising from sickness, accident and unemployment. The approach has suffered from a range of market failures – but in particular from covering a mix of individual and systemic risks (Ford & Quilgars, 2000; Whitehead & Holmans, 1999). The same solution applies to risks associated with buildings – for example, the chance of the building burning down is covered by buildings insurance. The chance of bad neighbours is far more difficult to insure against because of a range of possible market failures and the chances that investments are not independent of one another.

The alternative is to diversify into a portfolio of buildings which will reduce the risk of any particular event occurring. Then the issue becomes the scale at which one can invest. An owner-occupied unit is a very large asset from the point of view of the individual. That individual cannot buy thousands of homes – so in principle needs instead to risk-share or to unitise the asset so the risks can be spread across large numbers of investors.

Approaches to risk management are not mutually exclusive – insurance may work in some contexts; portfolio management in others; and risk sharing in still others. Because of the specificity and scale of owner-occupied assets, risk-sharing products have an obvious role to play.

The potential role for shared ownership/ equity products

SO and SE products have generally been developed as mechanisms for increasing access to owner-occupation, by reducing the initial costs of purchase and enabling people to build up to 100 per cent ownership. As such the aim has been to reduce initial payments to match available income and to allow investment to increase as income rises (Martin, 2001; Home Ownership Task Force, 2003).

This is generally done by a mix of SO/SE financial instruments and shallow subsidy. In some cases, the ex post (eventual) subsidy in financial terms is zero if the capital appreciation is greater than the return on capital that government could otherwise achieve. More often there is some form of subsidy involved.

While the objective has been to increase access to owner-occupation, the products, by their nature of substituting equity for debt, have some risk-reduction attributes in the context of volatility.

The most important areas where the costs of volatility can be reduced by SO/SE are:

Interest rates

Purchasers who use either SO or SE hold a traditional mortgage only on the proportion they are purchasing, so the impact of changes in interest rates is smaller. Instead, SO purchasers pay a rent relating to capital value. SE purchasers may in some circumstances pay a charge but this does not vary with market interest rates. The cost of this reduction in outgoings comes in terms of loss of capital gains but the price at the time of purchase of future tranches can be high or low depending on the market. These variations are related to equity values rather than interest rates. So SO and SE reduce the risk from interest rate changes by reducing the size of the traditional mortgage.

Deposit requirements

The risk associated with the deposit depends on how that deposit is funded. At the least, paying a deposit restricts the household's capacity to deal with other changes in their circumstances and may mean that they are overstretched and/or borrow in other ways.

Deposit requirements for SO and SE products have generally been very low. Under the original SE product, households bought 100 per cent of the property and had a 25 per cent buffer arising from the equity mortgage. Financial institutions were therefore happy to allow up to 100 per cent mortgages on the 75 per cent required in the form of a traditional loan.

The situation for SO households was less clear, as they purchased only a proportion of the property and the traditional mortgage funded that proportion. If, for example, they purchased 50 per cent on a traditional mortgage and they put up no deposit they were seen to borrow 100 per cent. Risks were therefore higher than for SE. Even so, financial institutions did lend on high loan-to-value ratios. This reduced the problems directly related to funding the deposit – but it increased the risks associated with variations in capital values.

In current circumstances institutions require some element of household equity – and this is likely to continue even if the market eases. As a result both SO and SE purchasers must find a higher deposit (with its associated risks).

Income loss

SO and SE, by enabling households to purchase with a lower traditional mortgage, reduces repayments and so takes a smaller proportion of income. If income declines this should, in principle, make it easier for repayments to be maintained. The extent of this benefit depends first on the nature of the payment to the secondary owner. In the case of SO the 'rental' payment can be as high as 2.5 to 3 per cent of capital value, worsening affordability and increasing outgoings to something closer to the mortgage payment. On the other hand, purchasers are eligible for housing benefit on the rental element. In the context of SE, many products have been zero-interest equity mortgages at least for the first few years – so the benefits to the purchaser are greater.

