

# **DELIVERING DECENT HOMES IN THE PRIVATE SECTOR**

**Funded  
By  
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**Report Authors**

**Doug Wright.  
And  
Deborah Carlo.**

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# INTRODUCTION

## INTRODUCTION

In 2003 Mercian Housing Association (MHA) a medium sized Registered Social Landlord [RSL] operating in the West Midlands, acquired ART Homes Ltd [ART Homes], an organisation offering affordable loans to homeowners for repair and improvement. The move was part of a strategy by MHA to become a major regional participant in regeneration activities. ART Homes had initially been established as part of the Community Development Finance Initiative [CDFI] Aston Reinvestment Trust (ART) following research, identifying access to finance as a significant factor in preventing repair and improvement in the private sector in Birmingham. The partnership between MHA-ART Homes allows a comprehensive approach to regeneration by enabling an RSL to take a lead in tackling disrepair in the private sector alongside social housing on mixed tenure estates.

This report details research undertaken into the possibilities that a model, such as; the MHA-ART Homes arrangement can present in regeneration activities. Funded by a Housing Corporation Innovation and Good Practice Grant, it aims to provide evidence that a model such as this can help assist Local Authorities to lever in private sector finance to provide suitable loan packages to bring private sector properties up to the Decent Homes standard.

## BACKGROUND

The English Stock Condition Survey [E.S.C.S.] (2001) indicated that there is a national problem with unfitness in the private sector, with 32% of owner-occupied housing not meeting the Decent Homes standard. Nationally, this represents a bill of approximately £50bn to bring all homes up to the Decent Homes standard; with an additional £46bn required for basic and urgent repairs.

In the Midlands alone, the E.S.C.S. estimates that the total of non-Decent Homes is 37% of the housing stock and that this requires investment of £4.5billion to bring the 620,000 homes up to the Decent Homes standard.

This high level of disrepair has arisen partly due to many low-income homeowners being unable to afford conventional finance to allow them to repair or improve their homes. There are a number of key target groups amongst low-income homeowners such as, older people, Right To Buy [R.T.B.] homeowners, and applicants for Local Authority Grants, but the common factor is that many of the homeowners in these groups cannot afford conventional finance and many cannot afford to service loans even where the interest rate is affordable.

In respect of the latter group, where the homeowner cannot afford to service any loan, the only option is to release equity from the property to pay for

improvements. It is recognised that not all homeowners in low-income groups will have equity to release, but many have, and a product that can facilitate this equity release will have a significant impact on achieving the Decent Homes standard.

The Government has recognised the scale of the problem and the fact that the Local Authorities grant-giving regime was not going to resolve this issue. Government policy has, therefore, changed recently with the introduction of the Regulatory Reform Order [R.R.O.] in the summer of 2002. The R.R.O. recognises the need for private finance to be introduced into the improvement process as the scale of the problem and the financial resources required are beyond the resources available to Local Authorities.

The R.R.O. has given Local Authorities the powers to make loans and take equity stakes in property and, also, to facilitate third party organisations to carry out these loans on their behalf. At the very least, the aim of the R.R.O. is to encourage Local Authorities' funds to be recycled by the use of loans, but the real key to success is to lever in substantial amounts of private finance into the improvement process.

### ART HOMES

ART Homes was established in June 2000, on a pilot basis, to provide affordable home loans to low-income homeowners. The purpose of the loans is solely to help homeowners to repair and improve their properties. The loans are only made in association with agencies who oversee and control the building repair process.

ART Homes aims to provide a range of affordable loans to homeowners, in the process trying to ensure that any owner-occupier wanting to improve their home will not be excluded from doing so by the inability to access finance.

ART Homes also has an aim of trying to increase the number of homes meeting the Decent Homes standard and in the process trying to lever in private finance to increase the scale of activity in this sector.

ART Homes was established and initially set up with both revenue and capital support from Birmingham City Council and revenue support from Nationwide Building Society. Additional support for the development of products was received from The Joseph Rowntree Foundation. In the last two years Barclays Bank has also provided substantial revenue support to help develop the model.

It was during the pilot phase that Government policy changed with the introduction of the Regulatory Reform Order (R.R.O.) in July 2002. This new policy substantially changed the environment within which ART Homes was operating and led the Board of ART Homes to move from a pilot project to considering the expansion of the new business. As this potential expansion was considered to be beyond the resources of its then parent ART, the Board negotiated an arrangement with MHA and in November 2003 ART Homes became a subsidiary of the Association. The fit between MHA-ART Homes

was found to be an excellent one as MHA is in the process of developing a strategy to become an RSL interested in wider regeneration opportunities, including private sector housing.

### The ART Homes Products.

To date the following products have been developed:

- A Repayment Loan. This has been designed as a capital and interest traditional repayment loan, but with an affordable rate of interest.
- The Interest only Loan. This loan has been developed for homeowners who cannot afford the Repayment loan but can afford lower monthly payments, of an interest only product.
- The Property Appreciation Loan [PAL]. Research carried out by ART Homes, in association with The Centre for Urban and Regional Studies at Birmingham University, for Castle Vale H.A.T. in 2001 led to the development of an equity share loan called the Property Appreciation Loan [PAL]. ART Homes research has also shown that any equity release product for low-income homeowners needs to be a relatively simple product. To be successful any product also needs to leave the target groups feeling that they still own the property and that an increasing proportion of the property value will not be lost to any lender [Focus group research in Sandwell 2001].

The PAL product developed can best be described by an example:

A loan of £5,000 is required on a property valued at £50,000 therefore a loan is secured, by a charge, against 10% of the property value.

When the property is sold for say £60,000, 10% of the sale value is repaid i.e. £6,000.

In the basic product there is no upper limit on the return, but the original loan must be repaid even if the property value falls. However, individual Local Authorities can amend the terms to suit their needs.

ART Homes was initially capitalised with a grant of £250k from Birmingham City Council for its repayment and interest only loan fund. In addition, Barclays has provided capital of £50k for the fund, so that the fund now totals £300k, of which £50k is designated as a guarantee fund. The purpose of the guarantee fund is to provide a fund from which any losses of capital can be offset and therefore to help lever in private finance.

In September 2003 a legal agreement was completed with Birmingham City Council in which the City Council agreed to put £1 million into a fund for equity share loans, the PAL fund.

A great boost to the development of the PAL and ART Homes as an intermediary lending agency was received in December 2003 when the West

Midlands Regional Housing Board agreed in principle a bid of £6.7m to support private sector renewal programmes throughout the West Midlands by supporting seven Local Authorities to pilot loans for their renewal and clearance programmes. To date six of the seven Local Authorities involved in the project have signed legal agreements with ART Homes and the first loan applications are now being processed.

Regulation of mortgage and other secured and unsecured loans will be an increasingly important part of the lending market. While Local Authorities and RSLs are currently exempt from legislation, they are expected to comply with the spirit of any legislation. This is likely to become an increasingly specialist and complex area and the models for delivery of loans need to be carefully thought through in terms of compliance.

The ART Homes model is fully compliant with all existing legislation and is registered with the Financial Services Authority and also registered for Consumer Credit Act lending.

During the financial year starting in April 2004, ART Homes has seen a dramatic increase in the number of cases being processed.

The current figures [at January 2005] are:

	<b>Number of loans</b>		<b>Value of loans</b>
Completed loans	84	Total loan value	£810,000
Approved loans	13	Total loan value	£163,000
Approved in principle	80	Total loan value	£1,140,000
Enquiries	36	Total loan value	£444,000
<b>Totals</b>	<b>213</b>		<b>£2,557,000</b>

This represents a significant increase in business, particularly as it only represents loans made in Birmingham through the existing Birmingham City Council scheme, and before any cases have come through the other sources of introductions being developed.

## **THE RESEARCH**

In order to demonstrate how the MHA-ART Homes model can help deliver Decent Homes in the private sector, a substantial and diverse amount of research has been conducted. The research began with an exercise to see how Local Authorities and lenders had responded to the change in the R.R.O. Following this was a study of four different housing markets, with the aim of investigating the suitability and demand of loan products in aiding regeneration in these areas. During this research over 500 homeowners were interviewed. This research then led directly to the requirement for faith based loans. The faith loan research was then expanded and products developed and market-tested. The popularity of the PAL as a means to help people afford homeownership after demolition, led to an analysis of current home ownership initiatives with the aim of proposing a comprehensive home ownership package of varying finance options.

Once the demand and the suitability of loans and in particular the PAL had been established, in a variety of market conditions, financial modelling as to the potential of a PAL fund, and a discussion regarding the possibility of leveraging in private finance to the process, began. This was followed by suggestions on how the MHA-ART Homes model could be franchised or utilised as an example for other RSLs to use across the country. A summary of the aims and content of each chapter is provided below.

### 1. Developments with Delivery Models.

This research began with an exercise to see what other initiatives were being carried out around the country to develop funding models to assist low-income homeowners. This part of the research was undertaken in conjunction with Birmingham University and consists of four case studies. The case studies are all examples of possible different ways forward in accessing private finance although not all of the case studies are currently doing so. This early research was published as a briefing note in the spring of 2004 and updated for this report and provided a sound base from which to continue to explore the MHA-ART Homes model.

### 2. Market Studies

Once it had been established how other organisations were responding to opportunities, the research focused on how equity-based loan products such as those provided by ART Homes in Birmingham could be used in different housing situations with the support of an RSL. Four individual studies were undertaken into the demand for and potential use of loans in:

- i. A failing housing market
- ii. A clearance area
- iii. A client specific approach (older people), and
- iv. A sustainable housing market.

Primary research was undertaken on varying numbers in each study area and the results were used not only to form a base for this report, but were also provided to the relevant Local Authority to be used for future policy formulation.

### 3. Faith Loan

The results from the four market studies then led to consideration of any other loan products needed. A significant demand for a loan product that was acceptable to faiths that do not accept the payment of interest became apparent. As a response to this the possibility of developing a faith loan was explored. This began with a desktop search of the current faith loan market, suggestions for a potential faith loan and market testing of the proposed product by the way of two focus groups.

### 4. Home Ownership Options

The popularity and potential of the PAL product as a means to assisting in house purchase also became apparent from the results of the market studies. To investigate this further, an analysis of the costs of current low cost homeownership initiatives such as Homebuy and Shared Ownership was

undertaken. The aim was to propose a comprehensive scale of homeownership where possible buyers could enter on varying levels of ownership and move freely up and down the scale. The analysis highlighted the need for new product-development at the lower end of the scale in the form of an equity-saving product and emphasised the potential benefits of using equity loans in this way.

## 5. Private Finance

Once demand had been established, the remainder of the report focused on an approach taken by MHA-ART Homes in utilising private finance in the provision of equity loans to achieve Decent Homes in the private sector. A financial model was developed that could model the growth of an equity loan fund over a 25 year period. This allowed for an analysis of the financial risks to Local Authorities, as well as providing a base for which to begin discussions with commercial lenders.

## 6. Franchising

The final chapter of this report considers the possibilities for the MHA-ART Homes model and use of the PAL product to be franchised or rolled out across the country. This involved considering two options: a PAL by post system, which would enable Local Authorities quick access to PAL loans, and the longer term suggestion of a network of regional agencies with one in each of the Regional Housing Boards.

The report concludes with a Summary and Recommendations section.

# 1. DEVELOPMENTS IN DELIVERY MODELS FOR PRIVATE SECTOR HOUSING RENEWAL

## INTRODUCTION

This initial chapter considers the responses of other organisations to changes in the RRO, with the aim of considering different models alongside the ART Homes initiative. This chapter was compiled in association with the Centre for Urban and Regional Studies at Birmingham University. For many years Local Authorities have been encouraged to seek to increase the levels of private investment into home maintenance and repair, but the RRO gave an additional boost to this process. The task has proved more challenging than expected, however, and progress in terms of the introduction of loan products and special purpose vehicles, such as Community Development Finance Institutions (CDFIs), with an orientation towards housing has been modest. This chapter summarises and disseminates information about a number of different initiatives, which are now up and running, and provides some directions for the future in terms of private sector housing finance.

Four different initiatives are highlighted in this information note. They are not intended as a comprehensive list, indeed several other similar initiatives are being developed by Local Authorities and other agencies up and down the country. Neither are they all currently accessing private finance, but we have included an example of direct lending by a Local Authority in order to offer a broader range of options for Local Authorities to consider. These initiatives do appear to offer genuine examples of the different ways forward in terms of accessing private finance. The four initiatives summarised are:

- The Home Improvement Trust (HIT), Nottingham – an intermediary special purpose vehicle operating nationally.
- HomeImprove – another ‘not-for-profit’ lending agency arising out of a partnership arrangement between an RSL and two Local Authorities
- The Derby Loans Group – a ‘not-for-profit’ CDFI
- An example of direct lending by Wigan Borough Council for private sector housing renewal.

In addition to summarising the key features of these initiatives in a series of case studies, this chapter describes the services offered to Local Authorities by these agencies; outlines the options available to Local Authorities in seeking to access private finance; and advises what Local Authorities need to do in order to access these services.

## THE HOME IMPROVEMENT TRUST

### Introduction

The Home Improvement Trust (HIT) was established in 1997. Its purpose is to provide independent financial advice and to make available access to affordable home repair and improvement loans for older homeowners (and those under 60 with disabilities) who are “cash-poor but equity-rich”.

### Background and development

The HIT was initially funded as a pilot project, for two years by the Department of Environment, Transport and the Regions (DETR), now the Office of the Deputy Prime Minister (ODPM). It also received funding and support from Age Concern England.

During this period, research conducted by Birmingham City Council suggested that the commercial loan products available on the market at the time would not provide the answer for these cash-poor but equity-rich people. Once the DETR grant came to an end, therefore, Birmingham City Council continued to provide financial support for the HIT in order to underpin its own strategy for private sector housing renewal.

