CDS CO-OPERATIVES

A simple guide to Mutual Home Ownership

Mutual Home Ownership (MHO) is a new form of tenure that seeks to increase the supply of affordable intermediate market housing without requiring a major increase in capital investment from Government. Unlike other forms of low cost home ownership, it is designed to remain permanently affordable and not move out into the open market.

The key is to make land available, as a sustainable community held asset, for MHO at nil cost to the mutual home owners who will live in the housing built on the land. The land can come from a variety of sources (e.g. section 106 affordable housing planning obligations, exception sites, surplus land currently in public ownership, industrial land given change of use consent on condition that it is used for MHO, or the application of creative estate management methods).[1]

In MHO residents pay for the build costs, but not the land. The land is transferred into the ownership of a Community Land Trust (CLT) that holds it in perpetuity for the provision of affordable housing in their community. Our Community Land Trust proposals have been based on the experience of similar organisations in the USA and Australia.[2] The CLT is the local accountable custodian of the land asset assuring its continuing use for the purpose intended. As the freeholder/head leaseholder of the land it has the legal power to ensure that the MHO scheme is operated by members as intended.

MHO is a market-equity form of tenure in which residents have an equity stake in residential property. This is because the research carried out for us by the New Economics Foundation clearly showed that the aspirations of key workers and others with moderate incomes excluded from the housing market was to have an equity stake in the housing market.

The residents interested and eligible for the housing are admitted into membership of a Mutual Home Ownership Trust (MHOT), a registered Industrial and Provident Society. This must be a mutual organisation for two reasons. Firstly, only a mutual housing organisation is excluded from statutory tenancy provisions. It is therefore free to create the tenure model that grants residents an equity stake through the terms of a contractual lease. Secondly, because it is a mutual, any payment of equity growth to members when they leave is tax exempt, in the same way that the increase in capital value of a home owner's home is a tax free gain.

The CLT grants the MHOT a lease of the land owned by the CLT at a peppercorn rent. The lease contains obligations to build a specified MHO project. It works with a development partner, an RSL (or private sector developer) which takes the development risk (and potential development construction profit) and agrees to build the housing for an agreed maximum price to specified Egan compliant standards. Finance for development is raised through a standard development period loan.

---

[1] A good example of what can be achieved by a positive estate asset management is what has been achieved in High Bickington, Devon - see the High Bickington Project and Community Property Trust website at http://www.highbickington.org/project.asp

[2] For an example of a mature community land trust in operation, see the Burlington Community Land Trust in Vermont at http://www.bclt.net/.

When the housing is complete the MHOT takes out a long term 30 year corporate mortgage that finances the project construction and development costs. It is a corporate loan rather than a collection of individual mortgage loans because it will be cheaper to residents, in the long term, and will avoid the arrangement and transaction costs, implicit in individual mortgage loans, that erode the benefit of equity growth in other sub market home ownership products. The loan will be structured to give MHOT members the long term certainly over interest rate risk that Professor David Miles commends in his report on the UK Mortgage Market.[3]

The value of the portfolio of property owned by the MHO is divided into units of property equity (say, £1,000 units, although they could be smaller) which residents fund through monthly mortgage payments under the terms of a long (99 year) lease. New residents will be required to take-up and finance a number of units of equity according to their income and ability to finance them. As their salary increases they can take up more units of equity when they become available for sale.

The lease sets out members' occupancy rights and responsibilities, including resident management responsibilities as in a leasehold management company and the obligation to pay leasehold service costs. It also sets out their right to an equity payment when they leave. The equity payment is due if the value of the units of equity they have funded has increased during the time they are resident in the housing owned by the MHO. Monthly charges are geared to be affordable at 35% of net income. In effect, the value of the land at nil cost is distributed according to income/need. It is a subsidy that reduces over time for each member as their income rises and they meet their obligation to finance additional units of equity; an obligation than can be enforced through the terms of the lease. All units of equity must be allocated to and funded by payments from members of the trust.

When a resident leaves they assign their lease (occupancy rights) to a new incoming member who cannot afford to buy a home on the open market and who qualifies for housing (if the land is made available for specific categories of key workers). The outgoing member's units of property equity are sold when they assign their lease. Some go to existing members who can afford to increase their equity stake because their income has risen. The balance goes to the incoming member at a lower affordable net cost. The value of equity assigned is determined by reference to a local housing market value index that is incorporated into the lease. This ensures that the benefit of the land held outside the market by the CLT and the affordability it creates is recycled from one generation of occupant members to the next.

The outgoing member takes 90% of any increase in the market-linked value of units of property equity they financed while they lived in the mutual. 10%, remains in the MHOT to strengthen its finances by creating an asset reserve. The 10% is an acceptable retention of asset growth given that the resident has had the benefit of the scheme. This growing asset reserve will enable the MHOT to drive down borrowing costs by lowering mortgage default risk.

[3] One option we are considering is an elegant capital tilted index linked form of mortgage that was used in Canada to raise $500 million for Canadian housing co-operative development in the 1980s. It is a form of mortgage that is very attractive to pension fund and life assurance fund investors because it guarantees a real percentage yield long term over the rate of inflation and is secured on the open market value of the property. At the same time it removes interest rate risk by having a structured guaranteed rate of increase in repayments; (repayments increase annually at RPI minus the tilt, typically 1%). Ken Bartlett, Chair of the Rowntree Foundation Land Inquiry, who served on the Common Ground report research advisory committee, considers this a particularly attractive form of mortgage for MHO schemes. The mortgage will be raised by or guaranteed by the Co-operative Housing Finance Society Ltd which we established 7 years ago and which to date has guaranteed £10 million of mortgage loans for rental housing co-operatives.

These arrangements create a new way of owning equity in the value of residential property. It is a similar way of holding property equity to the way pension equity is financed and held – specified numbers of units of market-value linked equity are financed by monthly payments and held in a common trust fund until a specific event in time – in this case not retirement from work but moving out and selling equity units held. Equity growth withdrawn is financed by topping-up the mortgage loan.

MHO members will also be expected to make a personal financial commitment to the scheme by financing 5% of their equity stake as a cash investment in the Mutual Home Ownership Trust. This will act as security against arrears of mortgage/service charge payments. It is planned, over time, to develop savings schemes to enable those interested in MHO to save for this investment. [4]

David A Rodgers
EXECUTIVE DIRECTOR
9 September 2004

[4] This is an element taken from the large Swedish tenant ownership co-operative movement which has its own members' savings bank in which those interested in buying a co-operative home can save for the deposit they will be required to make.