A particularly important question in this context has been the extent to which SO and SE enable people to buy more housing, in which case the risk mitigation is reduced; or whether they purchase on SO/SE because they are most risk-averse, in which case they do benefit from reduced risk. The evidence in the 1980s was very much towards the second – i.e. people who knew they were more risky than they appeared or who disliked risk more than average tended to purchase their first home using these products (Booth and Crook, 1986; Littlewood and Mason, 1984). In the 2000s the problem was more that of buying more than they could have afforded without the instruments, as affordability declined. The products therefore helped access at the cost of higher risk. In this context the National Audit Office (NAO) made it clear that they regarded it as poor value for money if households were enabled to purchase a SO/SE product when they could otherwise have afforded to buy on their own (NAO, 2006). Thus the NAO saw SO/SE as a means of allowing people to enter owner-occupation when that would otherwise have been impossible. They therefore emphasised access at the expense of both risk and affordability.

The major offset to this risk was that a third party (the HomeBuy Agent) was expected to assess the household for affordability, taking account of individual circumstances and perhaps also improving the individual household's understanding of the risks they faced (Monk and Whitehead, 2010).

Capital values

But the big issue in terms of risk and Low Cost Home Ownership (LCHO) is with respect to capital values. This is where the direct benefits of risk reduction from SO and SE arise because they are not subject to the risk of house price reduction on the full value of the property. In both cases the cost of this 'insurance' is that they lose the benefits of capital growth on that same proportion.

Shared ownership and shared equity as risk-sharing products

Models of expected utility maximisation in a risky world – models where people make decisions that are best for themselves – suggest that risk-averse individuals (almost all of us) should hold a diversified portfolio made up of a 'risk-free' product together with a mix of investments with different patterns of returns. Ideally, if the investor wants to have a portfolio with stable returns, they look to invest in products where returns move against one another (ice cream and sausages; bankruptcy professionals and merger specialists, etc.). More generally, if the patterns of returns differ at all (house prices move differently between regions) the returns on investing across the products (or regions) will be more stable.

Within this context, people undoubtedly want to invest in housing because it provides the possibility of a good return on capital. Moreover, the returns on housing, though they do vary with other investments, do not have quite the same profile. Financial modellers tend to suggest that a significant part of a household's portfolio (perhaps 30 per cent) should be in housing, but spread across the housing market so that they can bear the average housing market risk rather than the risk associated with a single dwelling (Caplin et al, 1997).

Owner-occupiers mostly do the exact opposite to what financial modellers suggest. The investment in the home is normally the largest or second largest investment (after their pension) that a household makes. Moreover, they buy one large investment in a specific location.

As a big indivisible asset the home also constrains the capacity of the household to diversify its portfolio effectively into other types of asset. (If the household is rich, of course, it can invest in large numbers of dwellings and many other assets, so it is not a problem).

Moreover, the volatility in returns experienced by owner-occupiers with a mortgage is much greater than it at first appears – because of the gearing arising from debt finance. Suppose the owner-occupier buys a specific property, taking out a 90 per cent mortgage. If the price rises by 10 per cent the owner-occupier's own asset (the 10 per cent) doubles in value. If prices fall by 10 per cent, they lose their whole housing wealth – a very good reason for being concerned about house price volatility.

Any capacity to diversify into other investments can help address the extent to which housing as a category of assets is volatile. Within housing there is also a strong case for diversification. Here the most obvious approach is to invest in property bonds or other financial products which are based on a basket of housing assets, so that the individual can buy smaller or larger tranches as they wish. That way they own a small portion of a large number of dwellings with slightly different risk profiles – so their portfolio is more stable.

Not only is the home a 'lumpy' asset, it also has very specific attributes that are reflected in that property's price (such as good neighbourhood, bad neighbours, etc.). Unexpected variations in these attributes generate changes in the price of that dwelling and therefore modify the rate of return. These problems can be evened out only by reducing the scale of the investment.