The Birmingham Home Improvement Partnership (BHIP) was then formed by an alliance between Birmingham City Council; the local Home Improvement Agencies [HIAs]; Birmingham’s own in-house Home Improvement service; ART Homes; and the HIT. A brand name was needed to promote the work of the HIT, to raise its profile and deliver a coordinated home improvement service. Hence, the ‘Houseproud’ scheme was launched locally in Birmingham in November 2000.

### The HIT and Houseproud

The HIT is a not-for-profit company with a Board of Directors from Age Concern England, Help the Aged, Housing Associations and financial and legal expertise from the City of London. It is based in Nottingham and operates nationally. It works with lenders, Local Authorities and Home Improvement Agencies (HIAs) to offer a range of products to older homeowners to fund repairs, improvements and adaptations, largely via equity release products. The actual improvement/repair work is carried out by HIAs. The HIT is not, therefore, a direct lender itself, but acts as an intermediary between the different parties, facilitating independent financial advice, property valuation, liaison with lending institutions, and ensuring all legal processes are carried out in order to facilitate access to affordable loans to fund home improvements, repairs and adaptations.

Following its initial success in Birmingham, the Houseproud scheme was launched nationally by the HIT in 2002. Houseproud is not primarily a loan scheme but an overall service, which includes access to grants, or other funding, either from the Local Authority or other charities, or alternatively from energy efficiency grants such as WarmFront. Funding may also involve part grant funding or family help.

Where funding is required, Houseproud offers three loan types: interest only; repayment loans; and those on a rolled-up interest basis. The eligibility criteria for applicants include those “in necessitous circumstances” aged over 60 years, or under 60 where an applicant is disabled. The loans are secured by means of a first charge on the property, which means if there is an outstanding mortgage on the property with a different lender, the property is re-mortgaged to cover the existing indebtedness and the amount needed to fund the repairs. Associated costs, such as legal and valuation fees, may be included within the re-mortgage figure. The loans are generally suitable for repairs, improvements and adaptations.

### Local Authority contributions

Local Authorities wishing to join the Houseproud scheme are requested to pay £10,000 per annum for two years towards the HIT’s running costs, plus an individual fee of £500 towards the costs of each completed loan. The latter includes the legal and valuation fees and other costs. Where four or five Local Authorities within the same geographical area wish to join the scheme, however, they can do so by forming a consortium. Each Local Authority then pays approximately £4000 per annum for two years, with the undertaking to provide the same contribution (£500) towards each completed loan.

Houseproud also offers training to those involved in administering the scheme in each Local Authority, plus guidance videos (for distribution to potential clients which explain the service provided by the HIT) and other publicity materials such as posters and visual aids. The Houseproud service also provides a free call-centre and a help-line facility to assist each applicant through to the completion of the loan, including payments to contractors.

Presently, around eighty Local Authorities are committed to Houseproud in England and Wales with lending being made primarily through the Dudley Building Society.

### Partners

The HIT works with the network of HIAs throughout England. The HIA acts on behalf of the homeowner in providing the client with intensive support, including the identification of any necessary work required; information on available grants; a welfare benefits check (if applicable); as well as identifying other financial options available. The HIA then also provides technical advice on the repairs/improvements as well as obtaining quotations from approved builders, selecting the contractor, and preparing a schedule of works. The HIA is also responsible for the day-to-day management of the work and supervises all aspects of the repair work through to completion. Some Local Authorities also inspect on completion, although this is dependent on the HIA.

The HIT service offers specially-negotiated terms with the District Valuer’s Office to assess the property’s value; specially negotiated solicitors’ fees for the conveyancing process; as well as the service of an Independent Financial Adviser (IFA) who provides written advice, free of charge, on which options may be appropriate or available, depending on the circumstances of the applicant.

The Dudley Building Society has also agreed to offer a written guarantee of no repossession, whilst the original borrower remains in residence. A written analysis of the costs involved is prepared for the borrower before they have to make any financial commitment or incur any expense.

## Products

The HIT offers access to three main products:

### i) Repayment Advance:

A straight-forward mortgage option available to single people; couples who are 60 years or over; and those who are disabled of any age. Repayments of interest, plus part of the original capital borrowed are made each month.

### ii) An Interest Only Advance:

Available to single people ; couples who are 60 years or over; and those who are disabled of any age. This type of advance involves repayments of only the interest each month; no capital repayments are made. The interest payments will continue until the property is sold, at which point the original advance is repaid in full plus any outstanding interest. The actual amount borrowed does not reduce and remains outstanding, to be repaid when the house is no longer the client's main residence and/or is sold.

The following criteria apply to both the repayment and the interest only mortgage advances

- The amount available will depend on the applicant's income and the value of the home.
- Most lenders will limit this to between 20 and 30% of the current value of the house.
- The amount of the advance and interest outstanding will be secured by a legal charge on the property.
- No evidence of health checks is required

### iii) Capital Release – No Service Advance:

Only available to single people , and couples over 75 years of age. There are no repayments of capital or interest until the house is no longer the main residence of the client or is sold. This means that the interest is 'rolled up' and is paid together with the capital when the mortgage is redeemed.

- The amount available will depend on the applicant's income and the value of the home.
- Most lenders will limit this to between 20 and 30% of the current value of the house.
- The amount of the advance and interest will be secured by a legal charge on the property.

- No evidence of health checks is required.
- There is no fixed period for the length of the loan.
- Payments to reduce the capital and rolled up interest can be made in advance if wished.

### Accountability

The HIT has a small Board of Directors; comprising representatives largely from the finance industry and RSLs.

## THE 'HOMEIMPROVE' [HI] INITIATIVE

### Introduction

HI is an equity release project pioneered by Rochdale and Oldham Borough Councils in partnership with West Pennine Housing Association [WPHA].

### Background

Its origins lie in the early efforts made by Rochdale BC during the late 1990s to make loans available for house improvement purposes from Rochdale's in-house home loans service. These efforts led to circumstances where Rochdale was willing to fund the set-up costs of the loans – a principle which has been carried through since then and continued in principle with 'HI'.

An Innovation and Good Practice bid was made to the Housing Corporation as part of the 'New Tools' initiative in mid 2001, to explore more thoroughly the potential for the use of loans. Funding was applied for by three separate partnerships including Rochdale and WPHA.

The key principles associated with the original loan product were seen to be attractive for the following reasons;

- There is no need for regular monetary payments with an equity release product,
- It is very beneficial for those on low incomes,
- Security of tenure may be guaranteed,
- It overcame the objections of the Islamic community to the payment of interest, and
- Children and dependants can take on responsibility for the loan.

So, an initial partnership was established in 2001 between Rochdale (RBC) and WPHA to make such loans available using funds from an Single Regeneration Budget 5 scheme. Three initial loans were made to cover internal works following a 'facelift scheme' in the SRB area. But at this stage no dedicated resources were available to support the loans scheme.

In the meantime, a Best Value [BV] review was undertaken which, amongst other things, included a review of the 'dormer grants' policy. Dormer grants had been in existence for some time; had been very successful in combating overcrowding; and had become an important element of Rochdale's Asian Housing Strategy. Costs of work had escalated and grant levels had begun to fall behind the level of grant available (£11k). At the same time staff were aware that some residents applying for the dormer grant had considerable equity in their properties. So the review began to link the need for increased spending on dormer conversions with the principle of equity release loans. This crystallised the need for a dedicated resource to deal with the issue of equity release and, through the Housing Market Renewal Areas 'early wins' initiative, Rochdale was able to secure finance from April 2003 to underpin the HI pilot project with a Director.

### The Equity Release Product

Funds for the loans are made available by Rochdale and Oldham BCs, but the actual loan is made by WPHA. The amount of the loan is equal to a proportion of the equity in the property. Originally this was not to exceed 25% of the free equity existing in the property. Because this severely restricted the amount of lending in certain cases, this has since been amended. Loans should not now exceed 80% of the value of the property after improvement, less any outstanding mortgage loans and charges. The loan is repayable when the property is sold, and the amount repayable is the equivalent proportion of the equity made available in the original loan but at the value of the property prevailing at the time of the transaction. Due to a concern that in times of high property price inflation, the return on this equity share loan could show a high real interest rate HI have now capped the return on this loan at 6.5% p.a. This restriction will also be applied retrospectively to all loans already completed by asking borrowers to complete new forms. In the event that property prices fall, however, the original amount of the loan will be repayable in full.

### The HomeImprove Pilot Project

The Director, with a background and qualifications in finance (crucial factors in the development of the project), introduced several refinements to the HI scheme

- Introduced a supplier's agreement under the Consumer Credit Act, so that builders were also tied in to contractual arrangements – prior to that all risk was assumed by HI
- Was concerned that lending criteria were not clearly defined. As an RSL, WPHA was providing its services to those "in necessitous circumstances", a much too broad definition of beneficiaries
- In particular there was concern that the original criterion of a maximum loan of 25% of the free equity limited the loans to a very modest amount – hence, the criterion was changed to 80% of the value of the property after improvement less any outstanding mortgages or charges on the property

- Slightly different criteria apply to applicants for dormer conversions – if the applicant has relatively little equity (less than £25K) then he/she receives a full grant of £18k. But if an applicant has more than £25k, then HI would seek to use 25% of total equity, (i.e. £6250) + a Home Repairs Assistance (HRA) grant of £5k. If the applicant has the equity but qualifies on low income and prefers to seek a grant, then HI will provide a maximum grant of £11k.

Following the BV review and the establishment of the HI pilot, RBC is now working on the principle that the contribution from equity comes first and then eligibility for grant aid (which is derived through a means-test) is considered next. Where a person is eligible for grant aid, however, grant would be payable. Equity release is, therefore, not seen as substituting for grant aid. But this change of approach has not been easy to introduce and carry through officers, councillors and members of the public.

The main circumstances where an equity release loan might be used are;

- Assistance with dormer extensions (as outlined),
- Disabled Facilities Grant [DFG] shortfalls or where an applicant might not be eligible for a DFG on income criteria,
- Aids and adaptations where excluded by income criteria, and
- Internal works following block improvement, paying particular regard to works required in order to attain the Decent Homes standard (e.g. energy efficiency works or new kitchens/ bathrooms).

Applicants for assistance through HI are mostly referred but some apply direct. Where the applicant is on benefit they would automatically qualify for consideration for a loan. Where they are referred on grounds of low-income an appraisal of their income, expenditure and available savings will be made. If disposable income/savings are sufficient to sustain a commercial loan, then that would be the recommendation – but this rarely happens.

For relatively small sums it is often not appropriate to offer an equity release loan, however. The set-up costs work out at about £800 and include a valuation, HI's legal fees, the applicant's legal fees, and a works inspection fee. So in most circumstances it is not appropriate to do a loan of less than £5k, but occasionally there are circumstances where a loan may be justified.

An HRA grant is also available to the over 60s on benefits, but with the condition that the grant will be repaid if the house is sold within ten years. Where the cost of works exceeds £5k an equity release loan may be used to supplement the HRA.

Renovation grants are available to the under 60s

With the recent history of mis-selling and the strengthening of FSA requirements, financial advice can only be given by those qualified to do so. The qualifications of the Director of HI enable her to do this. But securing a change in attitudes to the use of equity release loans within the Borough has been a difficult job and a 'new breed' of staff has been recruited to overcome some of these difficulties. The aim is to ensure that staff are not only aware of what needs to be done to the property, but have a better idea of how the funds may be assembled to pay for it.

#### Where do the funds come from?

Revenue funding for the project including salary costs is provided by the Housing Market Renewal Area budget.

The capital costs are currently being met from a variety of sources. RBC has an open-ended commitment whilst the pilot project lasts and this is being funded from the Housing Investment Programme. Funds to be spent within a local New Deal for Communities (NDC) area are from the NDC budget. Funds for Oldham (both Local Authorities were originally hoping to contribute £100k) are currently being supplied from the HMRA budget. The intention is to recycle the loans to help the fund grow.

Originally, support for the project was limited to one full-time member of staff with assistance from two others. But there has been such a huge demand for funds, (despite the fact that the service is not advertised and is dependent upon referrals and word of mouth contacts), that a second appointment has now been made. Most referrals at present are from Rochdale.

The Director already has some views on the further targeting of equity release loans. In view of the limited capital funds available she would like to;

- Eliminate properties less than ten years old,
- Further refine "necessitous circumstances".
- Prioritise "essential works",
- Share set-up costs between RBC and applicants – some funds need to be available at the outset, e.g. fees for planning/building regulations applications in connection with dormer conversions, and

#### Accountability

At present the project has a Steering Group with representatives drawn from Rochdale (2 reps), Oldham (2 reps), the HMRA project, Heywood NDC, WPHA and the full time worker.

Broadly, the terms of reference of the Steering Group are to monitor and review the progress of equity release products and direct their future development.

### Progress

Since April 2003 the project has recorded almost 200 enquiries for assistance with loans, the majority of which have been in Rochdale. 28 projects in the area have been completed and loans for £750k already drawn down. A further 21 applications are currently on site.

10 applications are at the legal stage; there are 57 ongoing enquiries and a further 53 applicants have yet to be seen and are awaiting a visit. Figures as at January 2005.

All of these applicants will have applied for grant assistance or an HRA and will have been means-tested out of eligibility.

### Ancillary Matters

The Director is currently writing to contractors to seek their involvement and support. There is no intention to provide a recommended builders' list. Instead the client, is expected to choose their own builder. If the one chosen is not on the list the builder will be approached to sign the supplier's agreement. A substantial discount (55%) with a major kitchen supplier has also been negotiated.

The scheme will not fund do it yourself repairs, and no payments are made until an inspection by WPHA is carried out and approved – where grant aid is involved a joint inspection is made. Stage payments are made on large contracts (subject to inspection). But there is no dedicated Clerk of Works (except where requested and paid for).

The scheme is being applied borough-wide in both Local Authorities, but only during the pilot. The work is also mostly concentrated in the HMRA area (works funded outside are apportioned in terms of cost to other appropriate budgets).

### What of the future?

If properly resourced with capital and revenue funds, there are potentially "no limits" to what can be achieved by the scheme. Already a further four Local Authorities in the Manchester sub-region are interested, and three have formed into a consortium with the intention of using Regional Housing Board funding to extend the scheme into their areas. This will help to secure the advantage of shared overheads and expertise. But there is also scope for further expansion.

