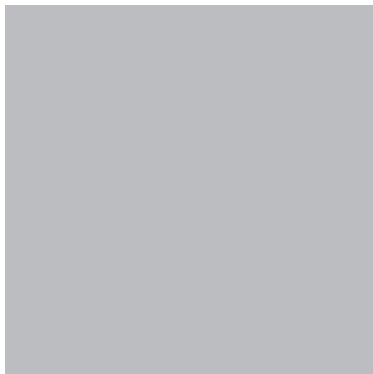




# Submission to New Enquiry and Call for Evidence for Communities and Local Government Committee Inquiry into Financing New Housing Supply

Supplied by Mill Group



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**Introduction:**

1. Mill Group welcomes the opportunity to submit its views on Financing New Housing Supply.
2. Mill Group is a property and finance company now focused on the home ownership expectation of young and upwardly mobile consumers. It has created the Co-investment Model which solves most of the investment issues faced by institutions and other investors by providing an effective and economically attractive route to investment in the residential market.
3. We are very pleased to be able to contribute to the debate, as we have a very strong view that the core requirement to housing supply is to ensure that there is adequate and well funded demand for owner occupation housing.
4. Our submission is focused on the First Time Buyer housing market; however the ramifications go far and wide beyond this, including the rental and affordable housing market.

**Executive Summary**

- **The First Time Buyer (FTB) has historically been the bellwether of the housing market – and remains so**
- **The FTB market is the primary source of new financing of housing supply**
- **Developers cannot invest in new housing without the knowledge that there is a well financed and willing market**
- **There is an urgent need to find new and alternative sources of finance for FTB's, given the current and anticipated longer term position of the mortgage market**
- **New models that can provide this source of finance need to be explored**
- **The Government should invest in and encourage such models**

5. Housing supply is totally dependent on a developer being able to build new housing, be that for rent, or for sale. Without developers having the resources to build, development will remain at current historically low levels.
6. Traditionally, the primary driver of the housing market has been First Time Buyers (FTB) funded by mortgage lenders. Not surprisingly, the significant fall in the level of mortgage lending to FTB's over the past few years has resulted in a dramatic fall in new housing supply.
7. Why? The housing market has lost £billions per annum that was consistently and increasingly channelled via the mortgage lenders to be used by FTB's to buy properties from developers, who in turn used it to finance their developments. Without a consistent continuation of this, or an influx of **new** money from other sources, the housing market is starved of resources for new build developments.
8. The primary Government focus always has been on the supply side – in keeping with its objective to increase the quantity of housing. However, supply in isolation can never guarantee demand, especially if that demand is restricted due to lack of finance.
9. Focus need to be put on an immediate solution for FTB's to kick-start long term change. National planning, investor cajoling, land resourcing or co-funding of developments will take too much time and will not result in a sustainable, long-term building programme without them.

#### **The solution lies in providing new sources of FTB financing**

10. With the current Financial Services Authority's ongoing mortgage market review, the Basel III rules, Solvency II and proposed European directives on mortgages, the mortgage lenders have become more cautious about loan volumes and associated Loan to Value especially with regard to First Time Buyers.
11. According to the Council of Mortgage Lenders, there is little likelihood of changing this liquidity of the mortgage market. A completely new source of liquidity in the housing market is urgently needed, a source that does not add to the debt burden of the purchaser, does not risk negative equity, and is affordable and competitive with other sources of finance and other tenure options.
12. Mill Group is proposing a solution to this limited liquidity within the housing market – which is called Co-investment – to put £billions of new funding into the hands of FTB's, for them to put it into the hands of developers.

#### **What is Co-investment - a Summary**

13. Co-investment introduces the principles and practice of the private sector's potential role in the residential property market, whereby owner occupiers ("the Co-owner") and Investors jointly buy and own residential property. The share of the property owned by each party can vary from 5% to 95%, depending on mutual agreement.

14. Co-investment is a new approach, focused on the mainstream housing market rather than the social or “affordable” end for which Housing Associations and similar organisations provide.
15. There are currently a series of problems, constraints and inefficiencies in the UK’s housing market. These are the three fundamental ones:
  - **Households are tied to either renting or owning**, unless they can access subsidised housing, which is limited and not open to everyone. Subsidised housing is tied to particular housing needs, which differ from the requirements and expectations of the many.
  - **Households are financially constrained**. Many cannot have the homes they want or the financial security they need, because they cannot command a large enough down payment.
  - **Investors have limited residential opportunities**. The current array of investment options in housing is often unattractive for investors, especially larger ones. New models are needed, of which Co-investment is one.
16. Co-investment opens up a new arena for mutual assistance and benefits between households and Investors. This helps to overcome these three major problems identified above.
17. The mutual benefits arise because Co-investment:
  - Provides new sources of liquidity
  - Mutually aligns the interests of homeowners and Investors to gain through transacting with each other
  - Enables risks to be pooled in new, innovative ways
  - Places repair and maintenance responsibility with consumers where it can most easily and cheaply be dealt with, improving net returns to investors to attract their capital
  - Lowers risks and the threat of default by smoothing out household budgetary burdens
  - Enables households more closely to optimise wealth, income and consumption
  - Facilitates Investor asset diversification strategies
  - Provides Investors with opportunities to invest in housing market capital appreciation without excessive lock-in.
19. The Co-investment model consequently has housing market, financial, investment, and housing policy benefits. The opportunities created are especially important at present because of:
  - **Reductions in public expenditure** which will press down on housing opportunities, including reduced housing benefit and lower subsidies for social housing and housebuilding.
  - **New mortgage regulation** is squeezing out more potential homeowners from traditional mortgage finance routes.