To limit the impact of these neighbourhood and dwelling risks, a risk-sharing instrument is needed. The individual household can then benefit by reducing the proportion of the specific housing asset that they own e.g. by some form of shared equity or unitising product and have the scope to invest elsewhere. In this way they can transfer part of the risk to others: in current LCHO schemes, the other element is held by the Housing Association in the case of SO, and by the central government and/or developer in the case of SE.

The two distinct elements of risk – housing market volatility and the risks associated with a particular dwelling – can both be addressed through SO and SE because these involve the transfer of some of the commitment and therefore some of the impact of price change to another (usually known as the secondary) owner. That secondary owner in principle takes both gains and losses on their share, reducing the impact of change on the individual household. This, again in principle, allows the SO or SE purchaser to diversify into other parts of the housing market and into other types of asset, both reducing their holding of specific risk and enabling a portfolio that better reflects the level of risk they are prepared to take on.

As can be seen from this discussion, managing portfolio risks is something that applies across the market, not just to those at the bottom end. The reason for concentrating on the lower end of the market is that the costs to this group of not managing the risk are far greater – and the alternatives available to them are far fewer.

A market approach requires finding a secondary buyer who can diversify very much more effectively and is therefore prepared to take on the risk. This would normally mean a pension fund or other institution looking for significant involvement in housing spread over the market as a whole. This can also be achieved by a securitised SE instrument which can then be sold to investors wanting to invest in the housing market. Such markets require scale if they are to be cost effective. The case for government intervention therefore lies both in supporting risk sharing and therefore cost reducing models and in enabling the development of these secondary markets (Whitehead & Yates, 2010).

Issues with risk-sharing approaches

Important issues that affect the potential costs and benefits of partial ownership approaches include:

- do purchasers see it as different and therefore behave differently as compared to purchasing on a mortgage?
- are there market failures that may be associated specifically with partial ownership?

The most fundamental benefits to the individual from full ownership are seen to lie in the integration of ownership and occupation, which gives greater control and decision-making capacity.

In the case of SO and SE there are additional contracts with the secondary owner and financial institutions that are complex and which could reduce these benefits. However, the evidence from those who have successfully purchased is that they do feel as if they are owners and therefore behave as if they are, for instance, with respect to repair and maintenance (Clarke, 2010). How much this attitude depends on the expectation of increasing their portion of ownership is not clear.

In the market context of optimal portfolios, Caplin and others in the USA (Caplin et al, 1997) and Joye and others in Australia (Caplin et al, 2003) have set out the case for a market approach to shared equity, which would involve developing a new category of market security. In neither case has it proved possible to develop large markets, and those instruments that have been offered have tended to be for niche sectors among the relatively well-off (Berry et al, 2006; Caplin et al, 2007). The extent to which this failure is about scale, consumer attitudes and/or inherent market failures is unclear.

Whitehead and Yates discuss why these markets have not developed in some detail and conclude that both people's attitudes to their home (and so the wish not to see it partially owned by someone else), and a wide range of market failures to do with managing, maintaining and valuing the property, make it extremely difficult to develop a market at adequate scale (Whitehead and Yates, 2010). They also suggest that this is partly because the regulatory and institutional frameworks do not provide a strong starting point for ensuring contracts are fulfilled. This does not mean that there is no case for SO and SE, but rather that the necessary conditions are not currently available. This in turn suggests a role for government in providing an appropriate regulatory framework.

In another paper, (Whitehead and Yates, 2010a) they discuss the costs of having only the highly specific forms of tenure that exist at the present time and the benefits, including better risk management, that could be achieved from enabling a range of intermediate tenures to develop. These would include rental as well as ownership products. They argue however that, in the short to medium term, these developments cannot occur without improved government support. The issue is in no way confined to England. In particular, current SO and SE products tend not to generate the risk-sharing benefits discussed above, because they were developed for other purposes.

There is broadly based literature on partial ownership across countries which would support both the need for government-led initiatives and the benefits in terms of lower public expenditure costs (see for instance Davis, 2006 for the USA; Pinnegar et al, 2009 for Australia; Holmans et al 2003).

