National Audit Office

A Foot on the Ladder: Low Cost Home Ownership Assistance

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 1048 Session 2005-2006 | 14 July 2006

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NATIONAL AUDIT OFFICE

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This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

John Bourn
Comptroller and Auditor General
National Audit Office

10 July 2006

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PREFACE

The Government is committed to offering everyone – owner-occupiers, first-time buyers, social tenants and people who rent privately – the opportunity of a decent home at a price they can afford.[1] But for many who would like to buy their own home, house price inflation has made it more difficult to get on the housing ladder and benefit from the choices, opportunities and wealth that owner-occupiers enjoy. In 2005 only 36 per cent of new households could afford to buy a property compared to 46 per cent in the late 1980s.[2]

The Department for Communities and Local Government (the Department) wants to offer as many people as possible the opportunity to own a home and plans to help 100,000 households into home ownership over the next five years. This report examines the value for money of the two main methods of government assistance: interest-free equity loans and shared ownership.

Supporting people who otherwise could not afford to buy their own home can help to create a better balance of housing types and tenures and mix of incomes and promote more sustainable communities. It can free up social rented homes if existing and prospective tenants take it up. Enabling key public sector workers such as nurses, teachers and social workers to buy a home near their place of work can help to address recruitment and retention problems in London and other regions where there are vacancies.

Demand for assistance greatly exceeds supply. Help needs to be tightly targeted at those who genuinely need it or funds will not achieve the maximum benefit.

Overall value for money assessment

Equity loans and shared ownership are successfully extending choice. So far they have helped about 40,000 households to take their first step onto the ladder of home ownership. These households typically have incomes between £5,000 and £10,000 lower than first time buyers as a whole and would not otherwise have been able to afford to buy a home. Many key public sector employees have benefited, which employers believe has helped with the retention of such staff.

The Department and the Housing Corporation have taken steps to improve the delivery of assistance:

- From April 2006 the process of applying for assistance has been streamlined with all applications now being made through one HomeBuy agent in each area. This will make the application process easier and less confusing than before.
- Purchasers will now explicitly be required to buy as large a share of a property as they can afford and sustain as previously some beneficiaries received more assistance than they required when they were sold a fixed share of their home regardless of the amount they could afford.

1 Office of the Deputy Prime Minister, *Sustainable Communities: Homes for All* (January 2005).
2 *Survey of English Housing: Provisional Results* (October 2005).

Better targeting and further refining of the programme could improve efficiency and enable more people to be helped. In particular:

- Helping existing and prospective social tenants into home ownership results in savings for the taxpayer as low cost home ownership assistance costs half as much as providing a new social home for rent, but the assistance could be targeted more effectively at these people.
- More could be done to help those households with incomes between £15,000 and £30,000 who cannot afford to buy using current equity loan products but who can sustain home ownership but do not have access to new build properties in their area.
- There needs to be greater oversight over the scale of gains Registered Social Landlords are making from low cost home ownership and their reuse of these gains on affordable housing.

We make recommendations at the end of this report to address these weaknesses. We estimate that these recommendations could result in future savings of up to £112 million a year, enough to help an additional 4,130 households a year into affordable housing.

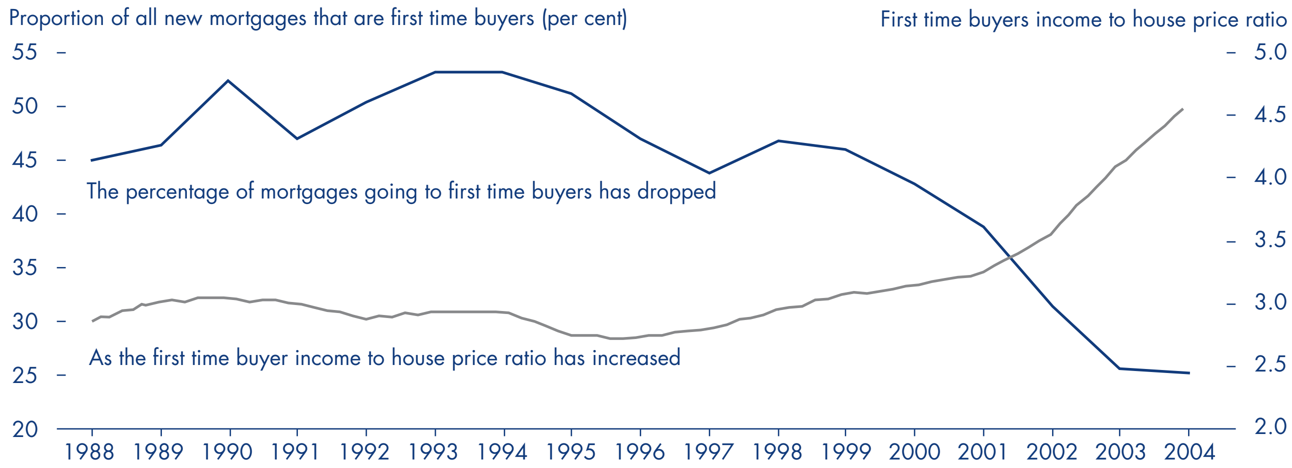
BACKGROUND

1 Ninety per cent of householders would prefer to own their own homes if they could.[3] Owning your own home provides many benefits. A home can be an asset and investment, something to pass on to others or to help fund a retirement. Owning your own home can also bring the security of being in your own place and the freedom to do what you would like to it. However, house price inflation has meant an increasing number of people are finding it difficult to purchase their own home **(Figure 1)**.

2 Currently 70 per cent of households own their own home. The Government aspires to increase this to 75 per cent, believing that supporting people to buy their own home helps to meet a number of objectives.[4] It can help to create a better balance of housing types and tenures and mix of incomes and promote more sustainable communities. If people move out of a social rented home to take up a home ownership opportunity, this can free up social homes for households in greater housing need.

1 It is getting harder to buy a first home

The ratio of average house prices for first time buyers in the United Kingdom to their average household income has increased by almost 50 per cent since 1999, making it harder for first time buyers to raise the finance to purchase their home.



Source: The Department's housing market information (Tables 513 and 517)

3 British Social Attitudes Survey 2001-02.

4 Office of the Deputy Prime Minister Consultation Paper *HomeBuy – Expanding the opportunity to own* (April 2005); Pre-Budget Report 2005 *Britain: Meeting the Global Challenge* (December 2005) (Cm 670).

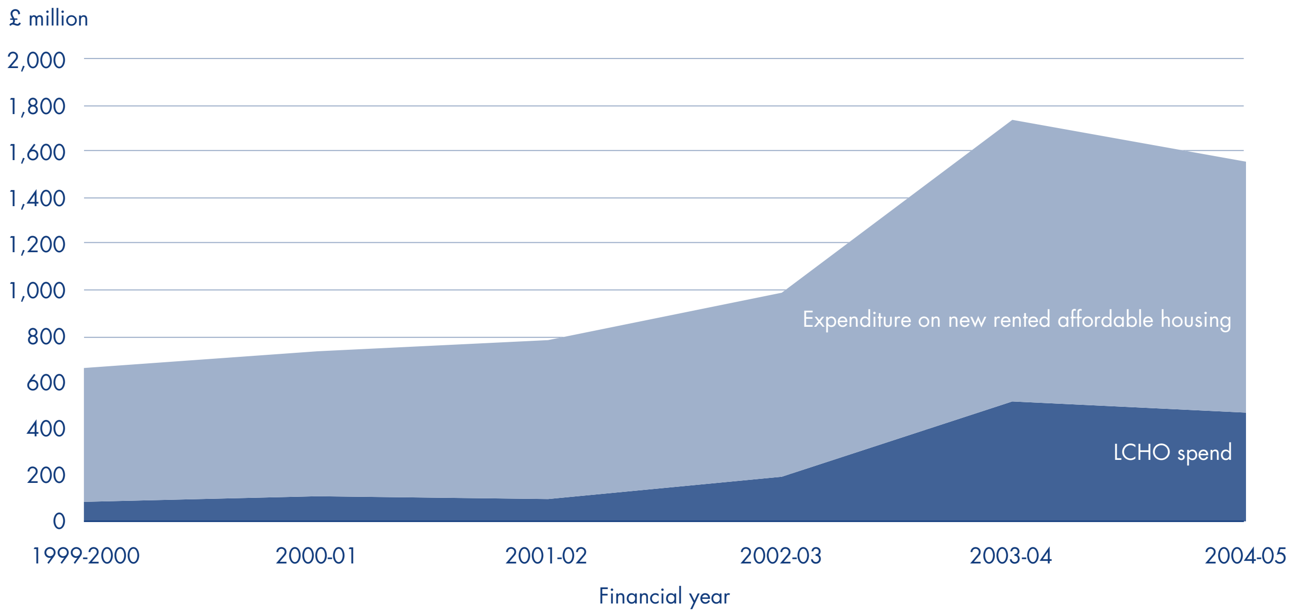
Providing assistance to key public sector workers such as nurses, teachers and social workers to buy a home near to their place of work can help to address recruitment and retention difficulties.

3 Low cost home ownership financial assistance products funded by the Department for Communities and Local Government[5] (the Department) aim to extend the opportunity of home ownership to those who would not otherwise be able to afford it. There are three types of assistance provided:

- **Discounts and grants**, which are offered to social tenants (those renting from local authorities and housing associations) either to buy their rented home or to buy a home on the open market (Right to Buy, Right to Acquire, or Cash Incentive Schemes – Appendix 1).
- **Equity loan** schemes, such as Homebuy, where a homebuyer purchases 75 per cent of a home using a commercial mortgage and receives an interest-free equity loan for the remaining 25 per cent. When the buyer sells, the loan is repaid as an equivalent proportion of the sales proceeds.
- **Shared Ownership** where a homebuyer purchases a proportion of the equity in a new home built by a Registered Social Landlord (Housing Association) paying rent on the share they do not own.

4 Our report focuses on Shared Ownership and Homebuy equity loans. In 2004-05 the Government spent almost £470 million on these two products. The products are absorbing a growing proportion of the support made available to the affordable housing sector, from 13 per cent in 1999-2000 to almost 30 per cent in 2004-05 **(Figure 2)**. The bodies involved in funding and administering low cost home ownership products are shown in **Figure 3 overleaf**.

2 Government expenditure on low cost home ownership assistance has grown



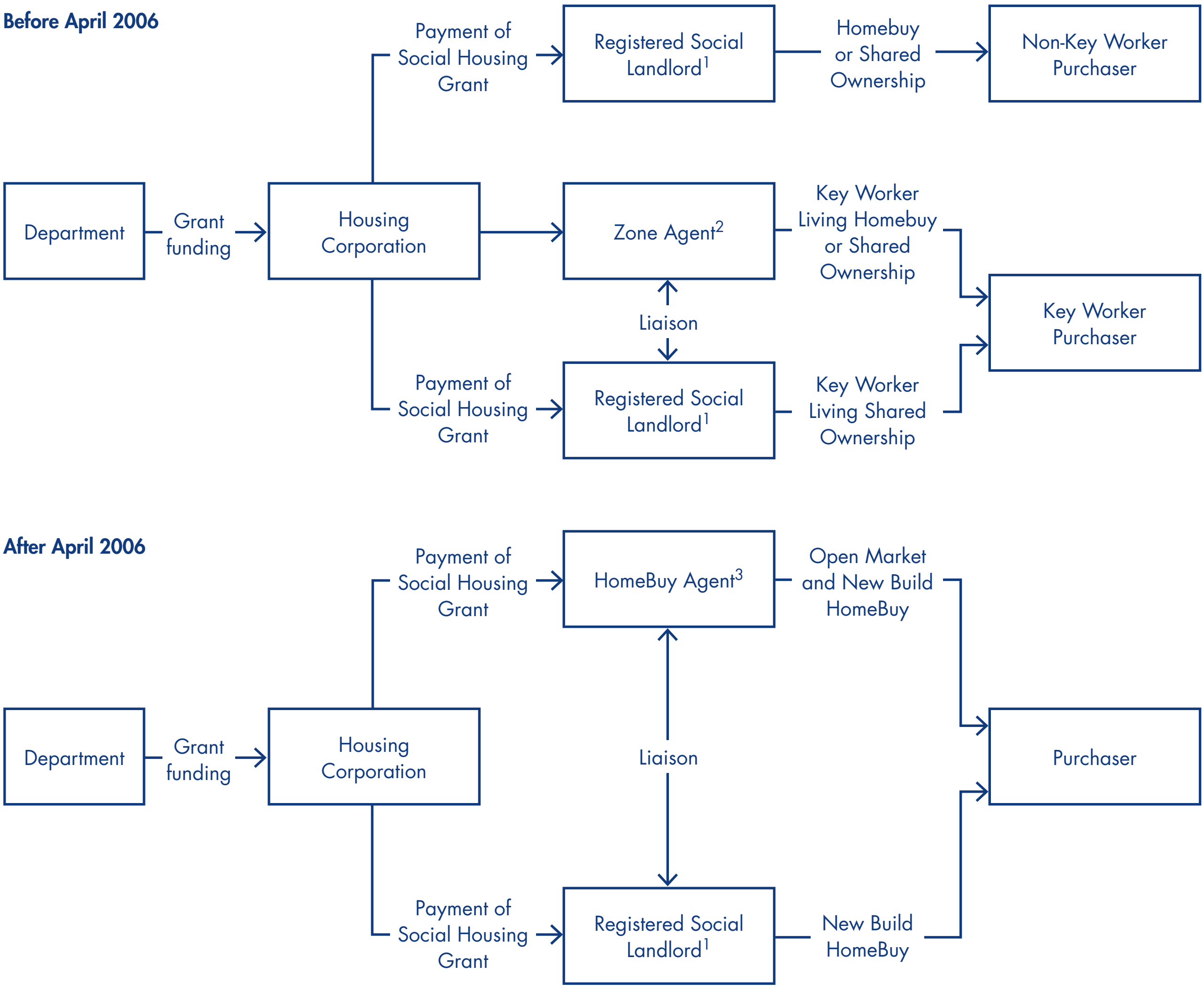
Source: National Audit Office analysis of the Housing Corporation's Investment Management System

NOTE
All figures are at 2004-05 prices.