- **The housing market is recovering weakly** and needs new purchase opportunities and finance.
- **The economy is growing only slowly** and there is a risk of renewed decline, partly dragged down by the problems of the housing market.

### **How Co-investment Works – for Home Buyers**

20. Under Co-investment a resident owner-occupier (“the Co-owner”) and an investor jointly purchase and own a dwelling. The initial share owned by each party can vary from 5% - 15% for the Co-owner and 85% - 95% for the Investor, depending on the Co-owner’s level of initial funding. The Co-owner has the right to live in the whole property as a normal home owner, without the threat of losing their right to occupy (provided payments are maintained). They own their share without debt, as their initial share is used to purchase their proportion of the property, without a mortgage.
21. The Co-owner pays an annual Co-investment charge to the Investor related to the property’s capital value for use of the Investor’s share of the property. This charge is then linked to RPI for a minimum of 5 years at which point it is reviewed based on the House Price Index and rebased, if appropriate. This provides Co-owners with long term predictability of housing costs, which can remain fixed in real terms for the duration of their Co-investment occupation.
22. The Co-investment charge is dependent on the value of the property, but should be lower than an equivalent repayment mortgage or comparable rent (depending on location).
23. The Co-owner has the right to purchase a greater share of the dwelling if and when they are ready, in small, manageable steps at the prevailing property value. As they do so, the Co-investment charge decreases accordingly.
24. When ready – for example the Co-owner has saved sufficient money to cover the deposit requirements; they can buy out the Investor and so own the property outright.
25. Co-owners can sell on their share in the property, sell their share back to the Investors, or sell on to another Co-owner – always at the prevailing market rate.
26. Property choice is crucial for both Investor and Co-owner. People who set up home with Co-investment have a much wider choice than renters. They can buy in their preferred localities from across the whole housing stock up for sale in the same way as other homeowners, rather than from the limited number of rental properties available in any locality at any point in time.
27. For potentially large numbers of people, Co-investment widens consumer choice and improves market outcomes. An implication is that Co-investment will appeal to a broader range of people than does the private rented sector itself.
28. In many respects, Co-investment is similar to direct house purchase. There are the ownership rights and freedoms that go along with owner-occupation, plus the financial and social benefits. A legal agreement is drawn up at the time of purchase which sets out how the property interest is held by the Investor and Co-owner. Under English law,

the property is owned jointly as ‘tenants in common’, with each party having defined ownership percentage and sale proceeds and clearly explained obligations towards each other. This type of ownership structure is well established, so represents no challenge to property holding structures; while the rights and obligations associated with tenants in common agreements are.

29. Co-investment can effectively last for as long as the Co-owner wants the arrangement. As part of the Co-investment agreement, the Co-owner would be expected to be responsible for on-going maintenance, so that the obligations and costs are clear-cut. Commonly, homeowners like to expand, or otherwise improve, their properties to enhance liveability and value. Under Co-investment arrangements, Co-owners can so if they wish, subject to approval from the Investor from whom they could expect a financial contribution in accordance with written provisions reflected in the contract.
30. Co-investment could also be portable. If a Co-owner wishes to move, the Co-investment arrangement can be set up for the new property, subject to checks and mutual agreement. Likewise when a Co-owner wishes to sell, the Investor can agree to put the whole property on the market jointly, or offer the Co-owner’s share to another applicant.

#### **How Co-investment Works – for Investors**

31. The Investor could be any individual Investor, institution, Local Authority or fund. Investment gains can be derived from owning a pool of Co-investment properties and in the origination and management of them. Consequently, Investors will tend to either be relatively large in size and, so able to finance several hundred or more properties or, alternatively, be special purpose funds.
32. Co-investment provides the Investor with a wide variety of specific investment strategies. Each has potentially different exposures to the housing market. For example, portfolios could concentrate investment by location, household type, or dwelling type characteristics, as well as differing development exposure and gearing levels.
33. Though in principle Investors could directly manage their own Co-investment properties, there are benefits to having specialist service teams undertaking the origination and management of Co-investment portfolios on their behalf. Asset Managers would have the scale to generate efficiency gains and the expertise to undertake all aspects of transactions: including the administration associated with property acquisition; the screening of potential properties for viability; the responsibility to evaluate the buyers’ credit-worthiness; and also to provide advice to both potential Co-owners and Investors on the best options for them to meet their requirements, such as capital gains provision etc.