Three areas where there has been discussion of risk sharing in England

First, after shared ownership was introduced as a national policy, the initial reviews of take-up and benefits suggested that many of those who purchased were relatively risk-averse individuals who would not otherwise have felt able to buy (Littlewood and Mason, 1984; Booth and Crook, 1986). The evidence suggested that purchasers used lower loan-to-income ratios than the average first-time buyer. This perhaps reflected the individual household's own knowledge of health, employment and other factors that meant they might be more at risk. Alternatively they were inherently more risk-averse households who were enabled to buy. As such the product filled a niche in providing shallow subsidy to enable owner-occupation where as a result there would be longer-term cost savings to all parties.

In the twenty-first century, however, this approach was almost ruled out by the National Audit Office's report in 2006. This stressed that the use of SO/SE to help people who could have purchased directly was poor value for money even though there was often no long-term subsidy involved (NAO, 2006). This pressure to move to more marginal buyers, together with increasing prices and worsening affordability, is one reason for the problems faced by purchasers in 2007–2008.

The second policy discussion around risk sharing has been in the context of older households buying sheltered accommodation. Here the risks can be either because of the specific attributes of the product and therefore the potentially 'thin' re-sale market, or because of more general house-price volatility. Even here, risk sharing has not been a dominant issue – these have been how to maintain specially adapted property into perpetuity by limiting 'staircasing' and how to enable equity withdrawal to support consumption in old age. For all the lack of discussion there is evidence in less pressured areas that older households do take up shared ownership products in this way (Cho and Whitehead, 2006; Cho and Whitehead, 2010). There is also evidence in other countries, for instance in New Zealand, of small, long-lasting, partial-ownership markets for older people.

The third area where partial ownership as a means of addressing risk has been discussed is in the context of regeneration, where it can be argued that many of the risks faced by potential purchasers have been incurred as a result of Government activity. For example, in deprived areas it may be difficult to ask people to become owner-occupiers as part of the Government's regeneration and mixed communities strategies because of the risks associated with the area. SO/SE products enable people to build a stake in the community without bearing all the risks associated with the project and the local economy.

Again, however, the discussion has been more about mixed communities than about risk sharing. It has also been about compensating those who put up with the disruption associated with regeneration by 'giving a stake' in the community (Whitehead, Travers and Keilland, 2006).

These are three practical examples within the UK context. Only in academic and (to a limited extent) Treasury circles has there been any discussion of the more risk management-based arguments for risk sharing and for optimising portfolios set out above (Shared Ownership Task Force, 2001; Whitehead and Yates, 2010).

Answering the questions

1 Is there scope for SO/SE to be promoted as risk-sharing products?

The Government's policies of using SE/SO for increasing access and getting people on the property ladder and so directing the schemes at marginal purchasers is inconsistent with good risk management except to the extent that they result in less exposure to interest rate risk and possibly a better chance of addressing loss of income.

The scope for SO/SE products for risk management comes mainly from putting the emphasis on sustainable home-ownership rather than on marginal purchasers and particularly in ensuring that the impact is not simply that consumers buy more housing.

The main requirements would be to:

- ensure the existence of a resale market – as the objective is not necessarily to encourage staircasing to 100 per cent (Wallace, 2008);
- better inform households of the potential benefits of risk sharing in particular contexts. This is likely to be easier in the current environment than in the pre-recession market where buying with a mortgage was seen as a step towards a 'certain' capital gain;
- the reintroduction of shared equity products for existing housing where the risks associated with the property are generally lower;
- persuade Treasury, the NAO and other government agencies that the role of these products should be to fill gaps in the market that can help reduce the risk of owner-occupation, especially for lower-income households, rather than to bring riskier households into that market.

Given the benefits to the public purse and to the mixed communities agenda of enabling those who can afford owner-occupation to do so and the estimated million potential owner-occupiers currently excluded from the market SO/SE may well be the cheapest option for Government. In this context it is particularly important to clarify that Government gains from any house price increases so at the end of the scheme there may be no subsidy involved.