5 The Department for Communities and Local Government replaced the Office of the Deputy Prime Minister on 5 May 2006. Where in the report and associated technical note we refer to the Department we refer to both the Office of the Deputy Prime Minister prior to this date and the Department for Communities and Local Government after this.

5 The differences between the two products are summarised in **Figure 4**. In the standard versions of these two products, priority was given to applicants who were in social housing or on a social housing waiting list and who were unable to afford to buy a home without assistance. There were also special versions of both products available to key public service workers in London, the South East and East of England under the Key Worker Living Initiative (which replaced the earlier Starter Homes Initiative in April 2004). The list of key workers eligible for assistance has increased over time **(Figure 5 on page 10)**. Of the total expenditure of £470 million in 2004-05, £221 million was spent on this Initiative.

3 Public and voluntary bodies are involved in administering low cost home ownership



Source: National Audit Office

NOTES

1 Registered Social Landlords are non-profit making voluntary bodies that are regulated by the Housing Corporation.

2 Zone Agents were Registered Social Landlords that acted as coordinators in each locality for Key Worker Living Low Cost Home Ownership.

3 HomeBuy Agents are 23 Registered Social Landlords who offer a "one stop shop" for all grant funded low cost home ownership products in their area.

6 Before April 2006 social housing tenants or those on a housing waiting list who were interested in obtaining assistance first approached a Registered Social Landlord or the relevant local authority who then passed them on to those Registered Social Landlords providing the two products in the area where they wanted to live. In contrast, Key Worker Living applicants simply applied to the local Registered Social Landlord appointed by the Department as a Zone Agent for their area. If an application was accepted, the prospective homebuyer then arranged a mortgage with a commercial lender.

4 The Department had two main low cost home ownership products and specific versions for Key Workers up to April 2006

	Non-Key Worker		**Key Worker in London, SE and E England**	
Available products	Shared Ownership	Homebuy	Shared Ownership	Homebuy
"Am I eligible for assistance?"	You must be unable to afford to purchase a property outright			
	You will be given priority if you are a social housing tenant or on the housing waiting list.	You must be a social housing tenant, or on the housing waiting list and nominated by the local authority.	You must occupy a job defined as that of a key worker.	
"What happens when I buy?"	You buy between 25 and 75 per cent of a property.	You get a loan for 25 per cent of the property and a mortgage for 75 per cent of a property.	You buy between 25 and 75 per cent of a property.	You get a loan of up to a maximum of £50,000 and meet the remaining cost with a private mortgage.
	You buy a newly built property from a Registered Social Landlord.	You buy any property on the open market.	You buy a newly built property from a Registered Social Landlord.	You buy any property on the open market.
	You enter into a lease with the Registered Social Landlord who owns the property's freehold.	You own the freehold; the Registered Social Landlord has a second charge over the property in respect of its loan.	You enter into a lease with the Registered Social Landlord who owns the property's freehold.	You own the freehold; the Registered Social Landlord has a charge over the property in respect of its loan.
"What happens while I am living in my new home?"	You are responsible for your home's maintenance.			
	You pay rent on the share retained by the Registered Social Landlord.	You do not pay rent on the share in which the Registered Social Landlord has an interest.	You pay rent on the share retained by the Registered Social Landlord.	You do not pay rent on the share in which the Registered Social Landlord has an interest.
	You can buy all, or part, of the Registered Social Landlord's share at a later date at the prevailing market rate.			
"What happens when I sell my home?"	You sell the share you own. The Registered Social Landlord can normally nominate someone to buy that share from you.	You must repay the value of any remaining unpurchased share at the prevailing market rate.	You sell the share you own. The Registered Social Landlord can normally nominate someone to buy that share from you.	You must repay the value of any remaining unpurchased share at the prevailing market rate.
"What happens if I change jobs?"			You must repay the assistance you received.	

7 In April 2006 the Department merged the wide range of existing products into a single, new HomeBuy programme **(Figure 6)**, while streamlining procedures to ensure people are treated more consistently and fairly. It extended the system of Zone Agents (now known as HomeBuy Agents) from the Key Worker Living Initiative so that all applicants for low cost home ownership assistance in England now apply to their local Agent in the first instance. Support is still directed at previous priority groups – social tenants, those on the housing register, and key workers, although the types of key workers who are eligible for assistance has been expanded (Figure 5). Priority is also now given to other groups of first time buyers, who cannot afford to buy their own home outright, who have been identified as eligible for assistance by Regional Housing Boards and approved by ministers at the Department. Some Boards have chosen to include within these other groups certain categories of key public sector workers not eligible for assistance under the Key Worker Living Initiative.

8 The Department has also agreed with three private mortgage companies (Halifax Bank of Scotland, Nationwide Building Society and Yorkshire Building Society) that, from October 2006, in addition to offering a 75 per cent conventional mortgage, they will offer an equity loan of 12.5 per cent alongside an equity loan from Government of up to 12.5 per cent. The Department expects this to more than double the number of households to be helped with the same amount of social housing grant.

Scope and methods of the examination

9 In the light of the growth in government spending on low cost home ownership products, this report considers:

- Whether the current products are delivering the intended benefits of making home ownership accessible to more people and of easing recruitment and retention of key workers.
- Whether the different products have reasonable costs and provide benefits for the home purchaser, the taxpayer and the affordable housing sector.
- Whether the funds available can be made to support more people into home ownership.

5 The categories of employment eligible for Key Worker support have expanded

Starter Home Initiative	Key Worker Living Initiative[1]	
September 2001 to March 2004	April 2004 to March 2006	From April 2006
■ Nurses. ■ Teachers in schools. ■ Police officers.	■ Nurses and certain other NHS staff. ■ Teachers in schools and further education. ■ Police officers and some civilian staff, in some police forces. ■ Prison service and probation service staff. ■ Social workers. ■ Occupational therapists. ■ Educational psychologists. ■ Local authority planners (in London only). ■ Fire fighters (only in Hertfordshire).	■ All clinical NHS staff. ■ Local authority employed clinical staff. ■ Teachers in schools and further education. ■ Qualified nursery nurses. ■ Police officers and community support officers. ■ Prison and probation service staff. ■ Social workers. ■ Occupational therapists. ■ Educational psychologists. ■ Speech and language therapists. ■ Local authority planners. ■ Uniformed staff in Fire and Rescue Services.

Source: National Audit Office analysis

NOTE

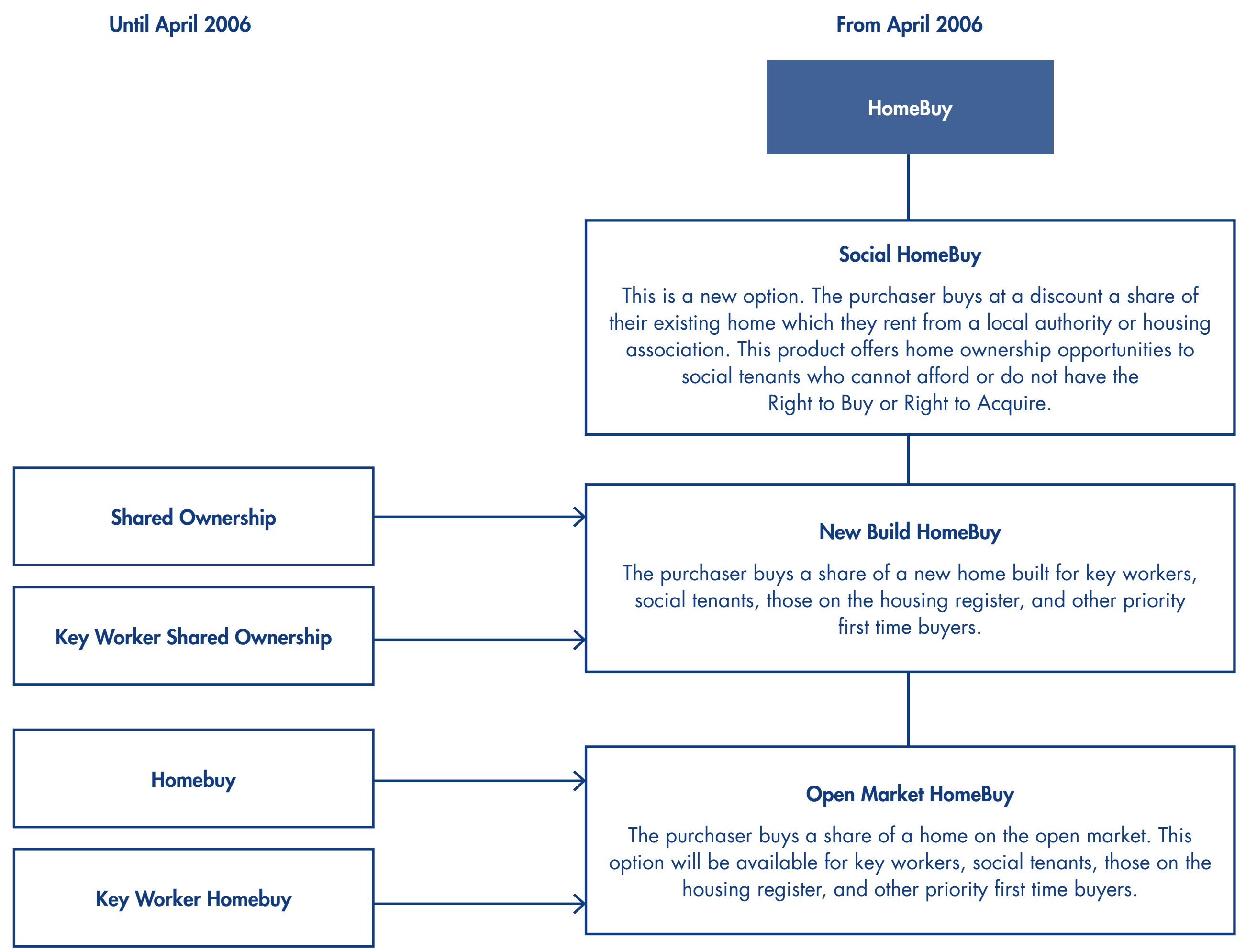
1 The Key Worker Living Initiative defines a key worker as someone who is: employed by the public sector; in a frontline role delivering an essential public service; and in a sector where there are serious recruitment and retention problems.

The report does not examine alternative policy options for helping people purchase their own homes, such as tax relief, or for addressing recruitment and retention problems in the public sector, such as localised pay bargaining.

10 Our findings are based on the first comprehensive analysis of data held by the Housing Corporation on all low cost home ownership transactions between 1999 and 2005. With the co-operation of the affordable housing sector, we developed financial models to help estimate the benefits and costs of low cost home ownership for the purchaser, the taxpayer and the affordable housing sector. We also surveyed 54 Registered Social Landlords and 89 public sector employers of key workers, and held detailed interviews and reviews of procedures with over 14 administering organisations. Finally, we discussed our methodology and emerging results with an Expert Panel and with the Department and the Housing Corporation during the consultation period for the changes to the products they were planning from April 2006. Details of our methodology are at Appendix 3.

11 The report builds upon our recent joint report with the Audit Commission on the delivery chain for building affordable housing, including homes built for part-sale under some low cost home ownership schemes.[6]

6 The Department has merged the low cost home ownership products into a single programme from April 2006



Source: Office of the Deputy Prime Minister Consultation Paper HomeBuy – expanding the opportunity to own (April 2005)

6 *Building more affordable homes: Improving the delivery of affordable housing in areas of high demand*, HC459 2005-2006 (December 2005).