#### **The Benefits of Co-investment**

34. Co-investment represents a new tenure form. It differs in several important respects from products such as shared equity and shared ownership. Specifically:
  - It is aimed at the intermediate and mainstream segments of the housing market, is a purely private sector solution and involves no element of subsidy nor third party involvement.

- It facilitates liquidity by creating new sources of funds into the housing market.
- It is a simple and transparent joint investment, with no hidden obligations or risks, so that both homeowners and investors can feel comfortable with their roles.
- It lowers the cost of entry to homeownership and enables households to optimise entry by lowering the initial deposit and other financial constraints.
- It provides a new form of home ownership, widening access to it while providing for security of tenure as long as payments and other contract conditions are maintained.
- It enables households to substitute potential future capital gains for current income, through trade with investors that have different time preferences.
- It improves the ability of homeowners to reassign their wealth portfolios and income horizons and to take positions on future house price change by altering their proportion of the ownership of the property they live in.
- It improves overall risk exposure, enabling risks to be reassigned between homeowners and investors on the basis of trades between them.
- It facilitates a route for investors into the mainstream residential market and improves the opportunities for funds to invest in housing.
- It enables investment funds and other large-scale investors to invest in residential in an efficient and diversified way.
- It can be made tax efficient in a variety of ways, potentially including REITs.
- It brings new, permanent sources of funds into housing finance and new forms of residential investment. By doing so, it improves competition in both housing finance and in the private rented sector.
- It offers the opportunity to limit the default risk arising from temporary loss of household income.

### **The Benefits of Co-investment for Public Policy**

35. Government rightly has long-term aims with respect to housing and is concerned with wider long-term housing issues, such as market efficiency and stability, consequences for labour market mobility, fairness, and increasing housing supply. In addition, short-term recovery is currently at the forefront of policy concern, particularly related to mortgage finance and house building. Co-investment can play a role in all of these aspects. Below we look at some of the key ones.

#### ACCESSIBILITY AND CHOICE

36. **Improving access to owner occupation** By lowering the substantial entry barrier to owner occupation represented by the deposit requirements associated with mortgage

lending, Co-investment expands the scope of ownership. It also speeds up the time at which some can buy into their home, stair-casing to full ownership later if they wish, and lowers the deposit barrier that it is impossible for others to overcome - even households that could afford the on-going costs of ownership.

37. **Widened tenure and housing choice** By increasing the option of owning or renting, Co-investment extends the range of choice open to consumers.
38. **Expanding the rental sector** By offering the choice to part rent on more secure terms than currently offered in the private rented sector, Co-investment is an attractive option for many households to consider. The ability of Co-investment to increase both ownership and renting at the same time is not a paradox because of the 'joint' tenure nature of the model.

#### IMPROVING THE FUNCTIONING OF THE HOUSING MARKET

39. **Bringing in new sources of finance** Co-investment offers Investors an equity play and a rental yield return on the UK housing market. It has a distinct underlying asset and default profile differing from either direct mortgage lending or the purchase of mortgage-related capital market paper or fixed income bonds offered by Housing Associations. As such it offers a distinct route for bringing additional finance into the UK housing market that will be attractive to a broad range of UK institutions and foreign investors.
40. This feature is particularly important at present because the UK mortgage market is suffering from a particularly large shortage of funds and near closed capital markets; characteristics that are likely to endure for some years to come.
41. **Helping to stimulate housing supply and regeneration** Recent research has highlighted that mortgage market constraints are particularly detrimental for new build, because new housing disproportionately serves purchasers worst hit by mortgage contracts, such as FTB's. By improving the ability of first-time buyers to purchase, Co-investment will help to stimulate the demand for new property and encourage expansion of housing supply.
42. First-time buyers are one of the main purchasers of newly built properties in regeneration areas, so that the stimulus effect will be disproportionately felt in such areas, where house building has been particularly badly hit. The possibility of Co-investment funds pre-purchasing properties would also help bring new development forward. Development finance is currently extremely difficult to come by, so that this type of supply-side stimulus would be highly effective.
43. Problem areas, such as bringing empty properties back into use, would be made easier through a Co-investment approach. It could both help incentivise purchasers by lowering deposit hurdles and spread the risks between the Co-owner and Investor.
44. **Freeing up the housing market** The housing market, outside of a few strong growth areas remains in a moribund state. Co-investment could help in freeing up the housing market in key aspects of activity. Mobility in general would also be improved.