## THE DERBY LOANS GROUP

### Introduction

The Derby Loans Group (DLG) was established in 2002 and began making loans in May 2003. It provides affordable personal and micro-business loans for those without access to credit. The aim of DLG is to extend into the housing field by beginning a pilot housing loans scheme, supported by Derby Homes.

### Background

Derby Poverty Profile published in 2001, highlighted four wards in the Borough with high poverty levels; poor access to High Street lenders; loan sharks; and a cash culture resulting in the high cost of credit. A 'visioning day' highlighted the need for a provider of affordable credit and a Steering Group was established in October 2001.

In February 2003 the Chief Executive of DLG was appointed. Community Investment Tax Relief (CITR) accreditation was secured from the Small Business Service (SBS) of the Department of Trade and Industry in March 2003 and the first personal loans were made in May 2003. The first small business loans were made in July 2003. By January 2004 the DLG had made in excess of £100,000 worth of loans. Both loan portfolios (personal and micro-business loans) are privately financed from shareholders' equity, loans and grants but the DLG has found it very difficult to sustain levels of funding. Although both personal and business loans are made, the main objective of the project remains the reduction of financial exclusion largely through the re-financing of high interest loans from sub-prime lenders. Indeed, DLG have recently capped the maximum amount of personal loans to £1k. So far 84 loans have been made, 6 of which are in arrears, with 2 potential write-offs.

### A Pilot Project for Housing Loans

DLG has been discussing the possibility of providing a management service for housing loans since January 2003 with Derby City Council. A pilot scheme has not yet started but is likely to begin during 2005 on the following principles:

- DLG will administer the scheme to fund home improvements for home-owners on behalf of Derby City Council (DCC)
- The loan fund will be created by an interest free loan from DCC and managed separately from the personal and business loans funds through a dedicated accounting process
- Responsibility for marketing the service, for ensuring the eligibility of particular loans; and for the completion of the building work will rest with DCC.

It is anticipated in the first instance that an interest free loan of £50k would be available from Derby CC in both the financial years 2005/2006 and 2006/2007 but with further potential drawdowns of £25K up to a maximum agreed limit.

During these first two years of the pilot, 20% of the drawdowns would involve a non-returnable management fee to cover the revenue costs of the project until the interest payments begin to contribute towards the management overheads of the project. The maximum duration of a loan would be for four years and hence the duration of the project would be for up to six years (the initial two years plus the longest duration of loans made).

### The characteristics of the loans

In the first instance the loans will be restricted to a designated geographical area and used to complement a Local Authority refurbishment programme by assisting Right to Buy owners on a Local Authority estate undergoing a maintenance contract. The main aim of this is to include as many owners as possible within the maintenance programme. Maximum loans are intended to be £3k and the maximum duration of the loan, 4 years. The loans will only be available to owners (not to landlords) and will be repayable by direct debit only. There will be no set up fee, no repayment holidays, but no penalty for an early repayment of the loan. The loans will be secured by a local land charge and the loan would become repayable in the event of a move by the owner prior to the completion of the loan term. The land charge would also secure repayment of the loan even in the event of default by the original owner. The APR for the loan will be fixed for the repayment period and is likely to be marginally above the current rates of High Street lenders. This latter arrangement will be to ensure that the DLG was seen NOT to be in competition with local lenders. Indeed the DLG will advise clients that if they already have dealings with a lender they should approach their lender first. As a rough indication of cost, a £3k loan at 13% APR over four years would amount to £79pm, whilst over a three year period this would be about £100pm.

### Accountability

The DLG has a Management Committee drawn from local RSLs (Derwent and Walbrook), the City Council, the Chamber of Commerce and the local business community, and a local building society. These organisations are shareholders.

### Implementation and Monitoring of the Pilot Project

The DLG anticipates that clients will be referred to them from the City Council and that the City Council will be responsible for identifying the works necessary to the property and an approved estimate for the necessary works, etc. before they are referred. The clients would be assessed and a loan agreed before completion of the works, but the loan would not be advanced until completion had been certified.

A quarterly written update on the progress and performance of the loans programme will be provided to Derby Homes.

There will also be a formal annual review of the programme to ensure equitability and to review the termination of the pilot scheme.

At the termination of the agreement there will be cash left in the scheme (loan repayments minus any write-offs) plus interest from any funds placed on

deposit. This sum could be rolled over to create another scheme or returned to DCC.

It is anticipated that the loans advanced could be in the region of £200k, i.e. 80 to 100 loans ranging from £2k to £2.5k. If demand for loans exceeded this amount it is possible that DLG would approach a private lender for additional funds.

DLG are awaiting a formal legal agreement from Derby City Council, as at January 2005.

## **WIGAN BOROUGH COUNCIL AND ITS DIRECT LENDING SCHEME**

### **Introduction**

Wigan Borough Council has introduced a grant and loan package as one of the fundamental changes to its private sector housing renewal programme under the RRO. The loan element of the package is a simple, low-cost 'capital appreciation loan' secured against the equity in the property. The package will be both directly funded and administered by the Borough Council.

### **Background**

When the new powers for Local Authorities were introduced under the RRO in 2002, Wigan Borough Council considered a range of policy options for providing financial assistance to low-income home-owners. It concluded in favour of a combination of continuing grant assistance accompanied by the availability of a low-cost loan provided directly by the Borough Council. In making its judgement the Council was mindful of the relatively low levels of equity available in some of the poorer, private sector residential areas and of the relative lack of success it had had in previous discussions in engaging commercial lenders with the private sector renewal programme. Hence, the major element of the package was to continue as grant aid, whilst the loan element involved a low-cost, 'capital appreciation loan' secured against the equity in the property and provided directly by the Local Authority. These arrangements were seen as satisfactory from a variety of perspectives:

- Owners became re-engaged in taking responsibility for their own properties consistent with their resources
- The grant element continued to provide a substantial incentive to poorer home-owners
- The Local Authority could continue to exercise control over the arrangements, thereby introducing flexibility into the grant loan package where this was seen as desirable.

### The arrangements for the provision of 'financial assistance' to home-owners

Under its new private sector housing renewal policy, Wigan Borough Council is providing various types of 'Housing Assistance'. In some cases this will continue as grant aid, e.g. Hospital Discharge Assistance, but grant and loan packages are being offered to owner-occupiers in a number of other circumstances:

- Home Fitness Assistance is being offered on a Borough-wide basis to tackle unfitness and, where repair/improvement is the most appropriate course of action, a grant/loan combination will be offered to low-income homeowners up to a maximum of £10k. The grant/loan ratios have recently been revised and currently involve a ratio of 90/10 for owner-occupiers in designated areas (Renewal Areas) and 75/25 for those elsewhere.
- Renewal Area Assistance for 'face-lift' schemes in Renewal Areas only. These are schemes determined by the Borough Council aimed at the renovation of the external fabric of dwellings. Currently they involve a maximum of £9k in the form of grant (+fees) and loan ratio of 90/10.
- Top-up loans for Disabled Facilities Grants (DFGs): where essential works on a DFG exceed the statutory limit of £25k, the Borough will provide a top-up loan to a maximum of £10k subject to certain local conditions.
- Market Renewal Assistance: this is available at the discretion of the Local Authority to assist home-owners living in areas of sub-standard pre-1919 terraced houses to enable them to move to another appropriate property nearby, thereby facilitating the process of land assembly and the retention of communities. This type of assistance may be in the form of a grant or loan up to a maximum of £12k.

Home Fitness Assistance and Market Renewal Assistance are subject to a means test. But in all circumstances where owner occupiers have little or no equity (i.e. less than £10k) they have the option of applying for a means tested grant of up to 100% of the cost of works. Under the new RRO policy, owners also have complete discretion as to where they obtain their finance. The Borough Council is also offering to cover the professional and administrative costs associated with the loans.

### The 'Capital Appreciation Loan'

The loans available from the Borough Council are intended to be simple to understand and relatively easy to administer, thereby reducing the costs to the Local Authority. The key features include:

- The loans will carry a simple interest charge (i.e. not a compound rate of interest) from the date of issue of the completion certificate

- The interest rate will be relatively low. It will be set at the Bank of England base lending rate existing on 1<sup>st</sup> April each year
- The capital and interest which accrues on the loan will be repayable on the sale or disposal of the property
- One of the key conditions for the payment of Housing Financial Assistance is that the property should remain owner occupied (or rented if the applicant is a landlord) for at least five years
- Another condition includes the requirement to undertake an energy efficiency audit of the premises and to include the necessary works in the overall schedule
- Breaches of conditions attached to eligibility for the grant/loan and the implementation of the works will result in the Housing Financial Assistance (both grant and loan + interest) being recovered in full
- Both grant and loan are registered as a charge on the property with the Land Registry

#### Future policy directions

The new policy of providing Housing Finance Assistance is now been in place and is seen to be working well. This is, however, partly attributable to the very high grant to loan ratios. The staff in Wigan Borough Council appreciate that these current ratios are not necessarily sustainable for the future and that there is likely to be a transitional phase during which the loan element will become a steadily increasing proportion of the package over time.

Staff within the Local Authority also recognise the need for the Local Authority to diversify its funding sources and attract private finance into the equation. To this end the Local Authority is currently in negotiation with a private lender to finance repair/improvement works for the over 60s with the collaboration of the local HIA as the delivery agent. A further possibility is that at some future stage the Local Authority will seek to re-finance its growing portfolio of loans as it did earlier with its mortgage portfolio in the 1980s. This would enable the Local Authority to continue to play an important role in underpinning the repair/ improvement programme within Renewal Areas and other pre-1919 stock.

Like the other initiatives described in this paper, the Local Authority is also convinced that its experience can be replicated elsewhere and that a number of Local Authorities in the Greater Manchester area especially, are interested in applying a similar approach

## **THE SERVICES OFFERED BY THESE AGENCIES**

This section compares the different services offered by these agencies and ART Homes with the aim of identifying best practice and a potential way forward.

### **Geographical coverage**

At present the only one of these agencies offering a national home loans service for repairs, adaptations and maintenance is the HIT, albeit not as a direct lender. The HIT offers its 'Houseproud' service to Local Authorities and Home Improvement Agencies (HIAs) throughout mainland Britain. Under this service a variety of loans are available to those "in necessitous circumstances" over 60 and to disabled adults of any age. About 80 Local Authorities in England and Wales are currently signed up to 'Houseproud' and a further 20 Local Authorities are considering doing so.

For the moment, however, the full range of loan products and other consultancy services provided by ART Homes is only available to Local Authorities within the West Midlands region. The amount of funding available for the range of loan products in these areas will vary according to the capital and revenue contributions made by individual Local Authorities, but it is anticipated that initial funding arrangements will create sufficient leverage to enable these Local Authorities to possibly double the amount of capital at their disposal for private sector renewal activity.

The remaining initiatives are all locally based with the HI project operating primarily in the Oldham/Rochdale HMRA, Derby Loans in Derby, and Housing Finance Assistance in Wigan. As we have seen, however, the HI Scheme is expanding into neighbouring Local Authorities and staff in Wigan Borough Council are also confident that their scheme for Housing Financial Assistance may be applied on an expanding geographical basis.

### **Coverage of different client groups**

Currently the widest range of products available is from ART Homes. These products include 'conventional' repayment and interest only loans, as well as the PAL equity release loan and a 'faith loan' being developed specifically for those who feel constrained by their religious beliefs from entering into interest-bearing loan arrangements. The repayment and interest only loans are at lower interest rates than those of commercial lenders. This is not intended to compete with commercial lenders, but by ensuring that the groups targeted by ART Homes simply cannot afford the repayments associated with commercial loans, to extend the range of affordability of these loan products to lower income groups. The PAL loan has been designed with the absolute minimum of administrative requirements but is obviously only suited to those with certain levels of equity in their property. These loan products are also available to all adult households.

In contrast, the range of loan products available through the HIT are all targeted at elderly households or households including a disabled person. These include repayment, 'interest only' and 'rolled up' interest loans. The

'rolled up' interest loan involves borrowing against the equity in the property and in view of the fact that the amount owed can increase very rapidly, this product is only available to very elderly households over a limited repayment period. The most appropriate choice of loan for a particular applicant, is recommended by an Independent Financial Adviser (IFA) and all loans come with a guarantee of no repossession. Loans are also available to disabled applicants "in necessitous circumstances" in any age group.

The products available under the remaining initiatives are all very much oriented to local circumstances. An interesting feature of the HI scheme in Oldham and Rochdale is that the equity release loan is determined according to a valuation *after* improvement rather than before and this is to increase the potential usefulness of the product. In Derby the pilot scheme is intended to restrict the amount of the loans to £3,000 and to target Right to Buy owners in order to maximise the impact of a Local Authority estate renewal programme. In Wigan, a transitional arrangement is in place and over time the loan element is likely to become an increasing proportion of the grant/loan package.

## THE OPTIONS AVAILABLE TO OTHER LOCAL AUTHORITIES

At present, the options available for Local Authorities to deliver private finance are limited. As this chapter shows, however, there are a number of models emerging that could provide them with more strategic choices.

The main options currently are

- To consider direct lending by the Local Authority
- To link up with an existing loan provider
- To consider establishing a loan provider.

### Direct lending by a Local Authority

In this option the Local Authority would need to decide on the loan products it requires to deliver the strategic objectives of its housing policy. It would then need to develop appropriate loan documents, systems and monitoring procedures. Although Local Authority lending is exempt from legislative compliance requirements, Local Authorities are expected to comply with the spirit of the legislation. In order to comply with this obligation Local Authorities will need to consider carefully the qualifications and financial expertise of staff carrying out any direct lending operation. Indeed it should be emphasised that Local Authorities and RSLs have been exempt from FSA mortgage regulation on the basis that they will provide a comparable level of service, and ODPM has recently released a Guidance note for consultation on this issue.