FINDINGS

1. Whether the products are delivering the intended benefits of making home ownership accessible to more people and of easing recruitment and retention of key workers

So far low cost home ownership assistance has helped about 40,000 households to purchase their own home but demand for assistance greatly exceeds supply

12 Since 1999 the Department's low cost home ownership products have helped about 40,000 households. The number of households helped each year has increased from approximately 4,000 in 1999-2000 to over 11,000 in 2004-05 **(Figure 7)**. The Government plans to help a further 100,000 households (20,000 a year) in England into home ownership through low cost home ownership products between 2005 and 2010. However, the Low Cost Home Ownership Taskforce estimated in 2003 that demand for low cost home ownership totalled about 20,000-22,000 new households a year, with potential demand of a further 40,000 a year from those existing households already in social or privately rented accommodation.[7]

13 In 2004-05 sales using low cost home ownership products made up less than four per cent of all house sales to first time buyers in England and about seven per cent of such sales in London. Over a third (37 per cent) of all assistance provided through the national schemes was taken-up in London and under one per cent in the North (the government office regions of the North East, North West, and Yorkshire and Humberside) (Figure 9). Of the assistance provided exclusively to Key Workers the majority of sales were in London (42 per cent) and the South East (44 per cent) with only a minority in the East (13 per cent).

Key workers and ethnic minorities have particularly benefited from low cost home ownership products

14 Ethnic minority households have benefited from low cost home ownership products. Nationally, five per cent of all owner-occupiers are from ethnic minorities. In comparison, 16 per cent of all households who received assistance in 2004-05 came from ethnic minorities.

15 In 2004-05 over 3,200 key worker households in London, the South East and the East of England benefited from the low cost home ownership financial products available exclusively to them. The majority were employed in the National Health Service and the education sector. In addition, 1,800 key worker households successfully applied for the national, non-key worker specific schemes, making up one quarter of all applicants on these schemes.

7 Low Cost Home Ownership Task Force *A Home of My Own* (November 2003). The Taskforce was established by the Government to examine how those in housing need could be helped to meet their home ownership aspirations.

Low cost home ownership products are typically helping households with incomes from £20,000 to £38,000 for non-key workers and £24,000 to £40,500 for key workers

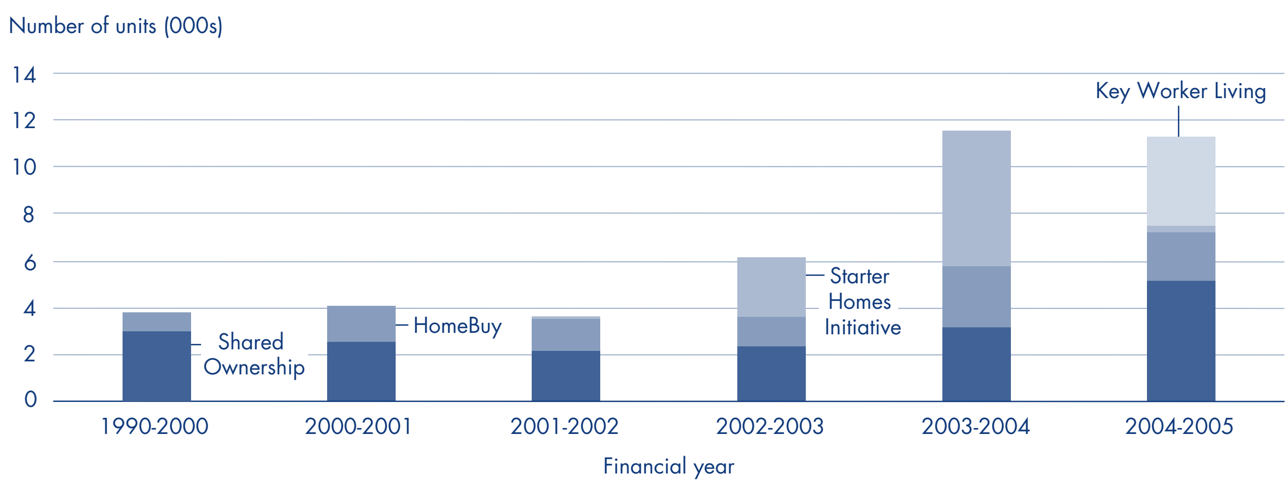
16 Households which have benefited from non-key worker specific low cost home ownership products in 2004-05 typically had incomes between £20,000 and £38,000 **(Figure 8 overleaf)**. The median gross annual household income was £25,500 for Shared Ownership beneficiaries and £29,500 for recipients of Homebuy equity loans. These were lower than the median for comparable first time buyers by £9,500 and £5,500 respectively, but significantly higher than the median of over £10,000 for those moving into social rented accommodation in 2004-05.

17 Household income of those being assisted by the products for key workers was typically higher. Such households typically had incomes of between £24,000 and £40,500 with the median income being £30,750. This assistance is only available in London and the East and South East of England where household incomes are in general higher than in other regions.

18 In general the price of homes purchased by those with low cost home ownership assistance was lower than the price of homes bought by other buyers but there were significant regional variations **(Figure 9 on pages 16 and 17)**. In London and the South East the homes purchased with assistance were typically about £15,000 cheaper than the average price home bought by all first-time buyers. In contrast, in the North and Midlands the price of houses bought with assistance was typically higher than the price paid by other first-time buyers. Registered Social Landlords are responsible for ensuring that homes bought with low cost home ownership assistance are appropriate to the purchaser's needs. House price to income ratios on low cost home ownership sales were higher than for other first time buyer sales, reflecting the fact that homebuyers only bought a share of a property with this assistance.

19 There is a risk that low cost home ownership assistance, and particularly Homebuy, in subsidising people to buy a share of an existing property will increase the demand for housing and thus contribute to higher house prices. However, the Department estimates that the impact of this assistance is likely to be small, given the relatively small number of low cost home ownership sales relative to the overall number of property sales in England. The Government is also undertaking a series of measures in response to the 2004 Barker Review of Housing Supply which it hopes will boost the supply of newly built properties.

7 The number of households helped has increased over the last six years



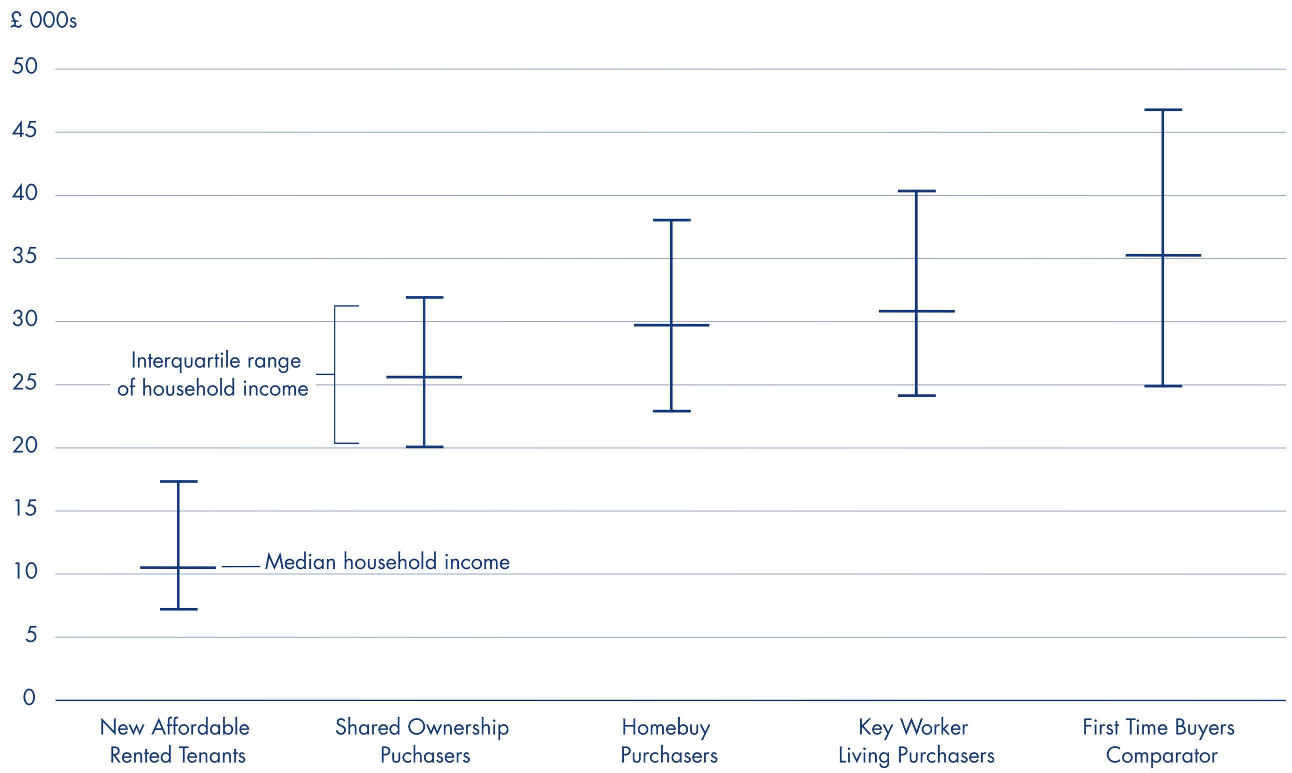
Source: National Audit Office analysis of the Housing Corporation's Investment Management System

Applying for low cost home ownership assistance has been confusing but steps have been taken to address this

20 There were variations in how people found out about the products, to whom they made an application, and how applications were handled:

- There were many providers of low cost home ownership assistance products in any one location and applicants could receive little support in finding out what each of these had to offer, making it difficult to exercise informed choice;
- The initial contact point for making an application varied from place to place. For example, in Cambridge an applicant had to apply for conventional Shared Ownership to their local authority, but to a Registered Social Landlord (Bedfordshire Pilgrims Housing Association) for Homebuy. In contrast, in Lewisham an applicant applied for both products to a single Registered Social Landlord (Tower Homes). Applying for the Key Worker products was easier as key workers simply applied to their Zone Agent using a standard application form, although in South London the Zone Agent for NHS workers was different to that for other key workers;
- Some Registered Social Landlords required a fee to reserve a Shared Ownership property, while others did not;
- There were variations in eligibility criteria which could result in an applicant being accepted in one location and not in another. For example, different Registered Social Landlords used different income multipliers to assess whether applicants could afford to purchase without low cost home ownership assistance. On Shared Ownership Registered Social

8 Low cost home ownership assistance is focused on those with incomes higher than those entering social rented housing, but less than other first time buyers



Source: National Audit Office analysis of the Housing Corporation's CORE data and the Department's Key Worker Living Initiative data, and Council of Mortgage Lenders "Understanding first-time buyers" (July 2005)

NOTE

Household income for 2004-05 buyers and those entering social rented housing. The First Time Buyers comparator uses first time buyer household incomes weighted to take account of the geographical spread of low cost home ownership.

Landlords could also consider other groups, in addition to existing social housing tenants and those on housing waiting lists. The additional groups considered varied, reflecting local priorities as determined, usually, by the local authority;

- For the products available exclusively to key public sector workers, in some police force areas only police officers were eligible, whereas in others other support staff could benefit; and
- The timing of the application could determine how quickly an applicant was able to buy their own home. Demand for the Department's low cost home ownership products, particularly Homebuy, exceeded the number of purchases that could be funded within existing budget limits. As a result, as funding ran out towards the end of a financial year, Registered Social Landlords placed eligible applicants on a waiting list until further funding became available.

21 Key public sector workers received support from Zone Agents in gaining access to the products for which they alone were eligible. Registered Social Landlords acting as Zone Agents served as the sole contact point and coordinating body in a locality for the Initiative. The Department extended the Zone Agent system to all low cost home ownership schemes in England from April 2006 (paragraph 7). We welcome this change which we expect to reduce variability of access, help to streamline the application process and reduce bureaucracy.

22 The Department and the Housing Corporation have also taken steps to introduce greater consistency in the assessment of eligibility. In January 2006 the Housing Corporation issued new guidance to Registered Social Landlords on the income multipliers to use when assessing applicants' finances. From April 2006 Regional Housing Boards are responsible for recommending which groups, in addition to existing social housing tenants, those on housing waiting lists, and key workers, are eligible for assistance in their region (paragraph 7).