2 What is the viability of SO/SE as an alternative to owner-occupation?

For partial ownership to work into the longer term there must be the capacity to trade (Wallace, 2008). At the present time staircasing to 100 per cent in order to sell is almost the only option other than buy-back by Registered Providers (RPs).

There has been some evidence of a resale market in SO with free purchase and sale (without RP involvement) but the scale has been very small.

In part this has been because of lack of demand – for instance where developers offered shared ownership products in the last recession these were bought out quickly as the economy improved.

The evidence in the USA and Australia also suggests that a large market cannot be developed without government involvement. But it also suggests that this, if not a mainstream product, is for a range of household types notably older people, rather than simply a product for those unable to afford owner-occupation by any other means. If the 'full owner-occupation at any cost and expected positive capital gains' environment returns there is little chance of developing a sustainable market.

3 How should these products be promoted?

This would need to be based on: simple schemes where the Government is not trying to achieve too many objectives at the same time; a consistent offer that is not ever-changing; and transparent explanations of the outcomes under different economic environments.

The evidence of strong demand for partial ownership products comes mainly from the queues, even in the worst of the credit crunch, for shared equity products (Burgess et al, 2009; Monk, 2010). In particular shared equity mortgages on existing dwellings allowed larger households to make a choice to buy a larger unit in a poorer neighbourhood and so address issues of overcrowding. This was an option taken up especially by black and minority ethnic (BME) households in the South of England (Cho and Whitehead, 2006; Cho and Whitehead, 2010).

SO is not such a valuable product from the point of view of risk in part because it has been mainly available in the form of small units on large new sites. This increases risks for the institutions as well as for purchasers. On the other hand, it enables more mixed development, which itself may reduce risk.

Households must clearly understand that if capital gains are made they may pay a significant 'interest rate' on the equity stake. However, they gain because they achieve a range of benefits in managing their expenditures and risks more effectively – in the current environment this looks like a good buy.

4 How big is the potential market?

The evidence on who has purchased during the last decade suggests that there would be markets if products were directed at: older households; at lower-income households looking for more appropriate units often in poorer areas (BME households benefited from SE particularly in the late 1990s/early 2000s); single parents and other households facing higher individual risks; and single earners (Cho and Whitehead, 2006; Clarke, 2007). More general markets for those wanting to achieve some equity release and those who do not want to be too heavily reliant on a single risky property could also develop.

There is no obvious reason why these groups should be particularly regionally concentrated. The evidence from Cho and Whitehead (2006) and in Monk and Whitehead (2010) suggests that in regions where this has been available, older households have seen it as a desirable product. Other evidence suggests that it has enabled mobility among households with otherwise restricted opportunities.

There has always been a demand for SE products where it has been available on existing units, and HomeBuy Direct has been a reasonably successful product even in the recession. The demand for SO products has been less buoyant partly because of the restricted range of units available and because of constraints on purchaser groups.

5 What scale of subsidy/financing is required?

Risk-sharing products should in principle be able to pay for themselves. The objective is to transfer risks to institutions better able to manage the risk than the individual owner occupier. There should therefore be a 'win-win' situation which entails getting households into SO/SE who would otherwise not be prepared to buy and therefore might end up with larger subsides in social housing and private renting. The objective is to pick up the middle group identified in the introduction, not those with little capacity to pay for themselves. Thus there is no case for significant subsidy in what is basically an insurance product.

At the present time greater transparency is required about the extent of subsidy on offer. Currently purchasers pay market prices for all tranches; so in principle the only subsidy is in the difference between the equity rate of return and the rent/interest on the secondary tranche. In this context there is no eventual or 'ex post' subsidy when prices rise rapidly but a real cost to Government if prices fall.