The drawbacks to this option are

- a) that the whole cost of the lending operation will have to be borne by the individual Local Authority which, depending on the scale of the lending operation, may not be cost effective
- b) the opportunity to lever in private finance to increase the amount of lending undertaken and hence, the number of properties being improved is more difficult to achieve
- c) gearing up with the necessary expertise and procedures will take time

#### Linking up with an existing loan provider

This option offers Local Authorities the advantages of sharing lending costs and leveraging private finance into their programmes which has so far proved to be difficult for individual Local Authorities. In addition it affords access to specialist providers who are developing expertise in this field, including the development of new and innovative lending products. It also offers the advantage that it will be the responsibility of the provider to comply with the increasingly complex financial compliance legislation.

The disadvantage, at present, is that there is limited national coverage by these models and access by Local Authorities is therefore currently limited. The HIT, however, is committed to providing this national coverage.

As mentioned above, Art Homes offers Local Authorities in the West Midlands the opportunity to access a full loans service, for all age ranges.

To access the services of ART Homes and the HIT, Local Authorities will be expected to

- a) Provide a full front-end delivery service for individual homeowners. This can be delivered by an established HIA or provided directly by a Local Authority in-house agency.
- b) To enter into a legal agreement with the loan service provider.
- c) To pay an annual fee for the service plus the costs associated with individual loan applications
- d) In some Local Authorities it will be prudent to conduct research in order to confirm whether specific products are appropriate to the local housing market
- e) To monitor carefully the progress of any scheme which is implemented.

### To consider establishing a loan provider

The option here is for a group of Local Authorities to consider getting together to establish a regionally based loans provider. It is unlikely to be financially attractive for an individual Local Authority (of whatever size) to consider “going it alone”.

The main advantages of such an approach, in addition to the cost sharing and private sector leverage discussed earlier, are that products and services can be designed for the particular needs of the local housing market in the Local Authorities concerned.

The main disadvantage is the time required in establishing a new provider and the delays this would mean for those Local Authorities in being able to access the necessary services and loan products. If there is an existing CDFI available in the region with the necessary expertise and capability to undertake this service, this development time could be potentially shortened by engaging its services.

## 2. MARKET STUDIES: A STUDY OF FOUR DIFFERENT HOUSING AREAS

### Introduction

Four different housing markets have been studied with the purpose of investigating the suitability and potential use of financial products to assist in the repair, maintenance and purchase of private properties.

Four areas were chosen in conjunction with the Local Authorities.

- A clearance area, Greets Green in Sandwell
- A failing housing market, All Saints /Blakenhall in Wolverhampton
- A client based approach, city wide in Coventry
- A sustainable housing market, Erdington in Birmingham

A summary of the key findings in each area, common trends and general conclusions is provided below. In addition to this summary a more detailed report from each of the four research areas can be accessed if required by contacting MHA. As each piece of research was conducted in partnership with the relevant Local Authority, the full reports have different formats and focuses. However, each report consists of an overview of the key findings and specific analysis on the suitability of potential financial products.

### **SUMMARY: KEY FINDINGS, COMMON TRENDS, GENERAL CONCLUSIONS**

#### Introduction

This section provides a brief overview of the findings from all four of the research areas and draws common trends and general conclusions from the research piece as a whole.

#### Research

Different approaches were taken, depending on the character of the area and the type of information sought. In Coventry and Birmingham a sample; was provided by the Local Authority for a door knocking exercise to an agreed questionnaire. In Wolverhampton and Sandwell residents were asked to volunteer for an in-depth interview. In Sandwell, research was conducted with a similar style questionnaire to Birmingham and Coventry, but was also accompanied by information for residents on home ownership options. In Wolverhampton a less formal structure was used to gain insight into a range of social issues affecting the area, with housing and repair being a part of that. In total during this research 555 people were interviewed in a mix of face-to-face doorstep surveys and in-depth interviews. When added to research carried out at the same time and linked to this programme, over 1000 interviews have formed the basis for the conclusions drawn.

## GREETS GREEN – SANDWELL: A CLEARANCE AREA

All of the respondents in the Sandwell study were from specific streets earmarked for clearance. After profile information was collected the aspirations of homeowners for a new property were discussed. Following on from this, financial information was collected to discover if the residents could afford to meet their own housing needs. For those who could not, a range of financial options was presented and their opinions sought.

### Homeowner profiles

A total of 83 in-depth interviews were conducted in the Greet Green area. The majority of people (87%) were homeowners, with the remainder either privately or socially renting. Households were typically large with 53% having four or more people. There was a varied mix of ages and ethnic origins, with the largest groups being the over 65s and those of an Indian origin. There was a large retired element to the sample (26%), but most of the remainder were in some form of employment (46%). Despite this, gross household income was relatively low with 78% having an income under £15,549. This usually suggests low paid or manual employment. This was combined with savings of either none at all (40%) or less than £2000 (21%)

### Property profiles

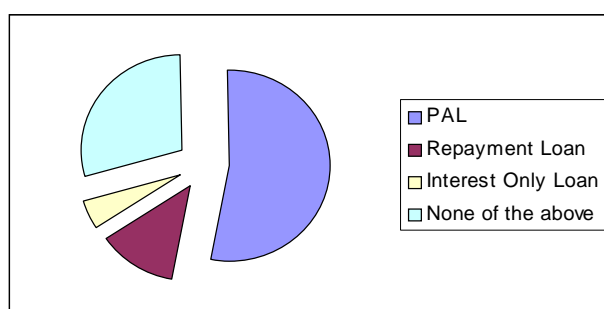
The respondents' properties were in varying levels of repair and were typically two or three-bed terraces. The average estimated property value was £76,585. Over half of the owner occupied properties were owned outright. From the remainder there was a mortgage outstanding of around £30,000 on average.



### Aspirations for new property

The respondents' aspirations for a new property were generally for it to be bigger, of a different type, such as semi-detached or detached and, as a consequence, more expensive. Evidence from the interviews suggests that the majority of people wish to remain very local, to stay near to their children's schools, or family members living on nearby roads. The average estimated value for the cost of a new suitable property was £117K. This was £41K more than the estimated value of their current property. Not all the homeowners wished to remain in homeownership with some, especially the elderly, preferring to rent and not have the worry of maintaining their home. Only 61% claimed to want to buy again if they were affected by clearance, with concern over affordability and finding a suitable location also being contributing factors.

Fig 1 Expressed Interest in Loan products



### Suitability of financial products.

A range of financial solutions were presented to the respondents who would potentially need help in affording a new property. These included the three loan products currently offered by ART Homes in Birmingham, the Housing Corporation's Homebuy Scheme, rent-to-buy schemes and Shared Ownership. Respondents' interest in loan products to bridge the gap between the value they would get for their current property and the cost of a new property was high.

The most popular loan product was a PAL that would enable people to afford a suitable property at no extra cost to them. Many people could not afford any monthly repayments and this made the PAL an attractive prospect. Over half of those who could not afford a new property were in favour of this type of loan being available to them. (Fig 1) Homebuy was also very popular for the same reason, but viewed as less flexible as the percentage is fixed to 25%. As most respondents were homeowners, rent to buy schemes and shared ownership were generally viewed as a step backwards in the property market and unsuitable in this situation.

There was also considerable interest in the repayment and interest only loans offered by ART Homes in Birmingham, with some preferring to pay back a loan as soon as they could and retain the full equity share in their property. (Fig 1) There were also a number of people who required financial assistance but would be unable to have a loan due to their faith. This situation is investigated further in a future chapter of this report.

## ALL SAINTS AND BLAKENHALL – WOLVERHAMPTON: A FAILING HOUSING MARKET

The Blakenhall and All Saints area of Wolverhampton is considered to have a failing housing market. Although at the time of this research house prices were not falling, they had not increased at a similar rate to surrounding private sector housing. Twenty in-depth interviews were undertaken with owner-occupiers who lived locally, with the intention of discovering their opinion on what could be done to improve the area and recover the housing market.

As these interviews took a different format to the three other pieces of research, profile information about the interviewees was omitted in favour of their opinions about the needs of the general area.

### Property Profiles

From the people interviewed the majority believed their property to be in good condition, although it is unlikely this is representative of the area as a whole. The respondents who believed their property to be in poor condition, were mainly retired. Many of the respondents owned their properties outright with an estimated value between £60-90K, with most people having equity of at least £50K.

### Good points/bad points of area

Most of the respondents felt negatively about the area. For these residents who maintained their properties, it was not their housing which was the problem. Other social issues such as a high turnover of tenants in social and rented properties, drugs and prostitution were given as the real problems of the area, and respondents believed these matters needed to be tackled alongside the housing issue if there was to be any sustained improvement.

### Interest in, and suitability of, loan products

As most of the respondents would like to move away, the most interest was in a financial product to help them move out of the area and buy property somewhere else. However, this would only be of further detriment to the area and does not offer a solution to the failing housing market. As most of the respondents believed their properties to be well maintained, the interest in loan products to help them repair the property was minimal. The most encouraging response was towards the PAL but there was concern over the possibility of going into negative equity if house prices should begin to fall. In this situation a PAL loan with the minimum repayment floor removed may be a suitable solution. While shared ownership and other schemes to help first time buyers were not of interest to these respondents, they could see the benefit of such schemes in their area to offer an answer to encouraging new home owners into the area and reviving the housing market. "Start up packages for new homebuyers could be the incentive to attract working people into the area."

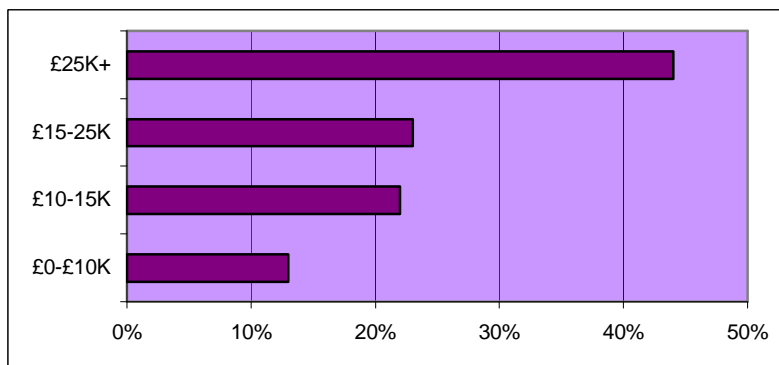
## ERDINGTON – BIRMINGHAM: A SUSTAINABLE HOUSING MARKET

Erdington in Birmingham was chosen as an example of a sustainable housing market. House prices have increased rapidly over the last five years and there is visual evidence of investment taking place. The purpose of researching this area was twofold. Firstly, to provide a comparator for the other housing markets and confirm what makes a sustainable housing market, and secondly, to find out if there is a need for financial assistance within housing markets that are on the whole sustainable. A face-to-face household survey of 250 homeowners was undertaken.

### Homeowner profiles

All of the households interviewed were homeowners living in the Erdington area. There was a varied age mix to the sample with a high proportion of over 65s. The majority of the sample were white British with a small BME element of 6%. A substantial proportion (63%) of the respondents had lived in their properties for over 10 years. Of the sample, 41% were retired, with the majority of the remainder being in some form of employment. Income levels varied with the mean gross household income being over £25,000 per annum. (Fig 2)

Fig 2 Income Levels



### Property Profiles

As most of the respondents had lived in their properties for over ten years, this has resulted in substantial equity amongst those who own their property outright and those who have a mortgage due to the continual house price increase over recent years. The average estimated value of property was £157,000. Nearly half of respondents owned their home outright, with the remainder having an average mortgage outstanding of between £30,000-£50,000. Over two-fifths of homeowners claimed to have continually repaired and maintained their property since purchasing it, and nearly all believed they had improved it in some way. Despite this, there remained a significant concern over household repairs. This was most commonly with the appointing of contractors and the need for advice on the level of repair needed, rather than in the financing of work.



### Interest in and demand for loan products

As most of the respondents had the financial ability to maintain and repair their homes themselves, the interest shown in all of the potential loan products was low. However, there was some noted interest in the PAL, especially from elderly respondents who may have relatively high value properties, which have been previously maintained, but now as income levels have dropped, they may need to release some of the equity to be able to repair their home. As Birmingham City Council are currently running a Houseproud scheme to meet demand from this specific group, the findings from this piece of research reiterate the need for the scheme and suggest that pockets of demand for affordable loan products still remain, even in a sustainable housing market.

## COVENTRY: A CLIENT SPECIFIC APPROACH

A citywide boundary was chosen for the Coventry area as the focus of this piece of research was to identify the needs of a specific group. In this case they were low-income homeowners, predominately over 65, who had previously contacted their local council for help with repairing their property. A face-to-face doorstep survey was undertaken with 202 households.

### Homeowner Profiles

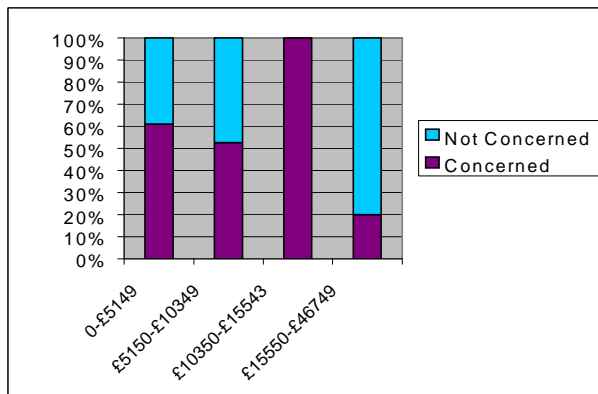
All of the 202 households interviewed were homeowners who had contacted the council about repairs. Nearly half of these were over 65, with a further 28% being between 45 and 65. Households were generally small, with 65% having a make up of two people or less. There was a diverse ethnic mix, with the majority of respondents being either white British or of Pakistani or Indian origin. Due to the high proportion of elderly households, 72% were economically inactive or retired. Income and savings levels were low, with incomes typically under £10K, and 40% having no savings at all.