Controls need to be strengthened to ensure those who lose key worker status pay back their assistance

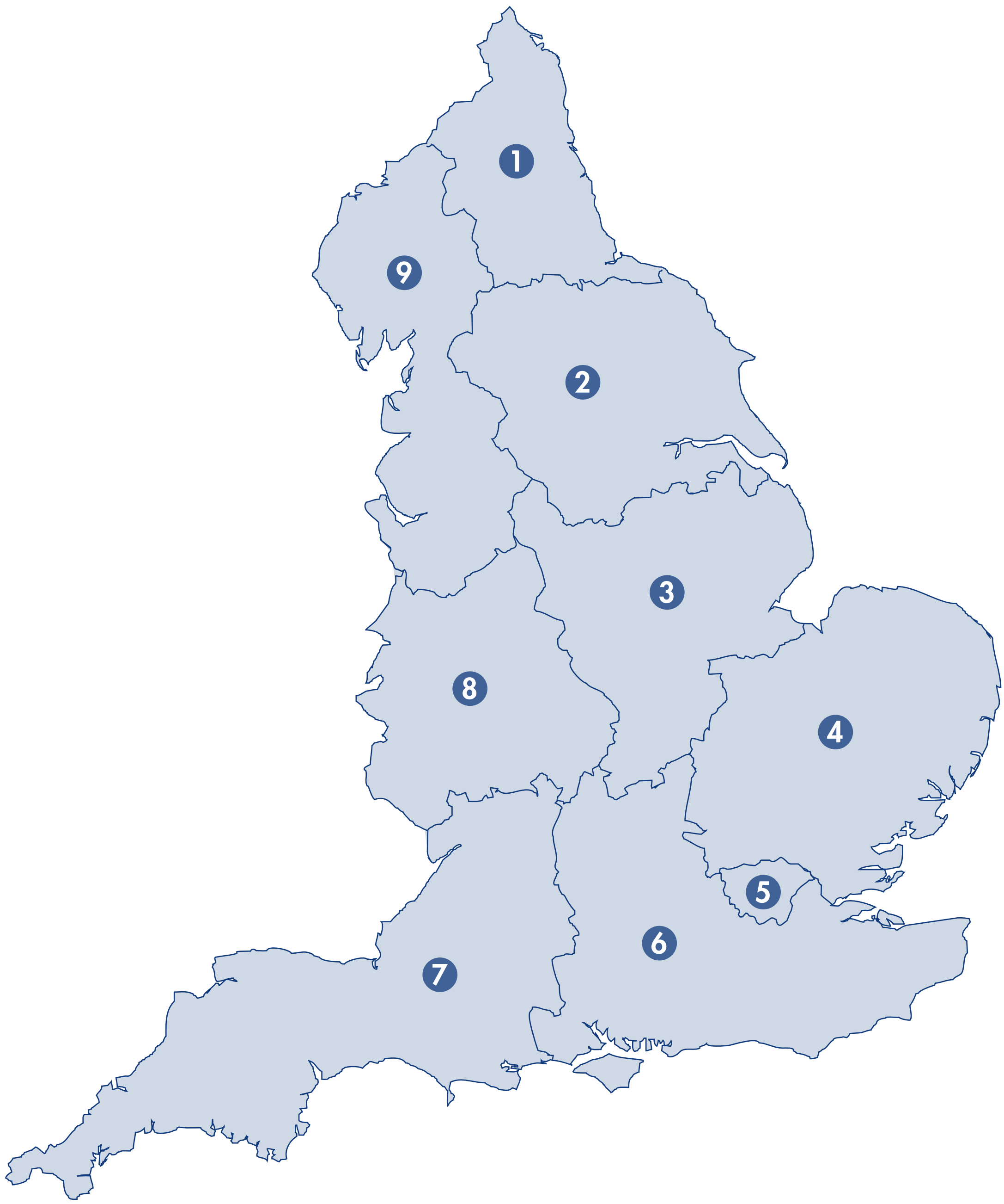
23 The Department has not been able to separately identify the impact of this assistance from the effects of other measures public sector employers have been taking to improve recruitment and retention; for example, enhancing career progression and increased flexible working. 61 out of 89 employers that we surveyed (69 per cent) told us that they believed the Key Worker assistance had contributed to improvements in recruitment and retention. According to a survey of key workers who had received assistance carried out on behalf of the Department,[8] 23 per cent stated that they would have left their post without the assistance. 62 per cent stated they were now more likely to remain in their occupation as a result.

24 Under the Starter Homes Initiative, key workers retained the assistance they had received even if they left key worker employment. In contrast, the Department introduced a requirement under the Key Working Living Initiative from April 2004 that key workers repay the assistance they had received within two years of leaving key worker employment (increased to five years for Shared Ownership properties marketed from January 2006). This repayment requirement acts as an incentive for recipients not to leave and is therefore crucial to the effectiveness of the Initiative in tackling recruitment and retention problems. The Housing Corporation requires Registered Social Landlords to notify employers at a local level of the details of every key worker purchasing a home, and employers to notify Registered Social Landlords immediately upon the employee changing their employment status. The Corporation also encourages Registered Social Landlords to undertake periodic checks that their key worker tenants and equity loan holders remain eligible for support. Despite these requirements, some Registered Social Landlords and key worker employers told us they were only starting to consider what controls they might put in place to ensure that this repayment is made. Currently, therefore, there is a risk that this assistance would not be repaid as required.

25 Up until April 2006, if key workers received assistance from the national Homebuy and Shared Ownership schemes (which were not designed specifically for key workers but for which key workers could apply) and they subsequently moved from key worker jobs, they were not required to pay back the assistance. However, from April 2006 any key public sector worker who receives low cost home ownership assistance outside the Key Worker Living Initiative by sole virtue of their employment will also be required to repay this assistance if they leave eligible employment.

8 This survey was carried out as part of an evaluation of the Key Worker Living Initiative for the Department which has yet to be published.

9 Low cost home ownership assistance has been mostly targeted at the South of England



KEY

FTBs Figures for first time buyers, taken from Department data for the housing market in 2004-05 (Tables 513 and 588).

LCHO Figures for non-key worker specific low cost home ownership products, taken from the Housing Corporation's Investment Management System database for Shared Ownership and Homebuy in 2004-05.

KW LCHO Figures for key worker specific low cost home ownership products, taken from the Housing Corporation's Investment Management System database for the Starter Homes Initiative and the Department's Key Worker Living Initiative database in 2004-05.

Source: National Audit Office analysis

England

	Number of sales	Average market value	House price to income ratio
FTBs	293,227	£139,573	4.1
LCHO	7,186	£160,442	6.5
KW LCHO	3,262	£157,967	5.1

5 London

	Number of sales	Average market value	House price to income ratio
FTBs	55,622	£203,927	4.6
LCHO	2,414	£194,550	6.6
KW LCHO	1,457	£172,049	5.0

1 North East

	Number of sales	Average market value	House price to income ratio
FTBs	15,881	£81,434	3.3
LCHO	91	£108,602	5.8
KW LCHO	0	£0	–

6 South East

	Number of sales	Average market value	House price to income ratio
FTBs	45,519	£170,092	4.5
LCHO	1,676	£159,276	6.3
KW LCHO	1,320	£150,574	5.1

2 Yorkshire & Humber

	Number of sales	Average market value	House price to income ratio
FTBs	30,015	£91,115	3.4
LCHO	67	£113,733	7.6
KW LCHO	0	£0	–

7 South West

	Number of sales	Average market value	House price to income ratio
FTBs	23,901	£197,926	4.2
LCHO	913	£135,868	6.6
KW LCHO	0	£0	–

3 East Midlands

	Number of sales	Average market value	House price to income ratio
FTBs	22,475	£110,592	3.7
LCHO	556	£112,060	6.0
KW LCHO	0	£0	–

8 West Midlands

	Number of sales	Average market value	House price to income ratio
FTBs	25,559	£107,990	3.7
LCHO	714	£122,272	6.7
KW LCHO	0	£0	–

4 East

	Number of sales	Average market value	House price to income ratio
FTBs	31,929	£146,442	4.2
LCHO	319	£148,115	6.0
KW LCHO	485	£135,785	5.0

9 North West

	Number of sales	Average market value	House price to income ratio
FTBs	42,326	£90,744	3.5
LCHO	436	£111,865	6.4
KW LCHO	0	£0	–

2. Whether the different products have reasonable costs and provide benefits for the homebuyer

Buying with low cost home ownership assistance provides considerable benefits for the homebuyer

26 The annual on-going cost of buying an average priced home (in the form of mortgage and rent) using low cost home ownership products is typically £2,700 to £3,300 less than buying it without assistance. This makes buying a home a possibility for those who otherwise would not be able to buy **(Figure 10)**.

27 Buying a home using low cost home ownership products typically offers better long-term financial returns for purchasers than renting, either from a private or social landlord (Figure 10). According to our financial modelling, on average house prices would have to fall steadily by roughly 1 to 3 per cent each year for 25 years before low cost home ownership buyers started to make a loss on their investment in buying a share of a property, compared

10 Buying a share of a home can be a good investment

The cost and return of housing: How much you have to pay to live in a £150,000 house and how much of a return on your investment you will make after 25 years

- The returns on buying a home or a share of a home are generally better than the additional cost of buying over renting.
- Low cost home ownership products are cheaper than private purchase but do not offer as good returns in a rising market.
- House prices would have to fall in real terms by as much as 1-2 per cent every year for 25 years for buying to cost as much as renting.

Note: Returns on investment shown assume 2.7% real annual growth in house prices. Actual returns will depend on actual movements in house prices and may go down as well as up.

Social Rent

Annual Cost[1]	
Mortgage Payments	£0
Rent	£4,140
Total Annual Cost	£4,140
Return on Investment[2]	
Net Return/(cost) over 25 years[3]	(£104k)
Internal Rate of Return[4]	N/A
Risk[5]	
Break even with social rent	N/A

Shared Ownership

Purchaser buys a 50% share

Annual Cost[1]	
Mortgage Payments	£5,550
Rent	£2,070
Total Annual Cost	£7,620
Return on Investment[2]	
Net Return/(cost) over 25 years[3]	(£14k)
Internal Rate of Return[4]	3.87%
Risk[5]	
Break even with social rent	(1.2%) per year

Homebuy

Purchaser buys a 75% share

Annual Cost[1]	
Mortgage Payments	£8,160
Rent	£0
Total Annual Cost	£8,160
Return on Investment[2]	
Net Return/(cost) over 25 years[3]	£60k
Internal Rate of Return[4]	5.62%
Risk[5]	
Break even with social rent per year	(2.8%)

Source: National Audit Office financial modelling and analysis of the Housing Corporation's CORE database and Investment Property Data Bank UK Residential Investment Index 2004

NOTES

1 All costs based on 2004-05 actual costs achieved by LCHO purchasers, standardised for a £150,000 house and assuming no deposit and excluding transaction costs. Our calculations exclude the costs of maintaining the property. Thus, for example, on the rental options we have included no estimates for service charges.

2 Returns on investment shown assume house prices grow at 2.7% a year – the trend growth identified in "Review of Housing Supply: Delivering Stability: Securing our Future Housing needs", Kate Barker, March 2004. For an analysis of the impact on the returns of different assumptions about house price growth, see the Technical Note to this report available on the National Audit Office website.

3 The net return or cost to the individual is shown over twenty five years in current prices.

to the costs of social renting. However, like other home owners, low cost home ownership buyers face the risks of losing their homes if they fail to keep up payments, and of falling house prices (Appendix 2).

The two types of assistance have different benefits and costs for the homebuyer

28 Homebuy equity loans allow prospective homebuyers to find a home on the open market. Shared Ownership assistance involves buying a new home built by a Registered Social Landlord specifically for shared ownership. For many home hunters the prospect of being able to purchase any home on the open market makes a Homebuy equity loan a more attractive option. It

Private Purchase

Purchaser buys a 100% share	
Annual Cost[1]	
Mortgage Payments	£10,880
Rent	£0
Total Annual Cost	£10,880
Return on Investment[2]	
Net Return/(cost) over 25 years[3]	£79k
Internal Rate of Return[4]	4.02%
Risk[5]	
Break even with social rent	(1.3%) per year

Private Rent

Annual Cost[1]	
Mortgage Payments	£0
Rent	£8,850
Total Annual Cost	£8,850
Return on Investment[2]	
Net Return/(cost) over 25 years[3]	(£222k)
Internal Rate of Return[4]	N/A
Risk[5]	
Break even with social rent	N/A

4 The Internal Rate of Return shows the real rate of return before inflation of buying compared to renting and can be used to compare to other investments such as shares, bonds or current accounts after accounting for inflation on the stated returns of those products. Transaction costs are not taken into account.

5 The indication of risk here shows how far the market value of the property would have to fall on average year on year over the 25 year investment for the investment to be as expensive as social renting. Other risks are not analysed here, including the risk of negative equity.

provides greater choice. Homebuy owners can also find it easier to sell their properties as some local authorities place restrictions on whom shared ownership purchasers can sell their properties to as part of the terms of the planning permission for the property's construction.