Large-scale subsidy cannot be justified to help the groups of households that have been gaining access over the last few years – which have included households with incomes up to, and in rare cases above, £60,000 p.a. (Hughes, 2010). On the other hand the case for risk management across a wide range of income groups is strong and there may be an economic and public finance case for extending homeownership to certain groups (Whitehead, 1979; Whitehead & Yates, 2010a).

The most immediate issue in terms of cost is whether this type of provision crowds out investment *aimed at more vulnerable households* or stops other more general investments from being financed. On housing investment, SO has clearly been a growing part of

Figure 1: Social rented and intermediate housing 1999-2008

Source: CLG live table 1000

the affordable housing market over the last few years (Figure 1) and this has been significantly because it has involved far less subsidy than social renting. So more people have been helped – but these people are higher up the income scale (Graham, 2010). An emphasis on schemes that can enable more social housing to be freed up would be one way to address this issue. Another is simply that effective risk management will help reduce costs for everyone. More generally there are well-operating partial ownership markets for instance for holiday homes. However, most of the benefits of partial ownership (particularly as a substitute for over-indebtedness or poor-quality equity release products) come from achieving scale. This cannot be done without well-constructed products (in financial, physical and locational terms) and better evidence of take-up.

In the current circumstances the most likely alternative option is private rental rather than an overstretched mortgage. This is a very different environment from that which existed during the last decade and it requires a more fundamental rethink of the basic attributes of possible schemes – ideally within a broader-based reassessment of tenure options.

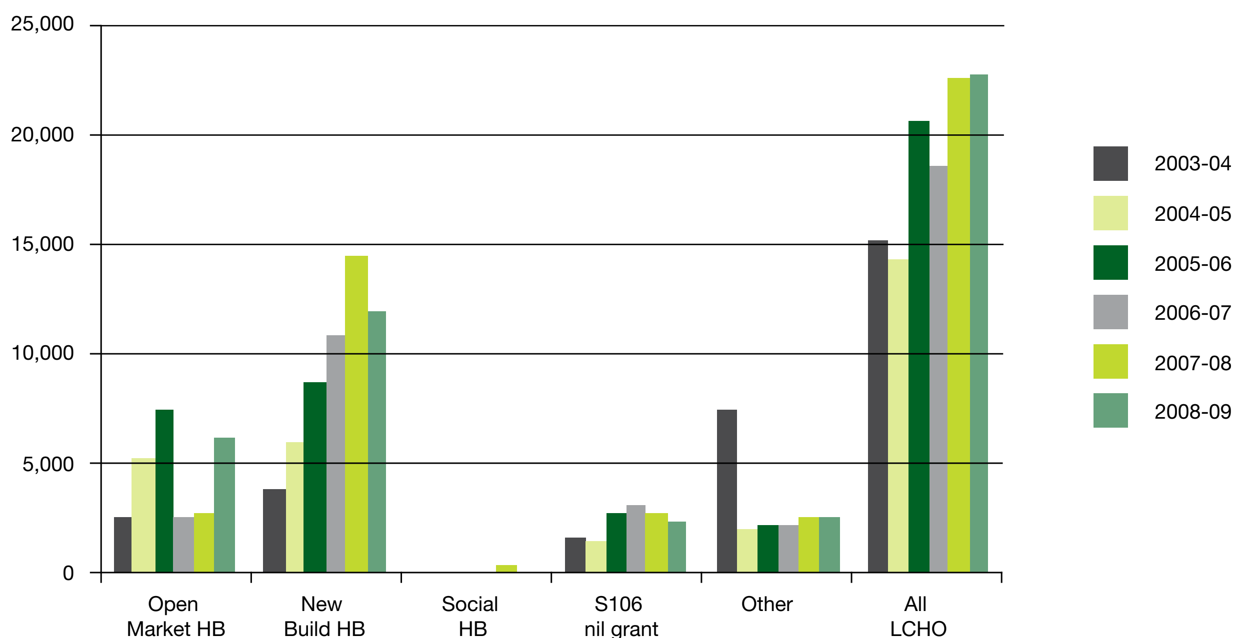
What can be demonstrated is the case for no or shallow subsidy schemes to fill the gaps between private renting and mortgaged-based full ownership. Only further work on product development and market testing in the new environment can enable this gap to be filled.