### Property Profiles

A large percentage of the properties (69%) were owned outright and nearly all of the respondents had purchased over 5 years ago. Due to the recent house price boom, both of these factors mean that for the majority of people there is substantial equity in their property. The average property value was estimated at £117K and, for those who did have a mortgage remaining, the average amount left to pay was £36K. A large proportion of the properties

had urgent repairs needed to them, commonly concerning roof, windows and heating requirements. Most of the respondents believed these would be financed through a Local Authority grant and did not have the financial ability to do the work themselves. Concern over repairs in this study was clearly linked to income levels, with the highest level of concern coming from those with incomes under £15,000. (Fig 3)

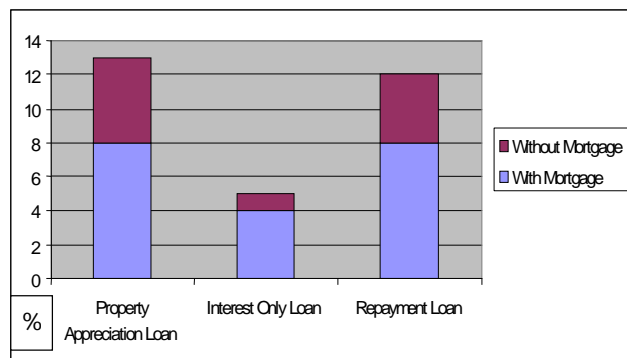
**Fig 3 Income levels of those concerned over repairs.**



### Demand for, and suitability of, loan finance

Interest in loans for home repairs was minimal, mainly due to the high expectancy of grants and the unfamiliarity with financial products as 45% had never taken up any insurance based contracts to deal with repairs in the past. Respondents with a mortgage were generally more receptive to the idea of loans for home repair and this is likely to be due to increased familiarity with loans products and repayments. (Fig 4) They were also likely to be younger and more prepared to take on the burden of a loan. Despite the low interest in financial products, the high level of repair needed and the relatively low income and savings levels provide a strong case for the provision of affordable finance in the Coventry area. While the low income and high equity levels demonstrate a typical cash poor equity rich situation for which the PAL is most suited.

**Fig 4 Interest in loans between respondents with and without a mortgage**



## COMMON FINDINGS

Although the results from the research differed between areas, there were several common key findings. With the exception of Erdington, the other three areas all demonstrated a high percentage of people who owned their property outright. Income levels, in all areas except Erdington, were relatively low, with the average household having an income of under £15,000. Little or no savings and the low take up of insurance based contracts, also demonstrated the low amount of expendable income available to households in these areas. Inevitably, this has led to a high frequency of urgent and non-urgent repairs in both Coventry and Wolverhampton, and the inability to raise finance to purchase more suitable property after clearance in Sandwell. Discussions around the potential loan products and the previous use of financial sources to repair the home, revealed a low understanding of finance in all three areas. While the research in Erdington demonstrated the link between slightly higher levels of affluence, housing repair and a stable housing market, it also revealed the need for advice and help to be available to all homeowners on repair issues, and this was echoed across the research as a whole.

Similar research work has also been conducted with a New Deal for Community project in Aston, and the Birmingham/Sandwell pathfinder. Both research projects were individual pieces with different objectives but the results also captured the same key findings. It appears that, regardless of the housing market or characteristics of an area, a need to find solutions to disrepair in the private sector still remains. In terms of the front end delivery service, there needs to be a range of different agency services tailored to the individual needs of the differing markets. There is a lack of skills among the Local Authorities in this field, and this suggests a need for Regional Centres of Excellence to disseminate best practice.

## GENERAL CONCLUSIONS

From the common findings it is possible to draw some general conclusions from all four pieces of research. The aim of the research was to investigate the potential for the use of loan products in differing housing situations and several conclusions can be drawn regarding this.

- In all of the research areas a substantial level of disrepair existed amongst privately owned properties. This was true even within the more affluent area of Erdington. Although various reasons were given for not repairing and maintaining property, the inability to finance repairs was the most common reason. These findings demonstrate a need for further assistance to be available to low income homeowners and a potential demand level for suitable financial solutions.
- A high level of equity within properties, and relatively low incomes and savings levels prominent in three of the research areas, means that there is a substantial market for equity release loans.

- Of all the loan products the PAL is consistently the most popular, mainly due to there being no monthly repayments. It appeals to a variety of people, not only to its main target group of equity-rich, income-poor homeowners, but also to those who are being relocated from clearance areas, and for first time buyers as an encouragement to buy in a certain area. Individual variations to the standard PAL product are needed to provide an individual response to very different housing markets.
- As well as financial concerns, many people are disqualified from repairing due to lack of knowledge and the worry of employing tradesman. The most popular solution to this was an advice agency linked to Local Government to give advice on repairs, recommend contractors and oversee the work.
- In areas where there is a high BME population, a need for providing finance that is compatible to specific faiths that do not allow the payment of interest was found. This belief prevented people from taking conventional finance and as a consequence they could not finance repairs needed to their properties. This demand is investigated further in chapter 3 and a potential faith-compliant loan product is suggested.
- Further explanation of all the potential loan products may be advantageous in areas such as Birmingham and Coventry where the research method was a large doorstep survey. Although this method is needed to reach a suitable sample of respondents, it does not allow much time for explanation of the loan products. Interest in all of the loan products may increase if they are explained in more detail; this should be taken into account with all of the research results, and it further highlights the need for appropriate agency services to assist homeowners.
- The research shows that there are different solutions required in each of the different type of markets. This relates both to the type of products required and the type of agency support required by homeowners to determine and oversee the works process.
- This potentially produces issues surrounding the skill levels required by Local Authority and Home Improvement Agency staff in being able to market and promote the appropriate solutions to homeowners with different needs. This issue is returned to in the Summary and Recommendations.

More detailed reports on each of the areas can be obtained if required by contacting MHA.

## 3. FAITH LOAN

### INTRODUCTION

Following on from the results of the market research, it was evident that more work needed to be done on the issue of faith loans, as the lack of an appropriate loan for certain religious groups was identified as a barrier to repair for some homeowners

The purpose of this part of the research was to examine whether any products are required to help religious groups whose faith prevents them from paying interest on loans and therefore excludes them from the usual loans market.

The existing loans market was researched first of all, to see if there were any existing products that were suitable for this group. At the same time, specialist Consumer Credit Act lawyers were consulted to see whether it was possible to develop a loan product that complied with religious interest concerns, and then to test the result in the market studies research and subsequently through specific focus groups.

### THE EXISTING MARKET

#### Desktop search

An internet search of current faith specific financial services was conducted to first establish what other similar products were available in the market place. The result was that there were very few faith services currently available in Britain and no small loans for home repairs. Some major lenders including HSBC and The West Bromwich Building Society, had started to offer Islamic compliant loans for house purchase, stock broking service and savings accounts.

Following the desk top search, five banks were written to, asking if they were planning to introduce any new Islamic loan products. There was no response from any of the five banks and it is to be presumed that none of the leading financial institutions are planning on launching a faith loan in the near future.

#### Islamic Bank of Britain

In addition to the services offered by mainstream lenders, Britain's first Islamic bank is soon set to open, with its headquarters being located in Birmingham. The bank has opened its first branch in London and is currently offering savings accounts, investment opportunities and loans to purchase properties. Although services may increase in the future, at present the bank has not launched any small loan facilities and in this respect still does not fill the void for small loans for home repairs. While the trend is for Islamic-specific products to increase, it is unlikely that commercial lenders will be able to offer small loans at an Islamic-compliant rate, without subsidy and, therefore, there still remains a gap in the market place, which the faith loan could fill.

## DEMAND INDICATORS FROM MARKET STUDIES

Questions around the need and demand for a faith loan were raised in three of the research areas used as part of the studies of housing markets. This gave a good indication of areas where demand may be higher and if a general demand for this product existed. In three of the four areas used as part of the market studies, participants were asked if their lack of interest in loan products for home repair was due to religious reasons. The most significant area to answer yes to this question was in Greets Green in Sandwell, where half of all those who were not interested in taking a loan said religious reasons prevented them from doing so, and all of these would be encouraged by a faith specific loan.

Although interest was lower in the Coventry and Birmingham market studies, this was partly linked to the ethnic make up of the sample, with the Birmingham- Erdington sample being 95% white British. The city-wide study of Coventry did demonstrate a level of need, with 8% of those who were not interested in the loan products citing religious objections as their reason. When it is considered that over 75% of the total were not interested in the loan products, this demonstrates a fairly significant level of demand.

Further studies along the same principle gave mixed results for demand for faith loan services. Research conducted in Aston in Birmingham, an area where the Muslim population makes up roughly 50% of the total, showed surprisingly little interest in faith loans. However, interest in any of the loan products and general response rates to any of the questions asked were particularly low in this study. More encouragingly, research for the Birmingham Sandwell HMRA pathfinder showed one in five of respondents who were not interested in any of the traditional loan products, expressing an interest in the faith loan; once again this is linked to the make up of the sample, which in this piece of research was 80% BME.

## PROPOSED LOAN DESCRIPTION

There is clearly a contradiction between Religious Groups whose religious beliefs discourage the payment of interest and the Consumer Credit Act, which insists that a rate of interest is shown on loan documentation. The fact that an interest rate is shown on the loan document means that the product is unsuitable for these Religious Groups.

Specialist Consumer Credit Act lawyers were contacted to see if there was any way of producing a product with accompanying loan documentation that would meet the concerns of the Religious Groups but also comply with the Consumer Credit Act.

The aim was to try and develop;

- A repayment faith loan product and
- A PAL product.

### The repayment faith loan product

The aim was to develop a product that could achieve the repayment of the loan over a specific term of years, i.e. 1 to 10 years as with a normal repayment loan, without the inclusion of an interest rate on the loan documentation, but also to recover costs associated with the loan.

After prolonged discussions, the lawyers confirmed that it was possible to produce a product that could obtain an exemption from the Consumer Credit Act, concerning the showing of an interest rate on the loan documentation.

To obtain this exemption the loan must comply with the following:

- The product is only to be available to specific Religious Groups.
- A “charge” can be made for the credit.
- The loan amount plus any charge must be for a fixed amount.
- The “charge” must not be for more than the equivalent of Bank Base Rate plus 1%.

If all these conditions apply, then the advice is that an exemption can be obtained from the Consumer Credit Act so that the rate of interest does not need to be indicated on the loan document. This would seem to meet the concerns of Religious groups and potentially provides a product available for this group.

### The PAL product

The PAL is a simple equity share product, where no interest is charged. Due to the different nature of this product it was felt that this loan may be suitable for the Religious Groups who cannot pay interest.

These two products were tested in the specific “Focus Groups”.

### FOCUS GROUPS

The next stage of the research was to organise two focus groups to discover local Muslims’ opinions of the repayment faith loan and the Islamic suitability of the PAL. Due to the difficulties associated with recruiting “hard to reach” groups such as Muslim Homeowners, local contacts in each area used informal networks to create a group of around 8-10 suitable participants. The groups were made up of different ages, but were predominantly men. The groups met during the evening in a neutral setting for about an hour and a half. External facilitators were used to run the focus groups, with a technical expert present to answer any specific questions the group participants may have had.

The first group were from Greets Green in Sandwell, an area we had previously researched as part of the market studies research, which had shown interest in faith loans. This group focused on the repayment faith loan first and then moved to voice their opinions about the PAL. The second group were from the Washwood Heath ward of Birmingham. They discussed the suitability of the PAL loan first and then moved on to the repayment faith loan.

The discussions in both groups were led using the following questions.

#### Repayment Faith Loan.

- How do they currently fund repairs?
- Is there a need for an Islamic-compatible repayment faith loan product?
- What do they think of the proposed repayment faith loan?
- Do they consider it to be Islamic-compliant?
- What do they like/ dislike about it? How could it be improved?
- Do they have any ideas about how such a loan could be administered or marketed?

#### PAL

- Do they consider the current PAL product to be compatible with Islamic Finance law?
- If not why not and what would make it Islamic-compatible?
- Would removing the repayment floor and sharing the risk more equally be sufficient?

#### Results/findings

1. The PAL and the repayment faith loan were generally perceived as a welcome attempt at helping people to repair their properties.
2. The existence of a repayment floor in the PAL product was of varying concern with some respondents disagreeing with the principle and others not being concerned due to a belief that house prices would never decrease.
3. Both products would benefit from the support of local Islamic leaders.
4. There were divided opinions on the compliance of the repayment faith loan to Islamic law and this was due to differing opinion of Islamic law and differing degrees of acceptance of finance products. Generally, respondents viewed this as unavoidable but it would be greatly helped by an Islamic authority supporting the product.
5. The non-profit making status, local base and transparent accounts of ART Homes make it a suitable agent for the provision of the loans.
6. Informed marketing strategies, delivered on a local level by representatives of the community, are viewed as the most effective way of reaching the target market.

## CONCLUSIONS

- Specific religious groups are not able to access loans for home repair because of a contradiction with their religious beliefs.
- Demand varies between areas and is highest in areas with a large BME population, mainly due to the concentration of Muslims in these areas.
- Faith-specific financial services are increasingly being provided by mainstream lenders but currently none of these are offering small loans for home repair.
- The contradiction between a loan not showing an interest rate and the Consumer Credit Act can be overcome.
- Initial market testing has shown positive feedback but has also demonstrated a range of attitudes depending on interpretation of religious laws.
- Further market testing by way of a pilot faith loan scheme in a high demand area would help identify the best methods of administering this product, and whether perceived need and demand can be turned into action and actual loan applications.

## 4. HOME OWNERSHIP OPTIONS

### INTRODUCTION

The recent increase in house prices has meant that an increasing number of people are priced out of the housing market. In 2002, only 37% of new households purchasing a house with the aid of a mortgage were first time buyers. (1) This is coupled with an overwhelming cultural desire to be a homeowner with homeownership rates currently at around 70%, significantly higher than most other European countries. Recent housing policy often makes the assumption that home ownership is the best option and as many people as possible should be helped into the tenure. This has resulted in numerous policies to help first time buyers onto the property ladder.