29 There have been problems in some areas selling new shared ownership housing for key workers under the Key Worker Living Initiative. A number of reasons for these problems were given to us by those we interviewed. Some of these properties may have been of the wrong type or built in the wrong locations. Some may also have been poorly marketed due to the initial confusion between the roles of Zone Agents and other Registered Social Landlords and some key workers may have been unwilling to buy where their neighbours would exclusively be other key workers. To address these problems in late 2005 the Department and the Housing Corporation allowed Registered Social Landlords to offer existing key worker properties that had been unsold for more than three months to non-key worker households. By March 2006, buyers had not been found for over six months for 94 properties (six per cent of key worker shared ownership properties completed).

30 The Department and the Housing Corporation have taken steps to prevent these problems arising again. In December 2005 we discussed with them a possible solution whereby Registered Social Landlords would no longer build separate shared ownership properties for key workers and non-key workers. Instead, such properties would be open to both sets of households, subject to the requirement to provide low cost home ownership assistance to a given number of key workers. From April 2006 the Department will not be funding specific key worker-only new build homes. Instead, key workers will be free to choose any new build low cost home ownership property as one of the three priority groups for assistance (paragraph 7). The new, extended HomeBuy Agent system (paragraph 7) should also encourage greater integration of the assistance given to key workers and non-key workers. We estimate that avoiding problems selling new build low cost home ownership properties in the future will save approximately £3 million a year.

31 The financial returns of buying a fixed share of a home are greater using a Homebuy equity loan compared to equivalent Shared Ownership. This is because under Shared Ownership homeowners are required to pay rent on that part of the home they do not own. Furthermore, unlike mortgage payments, this rent is increased with inflation. In contrast, rent is not charged on Homebuy loans.

32 Up until April 2006 Homebuy equity loan assistance required the owner to take out a private mortgage for 75 per cent of the property. Shared Ownership products allow the purchaser to buy smaller proportions of the equity using a private mortgage, typically 50 per cent but sometimes as low as 25 per cent. Shared Ownership therefore allows those with smaller incomes to own a stake in a property.

Government plans to lever in private funding for equity loans will help twice as many households but this is likely to be more expensive for purchasers than the previous equity loan product

33 The Government has reached an agreement to share the costs and returns of HomeBuy equity loans with three commercial mortgage lenders (Halifax Bank of Scotland, Nationwide Building Society, and Yorkshire Building Society) from October 2006 (paragraph 8). Under the new Open Market HomeBuy product, the commercial lender will provide the purchaser with a mortgage of 75 per cent of the property's value, plus an equity loan of 12.5 per cent. The Government's equity loan, plus any deposit the customer puts in, will make up the final 12.5 per cent of the price of the property. The Department considers that this agreement will enable more than double the number of HomeBuy purchasers to be helped with the same amount of social housing grant.

34 In return for providing an equity loan of 12.5 per cent, the commercial lender will receive 12.5 per cent of the increase in the value of the property when the purchaser repays the loan. The new Open Market HomeBuy product is likely to be more costly for the purchaser compared to the previous Homebuy product because the purchaser is likely to have to pay a small premium on the interest rate on their main mortgage.

3. Whether the different products have reasonable costs and provide benefits for the taxpayer

Controls exist to ensure that people who can afford to buy outright do not receive help, but some recipients could have afforded to buy a larger share

35 Before providing assistance Registered Social Landlords assess the household income of low cost home ownership applicants as they are required under the Housing Corporation's funding guide to ensure that applicants are not able to afford to buy a suitable home without assistance. They also are required to ensure that applicants can maintain the payments on their home, in accordance with the Government's policy of helping people into sustainable home ownership. Registered Social Landlords also have an incentive to ensure that low cost home ownership purchasers can sustain their payments on the property as both they and the taxpayer are more exposed to financial risk from payment arrears and repossessions than the purchaser's mortgage lender (Appendix 2). There is therefore a theoretical risk that Registered Social Landlords may target low cost home ownership at eligible households with higher incomes and provide them with more assistance than they otherwise would have in order to reduce their exposure to these financial risks.

36 For these reasons, we examined the processes by which six Registered Social Landlords within our case study areas reviewed applicants' income, and surveyed Registered Social Landlords to ask about the criteria they used to assess applicants. We found that Registered Social Landlords use a variety of means to assess applicants' household income including in-house interviews with the applicants about their finances, credit checks and referral to independent financial advisors who act as agents on the Registered Social Landlord's behalf. Our review of these controls showed that Registered Social Landlords are well placed to ensure that applicants are eligible for assistance and would not be able to afford a suitable home in the area without assistance.

37 In contrast, there was scope for Registered Social Landlords to improve their assessment of applicants' finances when determining what size share of a property they could afford to buy. We found a general lack of controls at Registered Social Landlords to ensure that purchasers bought as large a share of a property as they could afford and therefore that the minimum necessary assistance was given in each case. Some Registered Social Landlords marketed fixed proportions of Shared Ownership properties rather than inviting applicants to buy as much of their home as they can afford. For example, an applicant may be able to afford to take out a mortgage to cover 70 per cent of the cost of the home but, as the Registered Social Landlord is only offering for sale a 50 per cent share in these properties, it only checks that the applicant can afford this share rather than a larger percentage **(Figure 11 overleaf)**. In addition, Homebuy equity loans have been set at 25 per cent of the market value of the property being purchased regardless of the financial needs of the applicant.

38 Since 2004 the Housing Corporation has recommended that Registered Social Landlords use income mortgage multipliers of 3 times joint and 3.5 times single income when assessing Key Worker Living applicants' ability to afford low cost home ownership and determining how much support to provide.[9] However, we found that 32 per cent of all low cost home ownership purchasers in 2004-05 would have been able to buy a larger share of their home than they actually purchased, if these multipliers had been used in all cases. We estimate that, if all purchasers in 2004-05 had borrowed up to the maximum mortgage levels indicated by these multipliers, £63 million of taxpayer grant and Registered Social Landlord's funding would have been released for use elsewhere.[10]

39 We brought the scope for purchasers to buy a larger share of their home to the attention of the Department and the Housing Corporation in July 2005. In August 2005 the Housing Corporation amended the rules governing low cost home ownership sales, requiring from April 2006 that Registered Social Landlords ensure purchasers buy as large a share of a property as they can affordably sustain.

9 Housing Corporation Capital Funding Guide (2004).

10 Our examination of a sample of documentation held by Registered Social Landlords suggested that the 32 per cent of purchasers who had not borrowed up to the maximum mortgage levels did not have circumstances that prevented them from taking out larger mortgages. In calculating the potential saving, we have assumed that Registered Social Landlords have captured all regular payments in their documentation, such as child support payments, child costs and debt, and we have made allowances for these recorded outgoings in our calculations. We have also assumed that all this 32 per cent would have been willing to take out mortgages at such levels and would have been able to find a mortgage lender willing to lend on these terms. For more detail, see *A Foot on the Ladder: Low Cost Home Ownership Assistance Technical note on the financial modelling* available from www.nao.org.uk.

40 We found a number of instances where successful Key Worker Living applicants had high levels of personal debt. We looked at a sample of cases where Key Workers had relatively high income to property price ratios. Such households had outstanding debts of on average £15,231 and a small minority above £30,000. Such debt would have contributed to their difficulty in purchasing a property without assistance. We estimate that the annual cost of assistance given to key workers who without debt could have otherwise afforded to purchase outright was approximately £10 million. There is also the risk that other key workers, who did not have such high levels of debt, would have been rejected for assistance as they could consequently afford to buy without help.

Less government grant is needed to help a household to buy a home than to rent one but assistance is not targeted as much as it might be at existing or prospective social tenants

41 In terms of the grant paid to Registered Social Landlords, Shared Ownership is the cheaper of the two low cost home ownership products **(Figure 12)**. It also has the advantage of adding to the housing supply as it involves the construction of a new property, unlike Homebuy. However, both forms of assistance result in the taxpayer's exposure to the risks arising from falling house prices and the purchaser's failure to meet their home ownership payments (Appendix 2).

11 The money could go further with better targeting

Illustration: Two applicants approach a Registered Social Landlord wishing to jointly purchase a property worth £150,000. The applicants have a joint income of £32,000 and £13,500 in savings. They have an agreement from their bank to lend them up to three times their joint income – £96,000. The Registered Social Landlord assessed the applicants' income and agrees that the applicants can not afford to buy outright a suitable property on the open market.

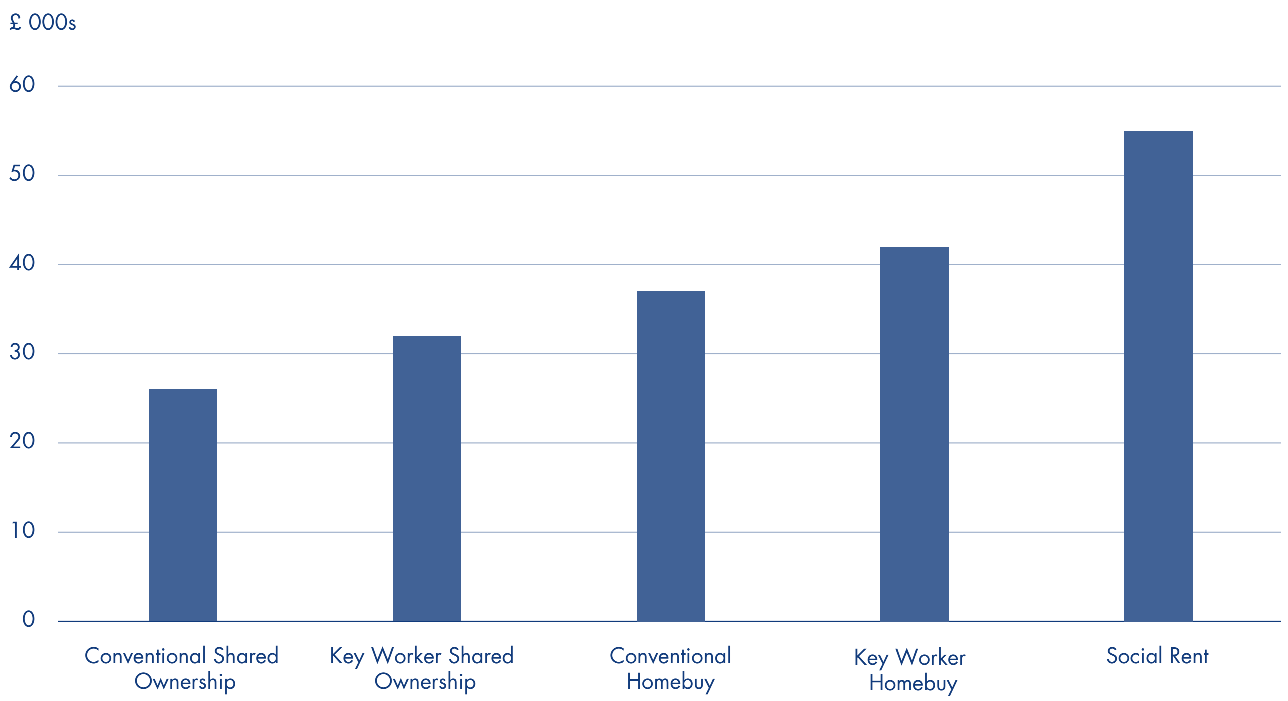
	Option 1: A fixed 50% share is bought	Option 2: The applicants buy as much as they can afford
Share of home bought	50%	70%
Transaction Costs	£3,500	£3,500
Deposit	£10,000	£10,000
Mortgage taken out by applicants	£65,000	£96,000
On-going annual cost to the applicants	£6,741	£8,108
Cost to the RSL to provide property	£130,000	£130,000
RSL's costs funded by:		
■ Initial Sale Receipt	£75,000	£105,000
■ Social Housing Grant	£26,000	£26,000
■ RSL own funds and commercial borrowing	£29,000	(£1,000)
Number of extra HomeBuy properties that could be funded by the savings to the Registered Social Landlord	0	1

Source: National Audit Office financial modelling. All costs are indicative but are based on our analysis of the Housing Corporation's CORE and Investment Management System databases.

42 We also calculate that the amount of government grant needed to provide a low cost home ownership home could be less than half that of providing a social rented home in 2004-05 (Figure 12). It is therefore better value for money for the taxpayer that those already in, or looking to move into, social rented accommodation are encouraged to part-purchase a property under low cost home ownership where they can afford to do so. We estimate that in 2004-05 about 8,000 households (six per cent) moving into social rented housing had incomes similar to those households currently buying homes with low cost home assistance and would therefore have been able, if they wanted, to part-purchase a property using low cost home ownership.[11]

43 Up until April 2006 Government guidelines expected low cost home ownership products that were not aimed specifically at key workers to give priority to social housing tenants or those on waiting lists for social housing.[12] In particular, Homebuy was only open to existing social housing tenants or those on the housing waiting list nominated by local authorities as being in housing need as it specifically aimed to relieve pressure on social rented housing.

