# Breaking Through the Affordability Ceiling

## National Housing Affordability Roundtable

11.30am - 2.00pm • Tuesday 25 February 2014

RACV City Club, Level 2, Bourke Room 2,
501 Bourke St, Melbourne

# Executive briefing

## Alternative forms of home ownership

The Business Council of Co-operatives and Mutuals (BCCM) invites you to a Housing Affordability Roundtable sponsored by Common Equity Housing Ltd and **bankmecu** to discuss and promote alternative housing tenure models that have the capacity to reduce the costs for those wanting to enter the housing market. The models under discussion include tested and successful co-operative approaches (although largely unknown here) that have facilitated the development of affordable housing sectors in other jurisdictions.

Given the rising costs of home entry and the persistent debates over the causes and solutions to alleviate the problem the BCCM believes it is critical to bring hitherto lesser known models into play.

It is intended that the Roundtable will generate a 'live' response with a 'blueprint for action' an anticipated outcome.

The purpose of the Roundtable is to bring together a range of people with expertise in developing housing to identify and refine models of housing development and the necessary legal and financial frameworks that will significantly reduce the cost of entry into secure housing for first homebuyers priced out of the current housing market.

The Roundtable will explore ideas currently discussed under numerous headings including Community Land Trusts, Equity Housing Co-operatives and Intentional Communities with the expressed purpose of guiding pilot projects to put to the market place.

## Housing prices beyond the reach of many

There is mounting evidence that the costs of housing are continuing to increase and there are many people who are effectively being priced out of the housing market. Traditionally there are two dominant types of tenure in Australia, home ownership, financed by individual mortgages, or private rental, which together account for about 95% of Australian households.

Home ownership still remains the Australian dream, as it offers ongoing security where owners can remain and engage in their communities, and long term cost reduction as mortgage payments reduce over time and eventually stop.  There has also being a strong sentiment that any investment in real estate is a secure investment and that land and house prices do appreciate over time.  There are also favourable tax incentives with profits on the sale of one's primary place of residence being exempt from capital gains taxes.

There is a deep psychological attachment to home ownership as it achieves status, stability and security and long term cost reduction compared with renting. There are also significant costs that home owners bear beyond the initial purchase price that are often not highlighted when considering the real costs of housing including rates and charges, owner corps fees for apartments, maintenance expenses, mortgage fees and insurances.

The percentage of people purchasing their own home has declined over the last decade due to rising prices and particularly the high entry costs to home ownership.

Some are looking to rental housing as being the more affordable option particularly because of the low entry costs, typically a rental bond equivalent to one month rent plus one month of rent in advance.

The major downsides of renting are that renters do not enjoy long term security with tenure at the call of the owner. It is 'dead' money and rental costs continue to increase as opposed to decrease for home owners. In Victoria, residential tenancy leases are limited to five year maximums but are typically offered on one year terms with the owner able to give notice periods as short as 60 days if they wish to sell, renovate or occupy the properties themselves or 120 days without any reason.

Also renters do not have any access to property appreciation or the capacity for self funded value added improvements to the property though they may pay rent for considerable periods or be very conscientious in maintaining the upkeep and subsequently the value of the property.

Home ownership is becoming more difficult and the demand for private rental continues to place pressure on supply and pricing of well located private rental dwellings.

At the same time landmark research undertaken by The Co-op of the 19-27 years demographic (The Future Leaders Index) revealed the aspiration to home ownership is persistent with over 70% of respondents expressing that home ownership was as important to them as it was to their parents but over 80% concerned about their ability to be able to afford to purchase a home.

The challenge is to develop an alternative form of tenure that will reduce the cost of entry and ongoing costs, yet retain most of the benefits of home ownership such as security of tenure and the capacity for self funded improvements to properties whereby the resident rather than the owner retains some of the added value of improvements.

There has been some significant progress through the strata title concept that have reduced the cost of providing homes usually in more sought after locations through increased yields and the concept of sharing some space or amenity through owners corporations.

The retirement village model, featuring multiple unit developments and long term leaseholds has been widely adopted to reduce the housing costs for retirees wanting to downsize but has not been made available to younger people or those still in the work force.