This chapter considers the options available to enable potential homeowners to move into homeownership and those affected by clearance to purchase a more suitable property. It uses the information obtained in the market studies to identify and consider the need for any new products or proposals and to gauge opinions of the products already available.

### A CONSIDERATION OF CURRENT LOW COST HOME OWNERSHIP (LCHO) OPTIONS WITH INPUT FROM THE MARKET STUDIES

#### Homebuy

The Housing Corporation's Homebuy scheme offers a 25% equity loan towards a property of choice. The loan is only repayable upon sale of the property and at current market value, be this higher or lower than the original amount paid. This scheme is open to council or Housing Association tenants or those in priority housing need, with the criteria being set by each co-operating Local Authority. Homebuy is not specifically for first time buyers and can be used in a clearance situation. It was popular in the clearance study because it allowed people to purchase more suitable property with no increase in monthly outgoings. Comments were made about the inflexibility of the percentage being set at 25%, whether you need it all or not, and the inflexibility in repayment in that the whole 25% had to be bought back at one time.

#### Shared Ownership

Shared Ownership schemes offer the purchaser, usually a first time buyer, the opportunity to buy a percentage of a property and rent the remainder. The percentage can vary but is typically between 25% and 75% of a property. The actual cost to a purchaser is dependant on the level of rent set, the principle being that this is cheaper than buying the whole property. The purchaser can buy the remainder of the property after one year on new build properties and this is referred to as "staircasing". Shared ownership was an unpopular idea to many homeowners in the clearance and failing housing market situations. They generally viewed it as a step backwards and most, especially those who owned their properties outright, were reluctant to begin paying rent. Shared ownership schemes are obviously going to be more attractive to first time buyers and can be used as a way of encouraging more homeowners to an

area to encourage tenure diversity, as in the Wolverhampton study. This will only be successful if the rent is heavily subsidised and shared ownership is a financially attractive option.

### PAL.

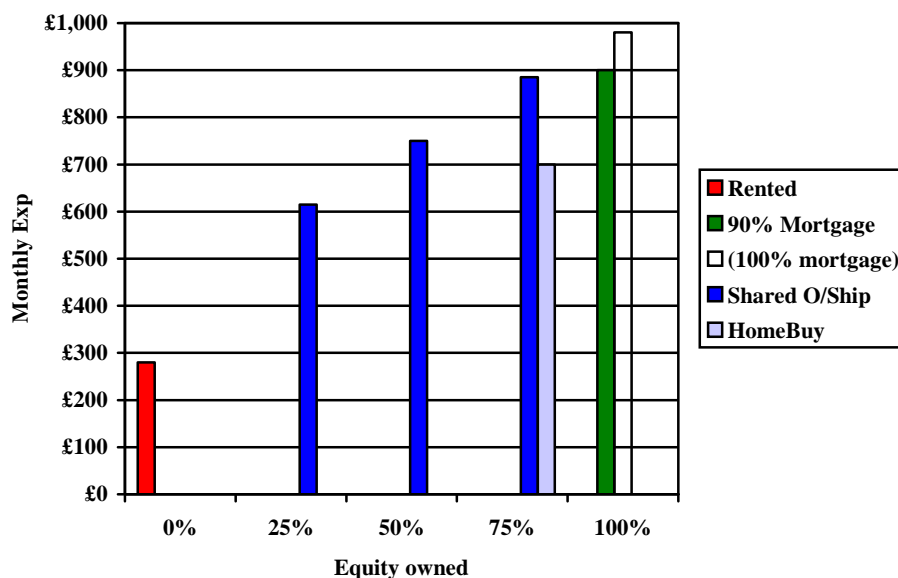
A PAL is an equity loan very similar to Homebuy but with flexibility over the percentage. PAL loans are already being used to help people in Birmingham buy more suitable property after clearance. They are repayable upon sale or title transfer and at the current house value. Unlike Homebuy, there is a repayment floor to guarantee a repayment level if house prices fall. These were by far the most popular option for people in the clearance area research. They liked the idea of only borrowing what they needed, for example 15% or 20% of the property value, and were attracted to there being no increase in monthly outgoings.

### A COST ANALYSIS OF LCHO OPTIONS

An analysis of the costs of the varying forms of LCHO has been undertaken with the aim of identifying any gaps in the market and ensuring the scale is accessible on all levels of income.

Fig 5 below demonstrates the average monthly costs associated with both socially renting and entering homeownership on a shared ownership level. The amount of equity owned and the cost to the purchaser are contrasted. As well as Homebuy and Shared Ownership an analysis of the costs with a 10% equity loan (PAL) has also been included.

Fig 5 A Cost Analysis of LCHO and Social Rents



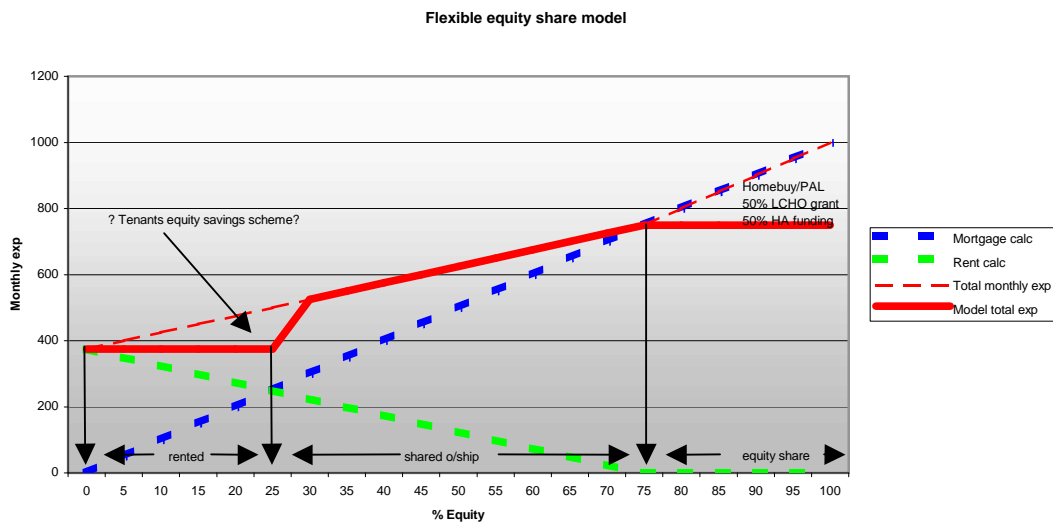
The graph demonstrates two key points. Firstly, that the biggest gap on the scale is between socially renting and having an equity stake of 25% in a property. Secondly, that the rental expense of shared ownership, even at a rate of 4%, means that, when compared with the equity owned in a Homebuy or even a 10% PAL situation, it is not such an attractive proposition. Offering a 10% PAL with the purchaser owning 90% of the equity in a property has roughly the same monthly outgoings as a 75% shared ownership deal. The major advantage of a shared ownership product for the purchaser is that they only have to be able to raise a mortgage for the percentage they are buying on the open market. Poor credit history, insecure overtime earnings or informal income from maintenance payments for children, may mean they can afford more but are unable to gain a larger mortgage on the High Street. For people in this position, shared ownership offers something a 25% Homebuy loan or 10% PAL cannot. However, if the purchaser has the financial capability to raise a mortgage for 75% of the property value and still be able to pay rent on the remaining 25%, the possibility of them finding slightly cheaper property, or being offered a bigger mortgage due to the 10% deposit funded by the PAL, puts the two products at a much fairer comparison. In this situation it is clear a PAL would benefit the purchaser more and allow them the freedom to choose their own property on the open market, rather than from a prescribed list of shared ownership properties as used to be the case under DIY shared ownership some years ago.

Allowing tenants to gain an equity share in their own properties has been on the political agenda now for some years. However, as this analysis demonstrates, the considerable increase in monthly outgoing for tenants either trying to purchase a share of their previously rented property, or move to a new part-owned property, may pose difficulties for many in this position.

Fig 6 identifies this gap and suggests the possibility of an equity savings scheme for those wishing to move onto the homeownership ladder from rented accommodation allowing entry onto the scale. At the further end is a suggestion of equity loans, Homebuy, PAL or grants to allow people to afford suitable properties with outgoings only equivalent to a 75%+ share. In the middle third of this model is the opportunity to staircase up or down dependant on changing financial circumstances.

This model is not only relevant to first time buyers but works as well in a clearance situation, where the research has demonstrated people have a wide range of financial situations and aspirations.

Fig 6 Flexible Equity Share Model



## CONCLUSIONS

- There are several products available to aid LCHO.
- The most popular product from the market studies was the PAL, due to the flexibility in percentage.
- A 10% PAL where the purchaser holds 90% of the equity has roughly equivalent monthly outgoings to a 75% shared ownership deal, even with a rent cap of 4%.
- Shared ownership schemes play an important role at the lower end of the equity scale and appeal to a different client group.
- The biggest gap between increasing monthly outgoings is the initial step from socially renting to owning a percentage of a property.
- An equity savings product may be needed to bridge this gap.

1. K. Barker (2004) Review of Housing Supply, [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

## 5. PRIVATE FINANCE

### INTRODUCTION

The purpose of this research is to instigate a debate on how private finance can be levered into the low-income owner-occupied sector, so that homeowners who cannot afford to service loans can achieve equity release, through a PAL type loan, and thereby improve their homes to the Decent Homes Standard.

This research sets out to open up the discussion on this subject and to invite potential funders to join in with this debate.

### RESEARCH

The research started in October 2003 with a meeting attended by; O.D.P.M, The Housing Corporation, MHA, The Government Office of the Region, ART Homes and the representatives of two Banks.

The meeting concluded that the ability to lever in private finance into equity loan funds was an important goal in trying to achieve the Decent Homes standard and that further research and the financial modelling of a fund should continue.

It was, therefore, established that a paper should be produced as a basis for further discussion and to set the research in motion.

This paper was produced in January 2004 and circulated to all present at the initial October meeting.

This paper has prompted further meetings with the Bank representatives, held in London in April 2004, from which broad agreement was reached on a way forward. This involved further financial modelling of a fund and the issues that would need to be covered in any detailed agreements.

Additional meetings and discussions have taken place to discuss the risk issues relating to the fund and how these risks can be mitigated to obtain an acceptable level of leverage into an equity loan fund. The details of this modelling and the risks associated are outlined later in this chapter.

### THE EXISTING PAL FUNDS

PAL lending is currently being made by ART Homes thanks to funds being made available from Birmingham City Council, and by WPHA in the Rochdale area thanks to funding from Rochdale and Oldham Local Authorities.

Birmingham City Council has provided a fund of £1m to capitalise a PAL loan fund for Birmingham for 2003/2004 with further funds identified for the current financial year i.e. 2004/2005.

To date 213 applications totalling £2,557,000 have been received for the fund. The fund only commenced in September 2003 and this level of take up is very encouraging.

A recently successful Regional Housing Board bid has allocated funds to support PAL loans, through seven participating Local Authorities. The precise use of these funds is still to be determined but they can be used either as a fund, for direct loans or to provide a guarantee fund for any private finance that can be levered into the fund.

This will involve ART Homes extending the availability of PAL loans to a further 6 Local Authorities.

WPHA has an ongoing commitment from Rochdale and Oldham Councils to provide funds for the loans; while funds are available.

However, despite these successes, the key to increasing the scale of repair to tackle the Decent Homes problem is to access funds from the private sector.

#### THE ART HOMES PAL FUND

ART Homes as a “not for profit” Company aims to manage PAL loan funds on behalf of the Local Authorities with which it has service or grant agreements, based currently on capital being granted to ART Homes.

These service or grant agreements will include within their terms the following: the granting of capital to establish a fund; loan and fund management costs [which will include the ability to deduct fund management costs from the fund]; and the basis upon which loans may be made.

This will ensure that legal agreements exist to cover the workings of the fund and that ART Homes will get its long term fund management costs covered in the event that a scheme terminates for new business after a number of years.

WPHA is looking to offer a similar service in the its area to interested Local Authorities, either directly through Home Improve or other members of the Regenda Group.

#### THE LOCAL AUTHORITY BENEFITS

There are a number of benefits that accrue to Local Authorities and the public sector from the proposal for an equity sharing loan fund; these include;

- That Local Authorities benefit from the Fund growing at the rate of property price inflation.
- The value of Local Authorities’ capital injections, instead of being lost through the grant regime, will be retained and the value will increase over time as the equity loan fund grows.
- The cost of making loans and managing of a loan fund can be spread by the model amongst a number of Local Authorities thereby reducing the cost to each one.
- The possibility of introducing private finance into the fund to help meet the Decent Homes standard.

- By borrowing funds the capital injection of private finance will provide an immediate fund to improve homes to the Decent Homes standard.

The benefits to the public sector resulting from a change from giving grants, to the taking of equity stakes, are substantial. The real benefit, however, only comes when private finance is levered into the process and the volume of repair increased.

If a fund performs well then a Local Authority would have the choice of what to do with any surplus in a fund. This could be:

- To repay the private finance as soon as possible
- To re-lend the funds,
- To build up a guarantee fund, or
- To offset interest charges.