12 The amount of government grant needed to provide a low cost home ownership home was less than half that of providing a social rented home in 2004-05



Source: National Audit Office analysis of Housing Corporation's Investment Management System

NOTE

The above figures are the average amounts of grant given for each type of housing option in 2004-05, unweighted for the location and size of the housing units provided.

11 For the detailed assumptions and calculations behind this estimate, see *A Foot on the Ladder: Low Cost Home Ownership Assistance Technical Note on the financial modelling* available from www.nao.org.uk.

12 Housing Corporation Capital Funding Guide.

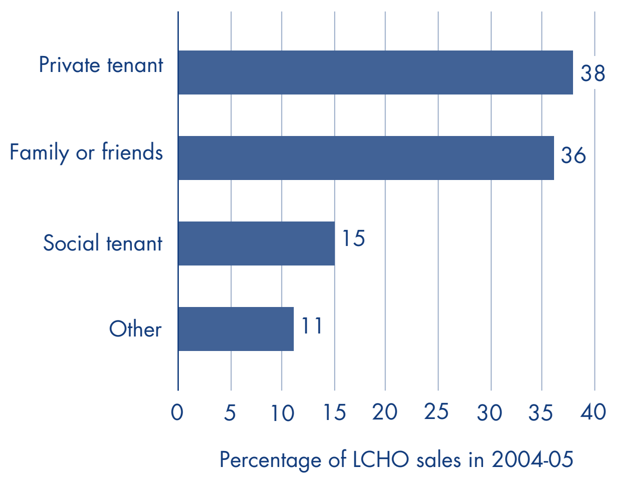
44 However, we found that the majority of low cost home ownership sales did not significantly reduce demand for social rented housing. In 2004-05 only 15 per cent of those buying homes using low cost home ownership products not specifically aimed at key workers were previously social housing tenants **(Figure 13)**. Although the remaining 85 per cent were on housing waiting lists, they were not normally in priority need and would not therefore have been likely to receive social rented housing. Most were previously in private rented tenure or living with family and friends. They were typically either single adults or families without children, whilst those entering social rented housing are often larger families as they are more likely to be assessed as being in greater housing need. Their home purchases were therefore unlikely to have led to a reduction in the pressure on social rented housing.

45 We also found that, in our three case study locations, there were few controls in place to ensure that applicants for low cost home ownership assistance not specifically targeted at key workers were in priority housing need. Applicants who qualified for Homebuy were provided with assistance on a "first come, first served" basis, rather than on an assessment of their housing needs. While Registered Social Landlords sometimes assessed the relative priority of Shared Ownership applicants where they had more applicants than properties for sale, they did not normally compare the housing needs of these applicants with the needs of others on the housing waiting list. Of the four local authorities we visited, only Cambridge City Council collected information on the relative priority housing need of low cost home ownership applicants, compared to the need of others on their housing waiting list. In 2004-05 successful low cost home ownership applicants in Cambridge had less than half the (locally defined) housing need points than successful applicants for social rented housing (although many of these social renters would not have been able to sustain home ownership even with assistance). Furthermore, in three out of four local authorities we visited, qualifying Homebuy applicants were added to the housing waiting list when they applied for a Homebuy loan, thus qualifying them for the product regardless of how their housing need compared to others already on the waiting list for social rented accommodation.

46 From April 2006, the Department's policy under the new HomeBuy programme is to help a range of people into home ownership to meet its objective of creating sustainable communities. Thus, whilst priority is still to be given to social housing tenants, those on the housing waiting list and key public sector workers, other first time buyers prioritised by Regional Housing Boards will also be assisted (paragraph 7).

47 Success in reaching social tenants and those in priority need on the waiting list is dependent on good relations between Registered Social Landlords and local authorities. Local authorities are responsible for housing waiting lists and have many social tenants themselves. However, 19 of the 51 Registered Social Landlords who replied to our survey on this point (37 per cent) did not consider liaison with local authorities to be effective, citing examples where contact details for local authority tenants were withheld or where lists of such details failed to identify those tenants who were eligible for assistance. From April 2006 the new HomeBuy Agents (paragraph 7) will be responsible for liaising with local authorities and others to ensure the effective targeting of assistance to eligible groups, particularly existing social housing tenants.[13]

13 In 2004-05 15 per cent of those taking advantage of low cost home ownership assistance not specifically aimed at Key Workers were social tenants



Source: National Audit Office analysis of Housing Corporation CORE data

NOTE

"Other" includes households in rented accommodation provided as part of their job, those in temporary accommodation and existing home owners.

13 Social housing tenants have further options available to them for meeting their home ownership aspirations as they are also able to buy their own homes under schemes offering grants and discounts, such as the Right To Buy (Appendix 1) and, from April 2006, Social HomeBuy (Figure 6).

4. Whether the different products provide benefits for the affordable housing sector

Registered Social Landlords receive grants from the Housing Corporation to help fund low cost home ownership assistance

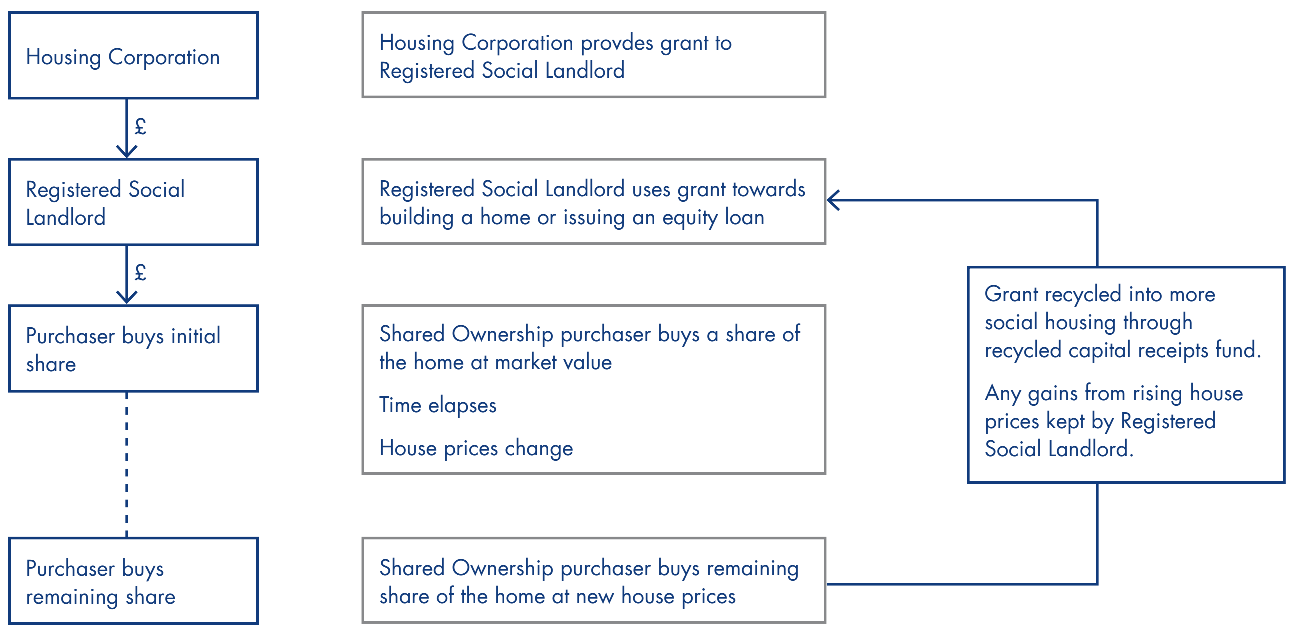
48 Registered Social Landlords bid for the funds they use locally to assist low cost home ownership from the Housing Corporation. The Corporation considers these bids in the light of national and regional priorities and provides Social Housing Grant to Registered Social Landlords for use towards the cost of constructing a Shared Ownership property or of advancing a Homebuy equity loan.

49 Registered Social Landlords use other funding sources in addition to Social Housing Grant to finance their Shared Ownership properties. These include commercial borrowing, their own cash reserves, and surpluses arising from sales of other low cost home ownership properties. In contrast, Homebuy loans have been 100 per cent funded by Social Housing Grant. We found that in 2004-05 every £1 of public grant enabled Registered Social Landlords to invest in £4 worth of Shared Ownership properties but only £1 worth of Homebuy loans. In comparison, the funding deal that the Department has agreed with three private mortgage companies from October 2006 (paragraph 8) should result in every £1 of grant producing at least £2 worth of loans to the purchaser under the new Open Market HomeBuy product, the successor to Homebuy equity loans.

Registered Social Landlords are required to recycle the grant to provide further affordable housing

50 Registered Social Landlords recoup grant in the form of receipts from the initial part-sale of each property and as further receipts when the purchaser buys out any of the remaining share of the property or sells their property on **(Figure 14)**. Registered Social Landlords are required to pay the equivalent of the grant into a special fund – "the recycled capital grant fund". The Housing Corporation requires Registered Social Landlords to use recycled grant on further social housing. Recycled grant from key workers assistance must be used to provide further key worker assistance.

14 Low cost home ownership results in gains for the affordable housing sector



Source: National Audit Office

51 Registered Social Landlords' recycled capital grant funds are an important means of providing new affordable housing. In 2003-04 for every five social rent properties built using grant, an additional one was produced without grant. Similarly, one low cost home ownership property was produced without grant for every 11 grant-funded ones.[14] Any reduction in the receipts paid in these funds will reduce the number of homes generated in this way. There is a risk that these receipts will be significantly reduced if house prices fall. If house prices have gone down and the receipt obtained is less than the original grant, then the Registered Social Landlord pays this reduced amount into the fund and the Housing Corporation writes off the unpaid amount of grant.

52 If house prices have increased, the Registered Social Landlord only repays the original value of the grant into the fund. In 2004-05 3,109 Shared Owners bought a further share in their property, resulting in the payment of £59 million into Registered Social Landlords' recycled capital receipts funds. Any receipts remaining after the repayment of the original grant remain with the Registered Social Landlord and the Housing Corporation has no direct control over how Registered Social Landlords use these surplus receipts, although these surpluses can only be used to fund activities within their remits as Registered Social Landlords. 25 out of 29 Registered Social Landlord survey respondents (86 per cent) said that they used their gains from low cost home ownership to subsidise not only capital work such as additional low cost home ownership assistance, the construction of new social rent properties and the upgrade and maintenance of public spaces, but also performance of more general landlord duties, such as their service to tenants.

Registered Social Landlords have received more grant than they needed for Shared Ownership

53 The Housing Corporation allocates grants using a competitive bidding process which is open to Registered Social Landlords and, from June 2005, other organisations. The Corporation has been generating significant cost savings in its grant funding of low cost home ownership. After allowing for inflation in land values and construction costs, the levels of grant funding required for building new shared ownership properties are forecast to be 19 per cent lower in 2006-07, and 33 per cent lower in 2007-08, than in 2003-04.

54 Registered Social Landlords submit their bids for low cost home ownership funding based on estimates of the associated costs and returns. Once funding has been secured on the basis of these estimates, the Housing Corporation does not subsequently adjust the level of grant given up or down to reflect the actual costs or returns achieved by Registered Social Landlords. This fixed grant regime provides an incentive for Registered Social Landlords to bear down on costs. However we found that, in order to guard against the risk of higher actual costs or lower returns, some estimates overestimated the amount of grant that Registered Social Landlords required. Some estimates assumed that interest rates would be higher than the actual marginal rate of borrowing achieved by the Registered Social Landlord, whilst others assumed that there would be no subsequent purchases of the remaining shares of the properties. Receipts from the initial part-sales were also higher than estimated due to the prevailing market conditions whereby increases in house prices during the period the properties were being built were higher than forecast.

14 Housing Corporation and Ecotec *Assessing Added Value* (January 2006).

55 We also found that some Registered Social Landlords calculate their grant requirement to allow them to use Shared Ownership rent to pay off the borrowing they raised to fund the Shared Ownership construction costs. However, if the Shared Ownership purchaser subsequently exercises their right to buy the remaining share of the property, they will provide a receipt that can then also be used by the Registered Social Landlord to pay off that debt. According to Registered Social Landlords, they calculate their grant requirement in this way because of the uncertainty over whether or not the Shared Ownership purchaser will actually buy the remaining share of the property. However, where the purchaser does exercise their right, then providing enough grant to the Registered Social Landlord so that they can use rent to also pay off that debt is an unnecessary cost to the taxpayer.

56 In its 2004-06 programme , the Housing Corporation did not collect information on the actual costs and returns received, compared to those estimated in Registered Social Landlords' funding bids. Based on our financial modelling we estimate that in 2004-05 Registered Social Landlords received over £90 million of grant in excess of that needed to make Shared Ownership economically viable for them, which they then used to subsidise other housing activities (paragraph 52). These surpluses occurred at a time of very large increases in property values and it is possible that Registered Social Landlords were unable to anticipate the rate of increase in house prices between their application for grant and the sale of the properties, resulting in over-cautious grant applications.