The issue of crowding out in funding terms relates to the types of schemes that have been made available. Figure 2 gives some idea of the proportions of different forms of SO/SE. Open Market HomeBuy (an SE product) has often involved no ‘ex post’ subsidy – and there has always been a queue for the product. New Build HomeBuy has been relatively expensive in terms of price and has sometimes been extremely difficult to sell because of restrictions to key workers, and because the attributes of new build properties have not met the needs of many of those looking for intermediate products.

Over the next few years the market sector is likely to be depressed and public expenditure constraints may make social rented housing too expensive. So SO/SE may be the cheapest way of maintaining a reasonable level of new affordable housing. This may well be the core of the public expenditure case for supporting SO/SE over the next few years. To be successful, however, this would involve a broader range of both types of dwelling and types of household.

If the Government has to put up 25 per cent or more of the purchase price for a significant period, this could crowd out other investment in a period of public borrowing constraint. Ideally the Government might want to transfer its stake to private investors. This raises the issue of how to develop a secondary market unless sales can be made to single institutional investors. However, it also points the way to demonstrating market viability.

Figure 2: Intermediate housing by type of scheme, 2003-04 to 2008-9



Note: HB = HomeBuy
Source: CLG live table 1010 (based on HSSA and HCA IMS)

Some developers have suggested that SO/SE products are preferable as compared to an over-reliance on private landlords because individual owners are seen as helping to stabilise the development. In some cases this has meant that developers have been prepared to take a longer-term stake themselves. Even so, they have normally sold out as the market improved for both demand as well as cash flow reasons – and it is likely to be a very limited funding opportunity in current circumstances.

A rather different question is whether, from the Government's point of view, institutional investment in shared equity products is preferable to building a more stable private rented sector – where landlords bear the risks and are able to diversify. This very much depends on their views of the benefits of owner-occupation and the capacity to increase the range of rented products available. The general attributes of the UK housing and housing finance systems, particularly the low transactions costs of owner-occupation and the continuing problems with renting, suggest it is a worthwhile option to explore further.

6 What are the funding mechanisms for delivery?

Clearly Section 106 agreements (S106) have been the main mechanism for delivering the land necessary for the development of intermediate tenures and have supported the growth of LCHO (Figure 3).

At present this model is not operational for a range of reasons, not simply the lack of development gains when planning permission is granted. In particular far fewer permissions are being requested. Even so, the potential market for a well-designed product could help to improve profitability.

On the demand side, financing SO has proved more difficult than even for mainstream first-time buyers. This is partly about scale but also because of the complexity of SO models and the lack of standardisation of both types of product from the point of view of financial institutions. It is also because SO/SE purchasers are thought to have been more risky because large numbers of purchasers have had little or no equity stake. As the products stand they have not ticked the right boxes – although SE is far more potentially acceptable than have been some regulatory changes.