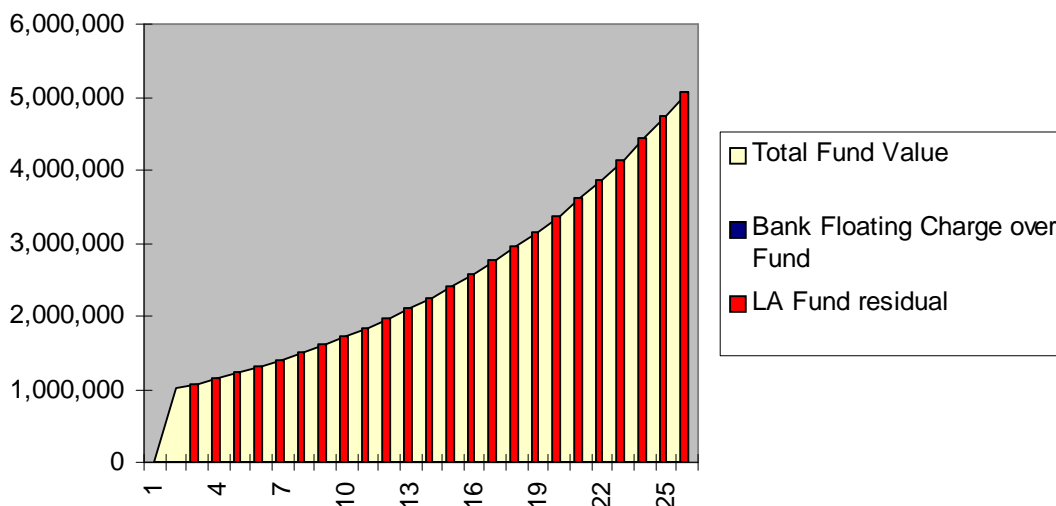
Clearly, funders and Local Authorities would have different priorities, but a Local Authority would be in a good position to use any surplus to meet policy objectives.

### FINANCIAL MODELLING

A financial model has been developed that will enable the growth of an equity loan fund to be estimated over a 25 year period.

Fig 7 shows the growth of an equity fund over 25 years at an average compound rate of growth of 8%. This is the approximate rate of annual compound growth in House Price Inflation [H.P.I.] over the last 25 years.

**Fig 7 Growth of £1m Equity Fund over 25 years at 8%**

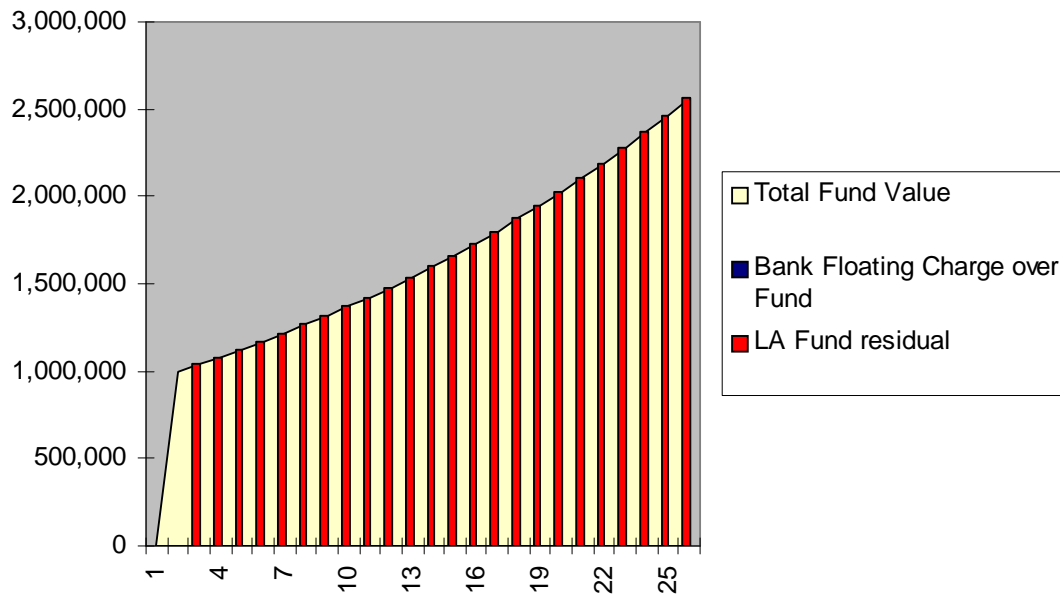


This graph shows that £1 million pounds invested by a Local Authority in an equity loan fund would grow to approximately £5 million over the 25 year period, at an average compound rate of 8%. The model assumes that any

costs for managing and maintaining the fund are covered separately and that all repaid loans are reinvested in the fund. In practice, a Local Authority may be able to cover costs from the fund depending on H.P.I. and the turnover of the fund.

The future rate of growth of H.P.I. is difficult to predict; however, in the current economic climate a rate of 5% would perhaps be a more realistic assumption. Fig 8 shows the growth in a £1 million fund over 25 years at an average compound rate of 5%. As can be seen from the table, the fund will be worth approximately £3 million.

**Fig 8 Growth in £1m Equity Fund over 25 years at 5%**



The equity loan fund will be available to a Local Authority for the continual reinvestment in the repair of property for as long as there is a demand. Clearly a Local Authority can add to the fund as and when required, up to a point potentially when the turnover of the fund meets the demand for new loans.

However, this point is unlikely to be reached in most Local Authority areas based on the resources available from within the Local Authorities' own available funding.

The key to increasing the resources available to Local Authorities to meet Decent Homes targets in the private sector, for the groups who cannot access commercial loans, is to lever in private finance.

### PRIVATE FINANCE

As part of this research project there have been a number of discussions with Banks concerning the possibility of leveraging in private finance into a Local Authority equity loan fund, managed by an intermediary lending agency such as ART Homes.

The discussions initially centred on how the interest costs of a commercial loan could be covered. This point proved problematic as Local Authorities were finding it difficult to give 25 year revenue guarantees to cover the commercial loan interest, to an intermediary lending agency. This does however occur in Private Finance Initiative [P.F.I.] schemes, whereby revenue payments are guaranteed for a period of 25 or 30 years in return for the provision of a service. The provision of loans; the raising of private finance; the management of an equity loan fund; could be considered as the provision of a long term service to Local Authorities and the possibility of a P.F.I. type of arrangement considered. Clearly to be a P.F.I. type of arrangement some transferring of risk would be required.

A potential breakthrough occurred in April 2004, however, when a major clearing Bank agreed in principle to let interest roll up on the commercial loan to the revolving equity loan fund.

This agreement in principle to allow interest to roll up on a loan is not without risk to both the Bank and the Local Authority. The risks associated with this strategy have been identified but at the present time need further discussions to overcome.

A debate has been started which will continue, and hopefully come to a satisfactory conclusion, over the next 12 months or so.

## RISKS

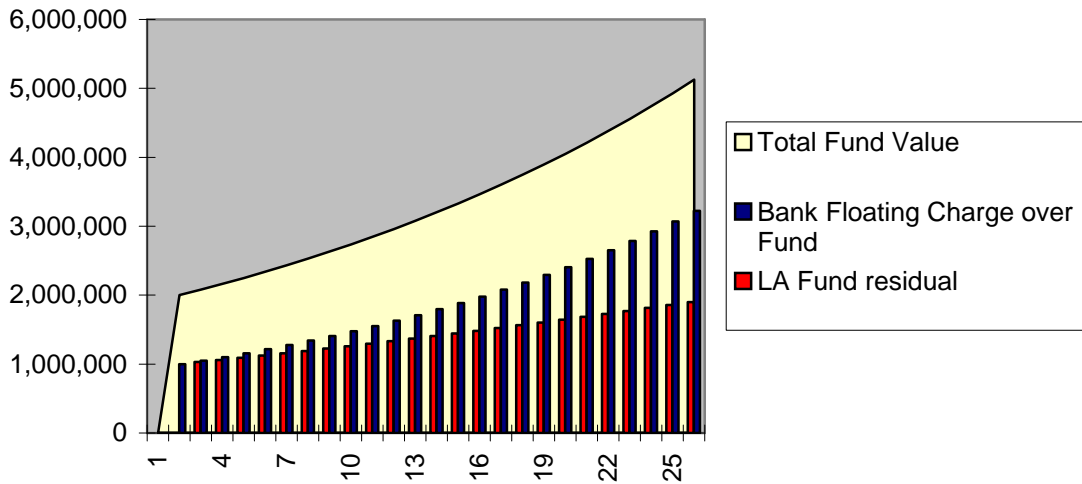
The risks to a Local Authority are low with an equity loan fund capitalised by its own funds. The growth in H.P.I. may not be as predicted but the fund should still grow over time and, with the loan backed by a charge over the individual property, default will be low and Local Authorities' capital relatively secure. If the product includes [as in the case of the ART Homes, PAL] the return of the original capital sum even if house prices fall, then the risk to capital is further reduced.

The risk to a Local Authority changes with the introduction of private finance into the equity loan fund.

The Bank will require a first charge over the fund, which means that if there is an overall loss in the fund, it would be the Local Authority's funds that are lost first. This would be a contractual requirement by the Bank, to reduce a large potential risk.

The real risk to a Local Authority's capital within the fund comes from the fact that interest would be rolling up on any private finance levered into the fund. The assessment of this risk will be a key one for Local Authorities. If H.P.I. is at a similar level to Bank Base Rate then there will be little risk to a Local Authority's capital. Fig 9 shows the impact of matching Local Authority funds with private finance [on a 1:1basis] assuming that H.P.I. is 5% and Bank Base rate 4%.

Fig 9 Growth of £2m Equity Fund over 25 years including £1m Private Finance at 5% HPI

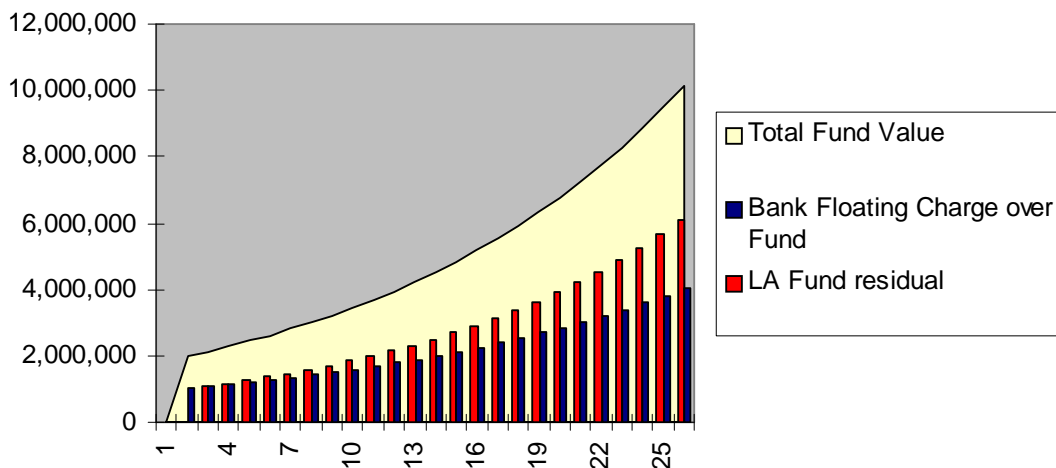


As can be seen from the graph, the total fund is worth £5m after 25 years, with the rolled up loan having a value of £3m. This assumes that all individual loans, when repaid are reinvested and that no costs are deducted from the fund. The Local Authority would still have equity valued at around £2m in the fund, even after allowing for the rolled up interest.

H.P.I. over the last 25 years has usually been higher than Bank Base rate; with the exception of the recessions of the early 1980s and 1990s, and in particular has been well above Bank Base rate since 1992, during a more stable economic period, which should be reinforced by the independence of the Bank of England.

However, Local Authorities would need to consider a range of interest rate and H.P.I. assumptions to get a feel for the impact on the fund of a range of scenarios. Fig 10 shows the result of a fund over 25 years with H.P.I. at 8%; the average compound rate over the last 25 years; and Bank Base Rate at 5%.

Fig 10 As Fig 9 but with 8% HPI



This shows a fund in a strong financial position, even allowing for the interest roll up on the levered in private finance. The expectation would be that over an extended period i.e. 25 years, H.P.I. would be higher than interest rates and a funds performance would be similar to Chart 4.

### COMMERCIAL RISK

The Bank will make any investment into an equity loan fund on a purely commercial basis. The Bank have looked at their risk in this investment and identified a number of risks, which will need to be managed to successfully attract their investment.

These risks include;

- Dilapidation risk;
- Mortality risk;
- H.P.I./Interest rate risk;
- Turnover of the fund.

#### Dilapidation risk

There is a risk that an individual homeowner who requires an equity loan now, may not be able to maintain their property due to an ongoing lack of resources. This could mean that further equity loans will be required to maintain the property, therefore increasing the risk of negative equity on the property.

#### Mortality risk

The existing commercial equity release products that are repayment free, calculate the amount of equity that can be released on the age of the applicant. The calculation is made based on the age and life expectancy of the applicant or applicants to the equity release scheme. There is a risk, however, that improvements to medical science could dramatically change life expectancy and therefore increase the risk that equity loans may not be repaid for a much longer time period than originally envisaged. This is not such a problem with a Local Authority funded scheme but clearly increases the risk when private finance is introduced. If the commercial loan cannot be repaid on time because loans are not recycling as envisaged, then the rollup of interest on the loan over a much longer time period could push the fund into negative equity.

#### The H.P.I./ interest rate risk.

The relationship of H.P.I. to interest rates can be tracked back over the last 25 to 30 years and assumptions made for the future projections of both indices. However, with the independence of the Bank of England and the overall inflation targets it is possible that the future projections may not correspond with past history.