Registered Social Landlords have made significant gains from subsequent sales of Homebuy and Shared Ownership due to the rising housing market

57 Registered Social Landlords have made significant gains when low cost home owners exercise their right to purchase the Registered Social Landlord's remaining share in their home. When an owner buys the remaining share, they do so at the then current market value which has generally been greater than the market value when they bought the initial share due to the rising housing market. The Registered Social Landlord returns the original grant to the recycled capital grant fund and retains any remaining sales receipts.

58 The Housing Corporation does not require Registered Social Landlords to provide information on these gains. We estimate that Registered Social Landlords have benefited from additional cash worth up to £56 million from purchasers who bought the remaining share of properties funded by Housing Corporation grant between 1999 and 2005, which they then used to subsidise other housing activities (paragraph 52). We also estimate that Registered Social Landlords' interests in those properties bought in that period where the home-owners have not bought the remaining share are potentially worth between £610 million to £720 million at current house prices, after allowing for the original cash value of the taxpayer's and Registered Social Landlords' investment in these properties. The actual gains Registered Social Landlords will achieve from these interests will be dependent on the number of home-owners who choose to purchase the remaining share (not all may choose or be able to do so) and the market conditions at the time.

RECOMMENDATIONS

Low Cost Home Ownership assistance has helped many households to buy a home they otherwise could not afford. The Government plans to greatly expand the number of people helped each year over the next five years. We have identified below a number of ways in which the Department for Communities and Local Government (the Department), the Housing Corporation, local authorities and Registered Social Landlords can improve efficiency. We estimate that these improvements in efficiency could enable each year for the same level of funding 3,440 further households to take a step onto the ladder of home ownership and release a further 690 social rented homes **(Figure 15)**.

Recommendation 1

The Department and the Housing Corporation should target a higher percentage of the non-key worker low cost home ownership provision towards the achievement of their objective of freeing up social rented housing, and should work with Registered Social Landlords and Local Authorities to do more to target those entering and those already in social rented housing.

One of the Government objectives for its portfolio of low cost home ownership products is to free up social rented housing. This is an important objective in terms of value for money to the taxpayer and purchaser. Low cost home ownership assistance can cost the taxpayer less than half the grant needed to house people in social rented accommodation. Therefore, targeting this assistance at those already in, or likely to move into, social rented accommodation can result in savings as it helps reduce the demand for this more expensive type of housing. In the past the freeing up of social rented properties was the principal objective of one particular product (Homebuy for non key workers) and a priority objective for another (Shared Ownership for non key workers).

We found that 15 per cent of those taking advantage of these products were previously in social rented housing and therefore directly freed up a social rented home when purchasing. The other purchasers were generally not in as much priority need as others on the social rented housing waiting list and their home purchases were therefore unlikely to have led to a reduction in the pressure on social rented housing and therefore to cost savings for the taxpayer.

From April 2006 Regional Housing Boards, with the approval of the Secretary of State, determine the additional eligibility criteria for low cost home ownership on a regional basis. While support is still directed at social rented tenants, those on the housing register and key public sector workers, the Boards have also identified other groups for assistance.



15 Implementing our recommendations could make efficiency savings of up to £112 million a year, enough to help 4,130 extra households

The full explanation of how these estimates have been calculated is contained in "A Foot on the Ladder: Low Cost Home Ownership Assistance – Technical note on the financial modelling" available from www.nao.org.uk.

	Annual savings to the taxpayer and affordable housing sector[1]	Extra households helped into social rented housing	Extra households helped into low cost home ownership
Targeting existing social housing and those in priority housing need[2] (Recommendation 1) Assumes that 20 per cent of all non-Key Worker assistance is given each year to existing social tenants who aspire to and can sustain home ownership	£48 million	690	–
Selling people the share of the property that the applicant can afford (Recommendation 3) Assumes that all those who received help borrowed up to the maximum that they could safely afford	£63 million	–	3,420
Better administration of Key Worker Low Cost Home Ownership (Recommendation 6) Assumes that extra controls identify 20 key workers a year who need to return the assistance	£1 million	–	20
Total	**£112 million**	**690**	**3,440**

NOTES

1 Indicative savings are annual savings starting 2007 and are repeatable year on year.

2 Number of extra households that could be housed from freed up social rented housing based on 2004-05 expenditure of Homebuy. The saving is the cost to the taxpayer of housing these people in new housing. Further people could be helped in social rented housing if Shared Ownership was also directed at those entering social rented housing or from greater investment in low cost home ownership aimed at those in or entering social housing but who could afford to purchase a share of a home.

RECOMMENDATIONS CONTINUED

In order to ensure that existing social tenants continue to receive an appropriate level of assistance and the value for money of low cost home ownership assistance is secured for the taxpayer, we recommend that the Department should set a target for the percentage of non-key worker low cost home ownership provision to be allocated to existing social tenants who can sustain home ownership. This will ensure that the value for money savings that arise from enabling existing social tenants into low cost home ownership continue to be realised. We estimate that, for every five percentage points that this provision is increased from its current level of 15 per cent, the number of social rented homes freed up will be equivalent to an extra investment of £48 million in new social rent homes a year. The remaining low cost home ownership provision should be targeted at achieving the government's other objectives for low cost home ownership, including aiding the recruitment and retention of key public sector workers. Such a target should be in place in time for the start of the 2008-10 funding round.

In setting a realistic target, the Department and the Housing Corporation should review the success of the revised HomeBuy programme in reaching social tenants from April 2006. To increase the level of assistance given to these people under this revised programme, we recommend that the Department and the Housing Corporation work with Registered Social Landlords and local authorities to improve cooperation at a local level when marketing low cost home ownership to existing social tenants. The newly extended system of HomeBuy agents should make such cooperation easier. We would also suggest that, when applying for social rented accommodation, eligible potential tenants are made aware of their options for low cost home ownership. We recommend that the Department and the Housing Corporation should publish a plan stating how they will help improve the marketing and targeting of existing and potential social tenants by December 2006.

Recommendation 2

The Department and the Housing Corporation should further develop the choice of low cost home ownership products available for lower income groups. In considering such products they should draw on the ability of Registered Social Landlords to raise money on the private market and focus in particular on providing new means for current social rented tenants to access home ownership on the open market.

The existing product that allows the purchase of an existing property on the open market (Open Market Homebuy) is restricted to a 25 per cent subsidy, with the purchaser contributing 75 per cent of the market value of the property. This restriction keeps the cost of these products down and allows more people to be helped by low cost home ownership overall. However, it limits the choice of those households who cannot raise 75 per cent of the market value of a suitable property to the purchase of a new build property offered under New Build HomeBuy, or, if they are an existing social tenant, to the purchase of a share of their current social rented property under Social HomeBuy.

Choice for those existing social tenants, and those who are about to enter social rented housing, who cannot afford to buy 75 per cent of a property on the open market, would be increased if there was a further low cost home ownership product which allowed these people to purchase a lower share of such a property. By providing this further choice to these people, the taxpayer might be able to take advantage of the large savings that we found arose if more people took up low cost home ownership instead of social rented housing. Our modelling suggests that offering shares of between 25 to 50 per cent would be affordable to households with incomes of between £15,000 and £30,000. On the downside, offering such shares would require a greater subsidy from the taxpayer on each individual property, with the result that fewer people in total would receive help. Allowing people to buy a 60 per cent share of a £150,000 property on the open market, rather than the 75 per cent share required under Open Market HomeBuy, would result in a reduction of 20 in the total number of households helped for every £1 million of grant used in this way. Putting public funding into this open market product would also reduce the public subsidy available for New Build HomeBuy, which contributes to supply of new properties and new tenure mix. Therefore, the Department, the Housing Corporation and the Regional Housing Boards, when setting the levels of local provision of each product, would need to balance the additional cost of allowing people to buy smaller shares of existing properties on the open market, with the value for money savings arising from not housing them in more expensive social rented accommodation.

To reduce the costs of this new product to the taxpayer, the Department could fund the product through a mix of taxpayer grant and Registered Social Landlords' own funds and commercial borrowings. We calculate that using Registered Social Landlords' ability to raise private finance could halve the cost to the taxpayer for each individual sale. In addition, funding the new product in this way would allow Registered Social Landlords to retain surpluses from future sales for use in the affordable housing sector **(Figure 16)**. The Registered Social Landlord would need to pass on the finance costs associated with the debt they raise in the private market to the purchaser in the form of a small interest or rent charge, as they did for Shared Ownership. However, the individual would be able to offset these costs by buying a smaller share of a property.

In the 2006 Budget, the Government announced the launch of a Shared Equity Task Force to consider new low cost home ownership products. We therefore recommend that the Department and the Housing Corporation submit the proposed variable share open market product to the Task Force for its consideration. The National Audit Office is willing to make its financial modelling of this product available to the Task Force. The Task Force would have to test the market's appetite for this product by consulting Registered Social Landlords and potential buyers. Should this product be deemed feasible, the Department and the Housing Corporation should aim to launch it in the 2008-10 National Affordable Housing Programme.

Recommendation 3

Registered Social Landlords should adopt a more sophisticated approach to assessing people's finances when encouraging purchasers to buy the maximum share they can afford and sustain.

We found that Registered Social Landlords did not always ensure that purchasers bought as large a share as they could reasonably sustain based on conventional mortgage multipliers. Over 30 per cent of low cost home ownership purchasers in 2004-05 would have been able to buy a larger share of their home, using conventional mortgage multipliers, than they actually purchased. We estimate that if these multipliers had been used in 2004-05 and applicants had managed to borrow up to the maximum mortgage levels indicated by these multipliers after allowing for their other regular outgoings, such as debt, £63 million of Registered Social Landlords' and taxpayers' funding would have been released for use elsewhere; for example helping roughly 3,500 more households to buy their own home.

16 Illustration of how the use of Registered Social Landlord's borrowing could increase the gains to the affordable housing sector with no increase in cost to the taxpayer

		Net return/(cost) from subsidising the part-purchase of a £150,000 property[1]	
	Share bought by individual (Per cent)	To the taxpayer £000	To the Registered Social Landlord £000
Current Homebuy	75	(6)	4
Open Market Homebuy – Funded by commercial lenders[2]	75	(3)	2
Addional Open Market Product – Funded by RSL borrowing	75	(3)	4
	50	(6)	8
	25	(9)	12

Source: National Audit Office financial modelling

NOTES

1 We have assumed an annual increase in property values of 2.7 per cent in real terms for a five year period between the purchaser's acquisition of their initial share of the property and their subsequent purchase of the remaining share to represent the trend growth rate as outlined in the Barker Report. We have discounted the resultant cash flows using the Treasury Discount Rate of 3.5 per cent to give a net present value for the return or cost.

2 From October 2006 half of the equity loan given under this product will be provided to the individual purchaser by commercial lenders. In return for this funding, the lenders will charge the purchaser a premium on the interest rate on their main mortgage. In addition, they will also receive half the gains made from any increase in the value of the share of the property not bought by the purchaser when the purchaser repays the loan.

RECOMMENDATIONS CONTINUED

Following discussions with the National Audit Office, from April 2006 purchasers will be required to buy as large a share of a property as they can sustain in the long term. However, to achieve the resultant savings, more needs to be done to improve how Registered Social Landlords assess applicants' financial means. Registered Social Landlords need to have an accurate picture of applicants' ability to sustain home ownership before they decide how large a share of a property to provide to them. Best practice for assessing applicants' ability to sustain borrowing focuses on the actual incomes and outgoings of applicants rather than just multipliers of gross earnings. Outgoings that should be taken into account include not only mortgage and rental charge costs, but also the costs of repairs and maintenance (including service charges and sinking fund contributions), standard household outgoings (such as transport costs), debt commitments, and other financial commitments, such as child support payments and child care costs.

We therefore recommend that the Housing Corporation work with HomeBuy agents and Registered Social Landlords to ensure that they adopt by December 2006 best practice in assessing applicants' borrowing capacity, taken from across the sector and comparable industries (including from banking and mortgage lenders).

Recommendation 4

The Housing Corporation should take into account the actual costs and returns achieved by Registered Social Landlords from their Shared Ownership properties when deciding the level of future grant allocation.

In recent years the Housing Corporation has been effective in driving down the amount of taxpayer subsidy required by Registered Social Landlords to build affordable homes. However, there is scope for further efficiency savings if the Housing Corporation developed a more sophisticated analysis of the costs and returns for Registered Social Landlords in building new low cost ownership homes.