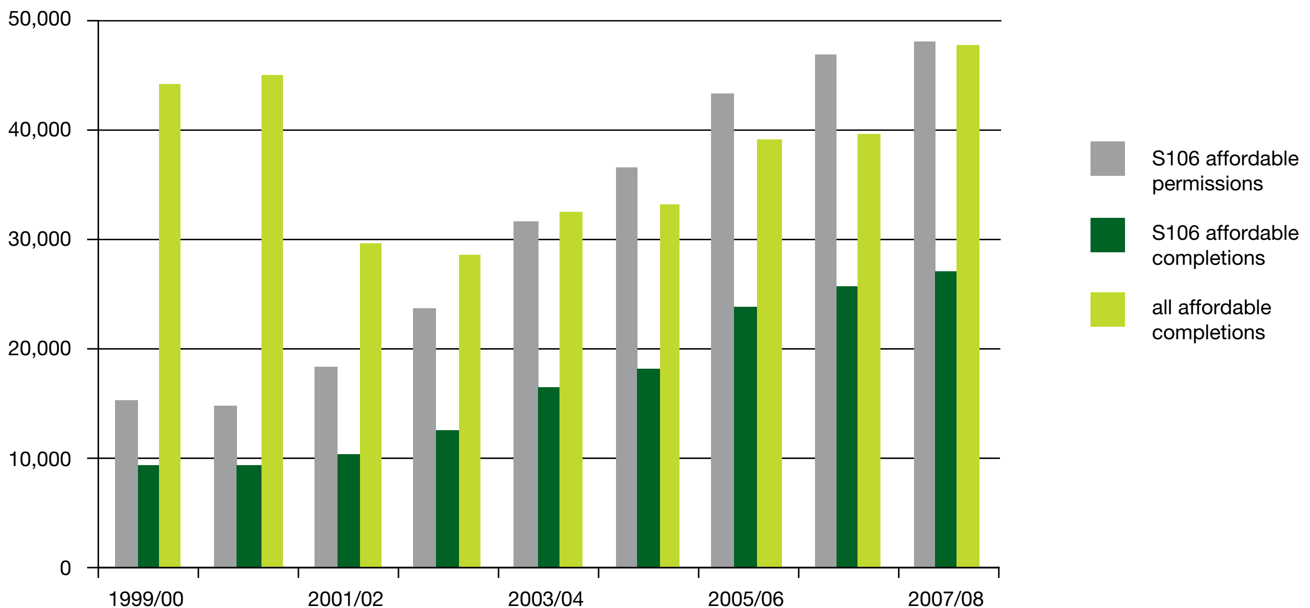
Secondly, SO is currently seen by RPs as a risky investment that many are not prepared to undertake because they have faced significant cash-flow problems as well as capital losses in the latest recession. Some of these problems could be overcome by more market-oriented products.

The latest report on Valuing Planning Obligations shows that affordable housing has become strongly embedded in the system with high levels of funds raised up to 2007/8 (Crook et al, 2010). Obviously these numbers will decline, but so far renegotiation has mainly been about timing and the ordering of development rather than about the removal of obligations.

Looking to the future, only if developers require planning permission can affordable housing be achieved through S106 agreements. In current circumstances permissions are much more likely to be requested on public land where (in the past) there has been a surprisingly bad record of achieving affordable housing as authorities look for maximum values. However, even during the crisis the Homes and Communities Agency (HCA) is looking for mixed rather than single tenure developments. At the present time that must involve SO/SE.

As the economy improves the grant of planning permission will inherently raise land values and therefore provide the basis for the maintenance of a simplified S106 approach. All parties seem to accept that S106 for affordable housing should continue – and other forms of planning gain are far less well established. It is therefore probable that some form of S106 will continue to ensure mixed communities and to provide land for affordable housing. How much finance can be raised through this mechanism in the next few years is much less clear.

Figure 3: Completions of all new affordable housing and S106 affordable completions



Source: CLG HSSA statistics

Conclusions

Current SO/SE products have been both relatively poorly designed and poorly targeted. In particular their value as risk management tools both for consumers and producers has been underestimated.

Theory would suggest that there is a case for partial ownership products for a wide range of people. However, evidence suggests that there are market and regulatory failures which have made it difficult to develop market-based products to any scale.

Government support can take many forms that do not involve subsidy, including regulatory adjustments to reduce costs and increase the incentives to provide both dwellings and finance. The main objective is to manage risk and make financing more sustainable for those who can be expected to pay for themselves over their lifetime. However, there may also be a case for shallow subsidy where alternative approaches may be more costly to the public purse.

Public/private partnership demonstration projects developed to address current economic and financial circumstances and the potential decline in owner-occupation could have an important role to play in moving forward. The objective should be a much broader-based set of risk management and tenancy arrangements that could help provide longer-term solutions that are sensitive both to housing careers and changing circumstances.

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