The average compound rise in H.P.I. over the last 25 years of around 8% may not be sustainable in the future. With a potential increase in the supply of new homes and a more targeted economic environment for inflation, H.P.I. of around 5% will be a much safer assumption over the next 25 years. Interest rate assumptions of around 4% to 5% would also be more realistic. However,

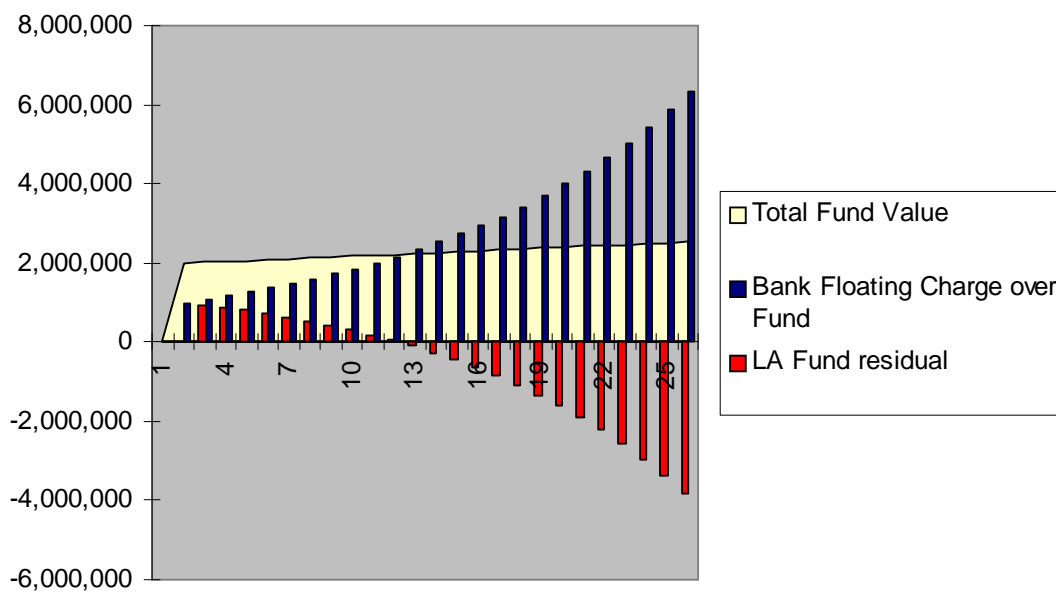
long term modelling will need to be undertaken on a range of assumptions, including a worst-case scenario.

The Bank has recommended that a worst case scenario should be based on H.P.I. of 2% and interest rates of 8%.

As can be seen from Fig 11 this produces a scenario where the private finance loan [on a matching £ for £ basis with public finance] with rolled up interest, results in a situation where the private finance loan is in excess of the value of the total fund, and the fund is in negative equity.

This is a key risk that needs to be mitigated by the public sector to induce the private sector to invest. The risk of interest rates exceeding H.P.I. and by a substantial margin for a prolonged period, is extremely unlikely. However, it exposes a worst-case scenario risk to both the public and private sector funds that will need to be overcome to encourage the private sector to invest and the public sector to accept that investment.

**Fig 11 £2m Equity Fund with HPI at 2%**



The situation as modelled in Fig 11 is very unlikely to occur over a sustained period and the outcome is much more likely to be that shown in Fig 9. However the risk needs to be understood by the public sector, and the risk to the private sector reduced.

### Turnover of the fund.

The turnover of an equity loan fund is difficult to predict as there are a number of variables to contend with and there has been no experience of a fund for this purpose.

If the fund were to be aimed at older people then the life expectancy tables could be a reliable basis on which to predict turnover. However, as already

identified, there is a concern that medical advances may affect this issue, particularly as loans will be made to younger homeowners. The turnover of an equity share PAL type loan made to a vulnerable 40 year old homeowner will be very difficult to predict.

While some early work has been undertaken in this study in relation to this area of turnover, it is clear that further detailed research is required to be able to assess this risk more accurately.

Normal mortgage loans tend to turnover every 5-7 years, but there is no evidence to indicate that this will be the same with vulnerable low-income homeowners. Little research or data was found on the topic and clearly further work needs to be undertaken to better inform this aspect of risk.

### THE WAY FORWARD.

This research has identified the risks associated with leveraging private finance into an equity loan fund with mixed public and private sector funds. A potential breakthrough has also been made in achieving an in principal agreement with a Bank to allow the roll up of interest on the private sector investment in such a fund.

However, more work needs to be done to detail the risks identified and to minimise the risks to private sector capital to achieve the level of leverage required. The aim would be to achieve a leverage of 1:1 of private finance to public sector funds.

However, this will not be achieved without the risks as identified in this study being minimised for the private sector. The Bank is prepared to take a substantial risk in allowing interest to be rolled up in the fund and the public sector needs to find a way of minimising the worst case scenario risk to the Bank, to achieve the leverage desired.

It may be that for a pilot funding exercise, a combination of Local Government and Central Government risk sharing is required until the model is well established, and the risks of leveraging in private finance understood and modelled over a medium term i.e. 5 to 10 year period.

The Housing Corporation could potentially play a role here in examining the option of providing capital for a revolving equity loan fund to assist in RSLs' regeneration activities. This capital could successfully substitute for Bank loan while the issues surrounding Bank Loan Finance are resolved. This would have the effect of providing a medium term expansion of equity loan funds and the repair of property to meet the Decent Homes standard in the private sector.

## 6. FRANCHISING

The Market Studies chapter has shown the need and potential use for loans and in particular a PAL type loan in a range of differing housing market conditions. To access the range of products Local Authorities could provide the loans directly to owner-occupiers who want to improve their homes and who for various reasons cannot access loans from commercial lenders.

However there are a number of reasons why this service may best be provided by a third party intermediary lending agency, they are:

- The overheads of providing a service can be spread amongst a number of Local Authorities.
- Regulation of the loans sector is becoming increasingly complex. Mortgages are now regulated as of the first of November 2004, and the expertise in lending and regulation may not exist within the Local Authority. Although Local Authorities are currently exempt from Regulation, this may not always be the case. Guidelines to Local Authorities may be issued in respect of loans in the near future. An external agency will be charged with meeting compliance issues.
- A specialist lender will have a greater understanding of the loans market; be able to develop new products more readily; and share best practice more easily.
- Finally, and most importantly, an intermediary lending agency can potentially introduce private finance into the Local Authority home improvement process.

The scale of the repair issue facing Local Authorities is such that, introducing private finance into the process has considerable benefits to increasing the scale of repair that can be carried out and, ultimately, helping to meet the Decent Homes standard in the private sector.

In order to access private finance Local Authorities will need to be able to access an intermediary lending agency such as those described earlier in this report.

Art Homes in particular has developed a model that is designed to encourage the introduction of private finance into the repair and improvement of homes for low -income homeowners. Art Homes has already received an offer of finance from a commercial lender for a loan to support its repayment loans.

Although these types of loans are not in greatest demand as determined by the Market Studies chapter, this offer of finance is a welcome start to the process of introducing private finance into the process.

The greatest demand for loans as shown in the Market Studies chapter is for PAL type loans. The demand for this product was significantly higher than for the other products and this is proving to be so in practice, as reported by ART Homes and also by the demand at WPHA.

The problems with introducing private finance into PAL loans are significantly greater but progress has been made as evidenced in the equity loan fund chapter.

So the key question is how does a Local Authority access loan products from an intermediary lending agency when there is currently limited national coverage by these agencies?

There are two options:

1. A PAL by post system.
2. Development of a National network of Regional Lending Agencies.

#### The PAL by post system

As part of this research it has become evident that the development of a national network of Regional Agencies, if it is to happen, will take time. Therefore as an intermediate step, discussions have taken place with ART Homes, which has now developed a PAL by post system.

Pilot projects for this system are under discussion and could commence in the near future. The Local Authorities concerned are intending to use the PAL for assisting in a clearance programme.

This system offers a Local Authority quick access to a PAL product produced through an intermediary lending agency, with the possibility of private finance being introduced at some stage. The system also offers access to Local Authorities who only wish to offer a PAL type product, perhaps where they have a limited programme of assistance in the private sector.

Standard legal documentation has been developed as part of this research programme that will enable a Local Authority to proceed quickly, to access this system.

#### A National network of Regional Lending Agencies.

In order for Local Authorities to access a full range of products and services from an intermediary lending agency, a network of agencies with one in each of the Regional Housing Board Regions would be required.

At the present time there is one agency which has a wide range of products, ART Homes has a Business Plan, with the aim of being a Regional Agency offering all of its products to Local Authorities in its region.

The other intermediary agencies outlined earlier in this research either have not expressed the desire to become Regional lenders or have different priorities in terms of products. Whether or not these agencies will develop along the lines of ART Homes; is not guaranteed.

## SO HOW DO OTHER REGIONS ACCESS A REGIONAL LENDER?

MHA agreed to acquire ART Homes at the end of 2003 as part of a strategy to focus the organisation as a major Regional participant in regeneration activities. Having ART Homes as a wholly owned subsidiary will enable MHA to become more active in regeneration. The support it has given ART Homes is behind the expansion of ART Homes into a Regional lender offering a National PAL by post system.

There is clearly the potential for other RSLs to develop similar strategies and assist in establishing intermediary agencies similar to ART Homes in the Regions that currently do not have such a lending model. Without the involvement of RSLs it is difficult to see who will act as the catalyst for the establishment of a new organisation. ART Homes evolved out of the work carried out by Aston Reinvestment Trust in Birmingham, but few organisations such as ART exist in the rest of the country.

RSLs could therefore play a lead role in the development of intermediary agencies to assist Local Authorities in their regeneration activities.

ART Homes has the model, systems, policies, products, documentation and the experience to help other RSLs to establish lending agencies based on its model. It has also developed a consultancy service alongside the lending service to help and advise in this area of operation. The lead in time to set up a new lending service would be dramatically reduced with co-operation between ART Homes and an RSL looking to set up a similar model.

However, this may not happen by chance and The Housing Corporation should consider acting as a catalyst and providing financial support towards the development costs of the new organisations in partnership with Regional Housing Boards and the Local Authorities. However, an interested RSL could act as the catalyst for this partnership.

The 'PAL by post' system could provide an intermediate step to providing access to the most in-demand product while a Regional lending agency is established.

## 7. SUMMARY AND RECOMMENDATIONS

The Regulatory Reform Order 2002 has given Local Authorities the power to make loans or to take equity stakes in property, as well as making grants to tackle disrepair in the owner-occupied sector. The potential is for funds to be recycled through loans and equity stakes, and for the introduction of private finance to increase the total amount of money being invested in an attempt to meet the Decent Homes standard in the private sector.

Local Authorities can either make loans and take equity stakes themselves or employ intermediary agencies to undertake this task on their behalf. This report has looked at the different organisations that currently provide this intermediary service, and what is clear is that access by Local Authorities to a full range of products and services at present, is extremely limited.

The majority of Local Authorities do not have access to an intermediary lending agency, with only, ART Homes, looking to provide a full loans service on a Regional basis, and to offer the PAL loan product on a wider basis.

This lack of access will potentially cause problems for Local Authorities wanting to take advantage of the new powers, unless they make the decision to make loans directly. This has potential disadvantages for Local Authorities in terms of: the sharing of cost; leveraging in of private finance; staff expertise; and issues regarding regulation. Although exempt at present, Local Authorities are required to operate within the spirit of legislation and will receive further guidance on the regulatory aspect in due course.

Wider access to intermediary agencies would appear to be advantageous to Local Authorities, in the development of their private sector renewal policies. At present the existing agencies only provide limited cover and there does not appear to be any catalyst for the establishment of new intermediary agencies.

The most successful lending agencies at present, ART Homes and WPHA, are both part of the RSL movement and it would appear that RSLs and the Housing Corporation, with a mutual interest in regeneration, would be ideally placed to further develop the intermediary lending agency coverage.

Further research is required on the financial viability of the intermediary agencies but an aspiration could be that each Regional Housing Board area has an intermediary lending agency providing a full range of product services within its operational area, providing that this is financially viable.

Individual RSLs are well positioned to sponsor the establishment of new agencies, with support from the Regional Housing Boards and the Housing Corporation. The existing agencies should be encouraged to assist in this process, depending on the model chosen. Without the involvement of RSLs the development of new agencies will be haphazard or possibly extremely

slow. The Local Authority requirement is for loans now, and wider access is a matter of urgency for them and for facilitating urban renewal.

Support from an RSL could also lead to new loan products being developed specific to the needs of the area. This has been demonstrated by the demand for a faith loan in the West Midlands.

The Market Studies chapter showed the potential use of loans, and in particular the PAL product in different market conditions. It will clearly take time for the use of loans to be widely tested as there is limited experience to date. However, it will be important for this experience to be shared amongst Local Authorities and this would seem to encourage the use of a Regional Centre of Excellence to ensure best practice is developed and widely disseminated. Such an agency could be sponsored by RSLs and be a partnership with Local Authorities. The “front end” delivery; of the improvement service, could then be undertaken by either: RSLs or Local Authorities.

A key aspect of the success in meeting the Decent Homes standard in the private sector will be to substantially increase the scale of repair and improvement from that currently taking place. It is unlikely that Local Authorities will have the funds available to finance a substantial increase in the programme from their own resources.

The introduction of private finance into the sector is a key issue. ART Homes has shown that it is possible to lever in private finance into standard repayment loans, but the PAL type loan is expected to be the product with the greatest demand. The popularity of this product; is already being demonstrated by ART Homes, and WPHA.

To attract private finance into the PAL loan product is more difficult. The Private Finance Chapter outlines the progress that has been made in this respect but there is still some way to go. If private sector leverage can be obtained then the PAL product can be used not only for repair and improvement, but to assist first time buyers, as outlined the Home Ownership Options Chapter.

A concentrated effort is required by all the interested parties to overcome the issues that still remain preventing the leverage of private finance into the PAL funds.

## **RECOMMENDATIONS**

1. The Market Studies Chapter has shown the potential for loans to assist in the repair and regeneration of homes in the private sector. This approach, should be considered; by all Local Authorities.
2. To achieve the scale of increase in repair and improvement required to meet the Decent Homes standard, ways of accessing private finance should be explored.

3. The most effective way of accessing loans and delivering private finance is to access an intermediary loans agency, for most Local Authorities.
4. Access to intermediary lending agencies should be widened by the involvement of sponsoring RSLs, with the support of the Housing Corporation and Regional Housing Boards.
5. RSLs should lead in the establishment of Regional Centres of Excellence, to oversee works and to share best practice in the delivery of the improvement service to individual homeowners.
6. Local Authorities should use their role as enabling authorities to set up a system of Regional lending agencies and Regional Centres of Excellence.
7. The Housing Corporation should increase its involvement in regeneration activities by seeking to support the establishment of further intermediary lending agencies along the lines of ART Homes and WPHAs HomeImprove.
8. The Housing Corporation should consider top slicing one to two percent of its ADP allocation to support the regeneration activities of RSL's.