The Housing Corporation allocates grants for the construction of Shared Ownership properties based on a Registered Social Landlord's estimates of the associated costs and returns at the time of the funding bid. We found that some low cost home ownership funding bids overestimated the amount of grant required as they contained overly cautious assumptions about, for example, movements in house prices during the construction period and the number of home-owners who subsequently purchased the remaining shares in their property. In the 2004-06 bid round, the Housing Corporation did not collect information on the costs and returns actually achieved and therefore cannot assess the accuracy of these estimates other than by comparing them to other bids for comparable schemes. Based on our financial modelling we estimate that Registered Social Landlords received £90 million grant more than was necessary to ensure the financial viability of the Shared Ownership schemes completed in 2004-05. These gains are likely to have been due to house prices rising more quickly than the costs of constructing the properties involved and it is possible that Registered Social Landlords were unable to anticipate this rate of increase, resulting in over-cautious grant applications. This additional grant will have freed up other resources for use by Registered Social Landlords for further housing activities within their remit.

The Housing Corporation should require Registered Social Landlords to supply information on the actual costs and returns achieved for Shared Ownership construction projects once the initial shares of the property have been sold. The additional burden on Registered Social Landlords arising from this new requirement should be minimal as Registered Social Landlords are already required to give cost information to the Building Cost Information Service. The Housing Corporation should use the information provided to improve the quality of Registered Social Landlords' future funding bids and thus the overall cost efficiency of social housing grant. The monitoring of the use of taxpayers' funding should also improve as a result. The Housing Corporation should consult with its development partners with the aim of introducing this requirement to provide information in time for the 2008-10 funding round.

Recommendation 5

There should be greater oversight over the gains many Registered Social Landlords make from their equity investment in low cost homes and how they then reuse these.

Rising property prices in recent years have led to many Registered Social Landlords making large gains when home owners subsequently exercise their right to purchase Registered Social Landlords' remaining shares in their homes. We estimate that Registered Social Landlords have benefited from additional cash worth up to £56 million from purchasers who bought the remaining share of low cost home ownership properties funded by Housing Corporation grant between 1999 and 2005. Despite this, the Housing Corporation has not collected information on the scale of these gains and Registered Social Landlords have been free to use these on other housing activities within their remit, whether capital or revenue.

In order to improve transparency over the size and use of these gains, the Housing Corporation should require Registered Social Landlords to supply information on the size of share purchased and receipts achieved for each subsequent low cost home ownership transaction. The Corporation should be able to collect this information relatively easily using its existing reporting systems. Such information should improve the Corporation's understanding of low cost home ownership; including its effectiveness at providing households with a means of achieving full home ownership and its impact on Registered Social Landlords' finances. The Corporation can then use this information to inform future bidding rounds. The Corporation should therefore incorporate this information requirement into its reporting system for the 2008-10 funding round.

For new sales, the Housing Corporation should also require Registered Social Landlords to pay into the Recycled Capital Grant Fund amounts based on the actual sales receipts achieved, rather than simply the nominal value of the original grant. This would maintain the value of the taxpayers' funds in real terms and give greater oversight over how Registered Social Landlords use taxpayers' capital funding. The Housing Corporation told us that it may need to establish new legal powers to introduce this requirement.

Recommendation 6

The Housing Corporation should require Registered Social Landlords to implement stricter controls over the repayment of assistance to key workers.

From April 2006, any key public sector worker who receives low cost home ownership assistance by sole virtue of their employment will be required to repay this assistance if they leave eligible employment. This is an extension of the arrangement which applied under the Key Worker Living Initiative before April 2006. However, we found that the controls to ensure that such repayments were made on this Initiative were not always in place, with the risk that some assistance would not be repaid. The extension of the requirement to repay makes sound controls in this area even more important than previously. We therefore recommend that the Housing Corporation:

- Change its guidance to require Registered Social Landlords to undertake periodic checks with the relevant key worker employers that their key worker tenants and equity loan holders remain eligible for support, by Autumn 2006.
- Inform Registered Social Landlords of the examples of good practice that we have identified in undertaking this report.
- Require the Board of every Homebuy Agent to write to it by Autumn 2006, confirming that they and all other relevant Registered Social Landlords and Key Worker employers in their zone have the necessary controls in place.

Employers should also ensure that their personnel systems are set up adequately to monitor the employment status of key workers who have received assistance and to inform HomeBuy Agents should they leave eligible employment, by Autumn 2006.

APPENDIX ONE

Low cost home ownership assistance: Discounts and grants

1 There are a number of low cost home ownership products which offer individuals discounts and grants to individuals to purchase a property. These products were not included within the scope of our report.

2 Over 80 per cent of social tenants have a statutory right to buy or acquire their home at a discount.[15] The vast majority who do not have such a right are tenants of charitable housing associations, which by law cannot dispose of their assets (homes which were built without public subsidy, often using charitable donations given by private individuals) at less than their market value.

3 Under the *Right to Buy*, most council tenants, most former council tenants living in homes transferred to a housing association, and tenants of non charitable housing association tenants living in their home since before 1988, have a statutory right to buy their home with a discount off the open market value. The level of the discount is subject to a maximum limit of between £16,000 and £38,000 depending on the local authority area. The Right to Buy has recently been modernised through the Housing Act 2004 to prevent abuses of the scheme and to limit its impact on affordable housing.

4 Under the *Right to Acquire*, housing association tenants living in homes built or acquired with public subsidy since April 1997, and those living in homes transferred from a local authority to a housing association from the same date, have a statutory right to acquire their home with a discount off the open market value if they meet the eligibility criteria and their property qualifies. The level of the discount is subject to a maximum limit of between £9,000 and £16,000 depending on the local authority area. Tenants are required to contribute at least 50 per cent of the purchase price. Some properties are exempt, including those in designated rural areas (generally those with 3,000 people or fewer) and supported housing for people with special needs. The Right to Acquire has also been modernised through the Housing Act 2004.

5 The above two schemes make home ownership more affordable for more people due to the size of the grants and discounts given. Thus, in 2004-05 at least 52,000 social housing tenants purchased their homes using these. This extension of home ownership contributes to the Department's policies of helping to create mixed, sustainable communities and enabling more people to share in increasing asset wealth. The receipts from Right To Buy sales have also been used for social housing or to reduce local authorities' debts. However the size of the grants and discounts involved means that such schemes are a less economic means for the taxpayer of helping such people into home ownership than Shared Ownership or Homebuy. Also, once the purchase is complete, the purchaser owns the entire property. The public sector no longer has a financial interest in it, other than that the discount is repayable as a percentage of the market value if the property is sold within five years.

6 In addition to the statutory rights to buy and acquire, social tenants can also benefit from the *Cash Incentive Scheme* under which council tenants can be offered, at the discretion of their landlord, a grant to help them to buy a home on the open market, freeing up their social home for new tenants. The grant is funded through local authorities' own resources.

15 Office of the Deputy Prime Minister Consultation Paper *HomeBuy – Expanding the opportunity to own* (April 2005).

APPENDIX TWO

Risks to parties arising from low cost home ownership

	Occupier defaults on repayments	Fall in property prices
Purchaser	Like all home owners, low cost home ownership owners face the risk of repossession of their home by their mortgage company if they fail to meet their mortgage payments. For Shared Ownership properties, their Registered Social Landlord may also repossess if they default on their rent payments. However, Registered Social Landlords told us that they monitor payments carefully and meet with those in difficulty to help them budget better. Shared Ownership owners can also reduce the size of their share of their home to lower their monthly outgoings, at the discretion of their landlord.	Like all home owners, falling property values will reduce the gains that low cost home ownership owners make if they sell their home. Their ability to use the sale proceeds to trade up to a better property will be limited if house prices in their area have changed at a different rate to prices in the area they are seeking to move to. Like all home owners, if the value of their share of their home falls below the value of their mortgage, then low cost home ownership owners are in "negative equity". Normally in this case, the homeowner may find it difficult to get permission from their mortgage lender to sell as the sale proceeds will not cover the cost of the mortgage. However, low cost home ownership owners are in a better position as the mortgage's repayment is effectively guaranteed since the mortgage lender has first call on the proceeds of the house sale. The homeowner then repays the low cost home ownership assistance they received (e.g. the equity loan) from what is left.
Registered Social Landlord	For Shared Ownership properties, Registered Social Landlords can repossess if the purchaser defaults on their rent payments. They may, however, face a loss if the proceeds from the property's subsequent resale are insufficient to cover mortgage and rent arrears as the homeowner's mortgage lender has first call on these proceeds. In this instance, the Registered Social Landlord may then pursue the homeowner for the repayment of any outstanding amounts.	Falling property values will reduce the gains made by Registered Social Landlords for reinvestment in affordable housing. If values fall to such an extent that, when a shared ownership home is sold, the proceeds are insufficient to repay in full the assistance received, the Landlord not only makes no gain but also faces a loss on that part of the assistance that it funded itself. Landlords face no loss on Homebuy loans as these are 100 per cent funded by grant.
Taxpayer	If a Registered Social Landlord's share of the proceeds from the sale of a repossessed Shared Ownership property is less than the value of the original grant which helped fund its construction, the Landlord pays a reduced amount into its recycled capital grant fund, making less money available for reinvestment in affordable housing, and the Housing Corporation writes off the unpaid amount of grant.	If property values fall to such an extent that, when a shared ownership home is sold, the proceeds are insufficient to repay in full the assistance received, the taxpayer then faces a loss on that part of the assistance funded by grant. This is because the Registered Social Landlord will pay a reduced amount into its recycled capital grant fund, making less money available for reinvestment in affordable housing, and the Housing Corporation writes off the unpaid amount of grant. For Homebuy loans, the taxpayer bears all the loss as these loans are 100 per cent funded by grant.

APPENDIX THREE

Methodology

Data Analysis and Financial Modelling

1 We examined databases to analyse purchaser profile and to model the financial impact of the low cost home ownership programme on the purchaser, the taxpayer and the housing sector. Databases examined included: the Housing Corporation's CORE database, which records new social lettings, low cost home ownership sales, data on tenants' and purchasers' characteristics and information on housing costs; the Housing Corporation's Investment Management Systems (IMS), containing data on the costs of the low cost home ownership programme; and the Department's data on the profiles of people assisted under the Key Worker Living Initiative.

2 We developed a financial model to map low cost home ownership cash flows to and from Registered Social Landlords. This financial model draws upon our data analysis of the Housing Corporation databases above; a review of Registered Social Landlord project appraisal systems; and interviews with Registered Social Landlords. We also developed a model of the costs and returns to the individual of the various housing tenure options open to them (outright purchase, low cost home ownership, and private and social renting) under different assumptions about the housing market. Details of our modelling work is contained in a separate Technical Note to this report available from www.nao.org.uk.

Surveys

3 We carried out surveys to gather information on the effectiveness of the programme covering: key worker employers, to inform us about the impact of the Key Worker Living Initiative on retention and recruitment, and about the effectiveness of Zone Agents and the marketing of the programme; and Registered Social Landlords who had received social housing grant for low cost home ownership in the period 2004-2006, to collect information on the financing and financial impact of low cost home ownership activities, marketing and purchaser feedback.

4 The response rates for these surveys are given below:

	Total population	Questionnaires sent out	Responses received	Response rate (Per cent)
Registered Social Landlords	123	96	54	56
Key Worker employers	296	270	89	33

Case Examples

5 We selected three case example areas from each of the Key Worker Living Initiative zones to assess how both conventional and key worker low cost home ownership schemes operated locally. We held 14 interviews with local authorities, Registered Social Landlords, Zone Agents and key worker employers, and reviewed the procedural information provided by the Registered Social Landlords. The three areas were: Cambridge City Council and South Cambridgeshire District Council (Eastern region); Lewisham Council (London region); and Southampton City Council (South East region).

Expert Panel

6 We convened an expert panel to comment on the scope and methodology of the study, our emerging findings and our recommendations. We are grateful to the following members of the expert panel for their contributions.

Name	Position	Organisation
Jackie Bennett	Head of Policy	Council of Mortgage Lenders
Glen Bramley	Professor of Urban Studies	Heriot-Watt University, Edinburgh
Bernie Conroy	Assistant Director	Metropolitan Home Ownership
Paul Harris	Director	GHK Consulting Ltd
Bev Hobson	Housing Strategy Co-ordinator	Thames Valley Police
Mike Maunder	Head of Housing Markets	Audit Commission
Alan Murie	Professor of Urban and Regional Studies	Centre for Urban and Regional Studies, University of Birmingham
Steve Nunn	Director (Operations)	Tower Homes
Adrian Shaw	Director	Southern Housing Home Ownership
Jack Stephen	Finance Director and Deputy Chief Executive	Thames Valley Housing Association
Steve Walker	Chief Executive	Tower Homes
Christine Whitehead	Professor in Housing	Department of Economics, London School of Economics
Piers Williamson	Chief Executive	The Housing Finance Corporation Limited