45. **Increasing competition in housing finance** By introducing a new flow of housing finance; by offering consumers alternatives to simple renting or buying. Co-investment compliments current housing market offers. Competition is thereby enhanced. Furthermore, Co-investment is not a proprietary brand. Once it is successfully in place, the expectation would be for new entrants to be encouraged into the market place, stimulating competition and the potential for innovation around the Co-investment theme.
46. **Improving housing market efficiently** Co-investment can impact on housing market efficiency; by enhancing housing finance; optimising housing mixes; improving mobility; risk pooling; lowering transaction costs; and making better use of the stock. These and more suggest that the widespread option of the approach would offer significant efficiency gains.
47. **Stabilising the housing market** The housing market is subject to substantial fluctuations and innovations can play important parts in inducing greater housing market stability. There is a much lower risk of repossession under Co-investment, as there is no debt and no risk of negative equity. Moreover, Co-investment funds are distinct from those of investment in mortgage finance and spin-off instruments. Therefore, the flow of funds into Co-investment would be distinct from that of mortgage finance.

#### WIDER ECONOMIC AND SOCIAL EFFECTS

48. A variety of economic and social goals are facilitated through Co-investment in housing. Trend economic growth is enhanced by the greater labour mobility that would arise from the widespread adoption of Co-investment. That, in turn, would limit inflationary pressures as the economy expands.
49. Concern has increasingly been raised about the difficulty of those without wealth, to gain access to it via housing. By offering an intermediate stage towards full ownership, Co-investment opens up greater equality of opportunity by offering a chance to enter homeownership for those without parents affluent enough to offer financial assistance, especially those that missed out on the cyclical property booms.
50. Worries over growing consumer indebtedness would be diminished, particularly with regard to the young who currently face the prospect of higher debts to go to university, larger mortgages to become homeowners, and other financial pressures to fund deposits.

#### **A. What the role is of state lending or investment, as opposed to grant funding, and the appropriate balance between them;**

51. Grant funding should, in our opinion, be focused on those that cannot necessarily raise the capital required by any other means and/or are unlikely to be able to repay the monies. Grant funding, therefore, should be directed at those that cannot get any other means of support.
52. On the other hand, state lending or investment must be assessed on a purely commercial basis. For loans, the key criteria are: Will the money be repaid, including interest; Is it supported with sufficient security in case of default? For investment, it is

ensuring that the returns, whether in asset growth and/or yield is such that it makes sense to allocate the funds to this or that investment.

53. It is perfectly acceptable, as part of the evaluation of cost, to include an element of 'social impact' as this has an opportunity cost attached to it by reducing costs in different areas of Government budgets.
54. State lending or investment into Co-investment would demonstrate an understanding of the need to generate new sources of funding for the owner occupier market. It would accelerate the 'proof of concept' that is so critical to Investors considering a new financial model. It can and should be done on a commercial basis, with minimal risk and in expectation that, at worst, the initial investment will be returned, in full.

**B. What the role is of the public sector in providing support in kind—for example land or guarantees—as opposed to cash, and what the barriers are to this happening;**

55. If cash is not available, the State can have a significant influence in gaining traction for new models by declaring publicly that it can see merit in the concept and would like to see it in action.
56. The State is able to help facilitate a meeting of minds between potentially interested parties and, by doing so, demonstrate its support for the concept of Co-investment, recognition of its value and a desire to see it take place.
57. Too often, the State takes the view that if there is no direct action needed, then *no* action is needed – and nothing can be further from the truth, especially if, at the end of the process, the State becomes the major beneficiary!

**C. How long-term private finance, especially from large financial institutions, could be brought into the private and social rented sectors, and what the barriers are to that happening;**

58. The major barrier to long-term private finance from large institutions is the lack of attractive residential housing investment models. Most institutions have considered the existing models and have concluded that the returns on investment are insufficient and the reputational risks too high to justify their commitment to any significant scale of investment.
59. The Co-investment model specifically has been developed with this firmly in mind and is able to generate higher IRR's than other models through the unique concept of co-investment. Not only does this deliver a higher and indexed yield for investors, it also provides them with a higher level of security about the quality of occupier they are associating with – and more significantly, one that is committed to looking after the property until such a time that they either buy out the investor in full, or move on, by selling their share of the property back to them (or on to another Co-owner).

**How housing associations and, potentially, ALMOs might be enabled to increase the amount of private finance going into housing supply;**

We have no comment to make

**How the reform of the council Housing Revenue Account system might enable more funding to be made available for housing supply;**

We have no comment to make

**How effective the Government's 'Affordable Rent' proposals are likely to be in increasing the funds available for new housing supply, and how sustainable this might be over the medium to long term.**

We have no comment to make