## Exploring new models

The aim of this paper and the proposed Affordability Roundtable is to explore and pilot alternative types of tenure that will significantly reduce the entry cost to housing whilst achieving similar benefits as home ownership and the potential to unlock social capital growth in co-operative arrangements.

The alternative is for properties to be developed and owned by not for profit entities that will forgo the traditional developers' margin and also bring the benefits of scale development, innovative designs, delivery expertise and increases shared usage of many facilities as demonstrated to some extent in strata titled subdivisions.

The owning entity will be willing to offer long term leases to the operating entity on a cost recovery rather than a profit driven basis.

The operating entity will sell shares to individuals wanting to live in the complex based on the price set by the owning entity.

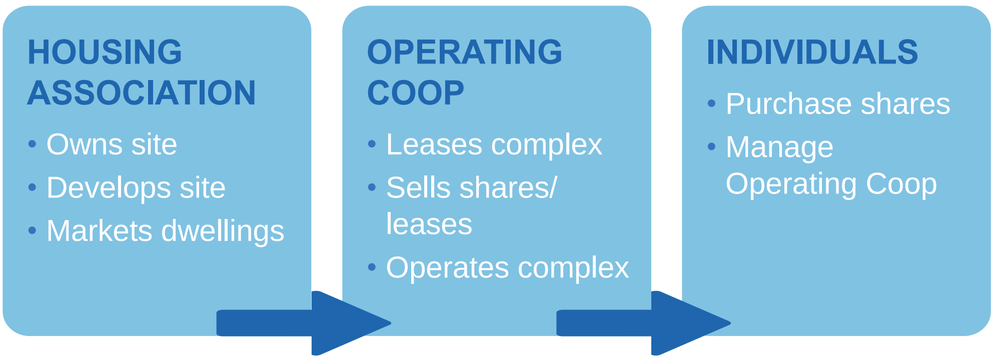
It is anticipated that the initial entry costs for a new dwelling can be reduced by 20% to 25% of costs of standard like single dwelling purchases. This price could be reduced even further if land is available below market value through land trust or philanthropic mechanisms.

The model has the potential for developing high levels of community engagement amongst members who would have mutual interests in the success of the operation of the complex and retaining its value and marketability.

The necessity of a formal legal operating entity such as a co-operative requires all residents to be actively involved in the operation of the complex and has the potential to dramatically reduce individual's costs in areas such as purchasing maintenance and equipment as well as other social benefits.

Whist the model is not intended to be limited to 'intentional communities' different developments have the potential to be designed and marketed for particular cohorts or interest groups.

## The model




A site is purchased by a not for profit Housing Developer (Housing Association) and an agreed number of dwellings are constructed on the site.

The site including the dwellings are leased on a long term basis to an entity that is owned and controlled by those wishing to buy a long term lease to a dwelling on the site. Let's call this entity the operating entity (OE) and it would be ideally set up as a co-op or a mutual and take on the traditional responsibilities of an owners corporation in strata title subdivision but would have additional responsibilities as the leaseholder of the complex from the owner (Housing Association).

Individuals would purchase the lease of individual dwellings from the Operating Entity by buying a share in the operating entity, which in turn would pay the full cost of the development to the owner.

Each purchaser would be an equal shareholder in the operating entity and that share would entitle them to occupy a specific dwelling in the complex as well as use of all common areas and facilities.

Similar to Owners Corporations the Operating Entity would need to establish a fee structure for leaseholders to cover costs of the upkeep and maintenance of common areas and shared facilities.

Consideration could be given to include external fabric of dwellings dependent on type of construction.

Individual leaseholders would be responsible for upkeep of internals of dwellings.

Developments could be done in line with standard development practices with the developer (HA) responsible for site development and constructing of the dwelling. Marketing of dwellings could be either of completed dwellings or ‘off the plan’ increasing the ability to customise dwellings to meet purchasers’ preferences.

Purchasers would be purchasing a share in the operating entity including a long term lease that would retain a commercial value.

## Selling your share/leasehold

Individuals would have the right to sell their share/lease to any eligible individual with limited capacity for the other shareholders or operating entity to restrict any sales.

If a buyer cannot be identified within an agreed timeframe (for example six months) the shareholder has the right to sell their share/lease back to the owning entity (HA) at the price established by an agreed mechanism. (See sharing property appreciation section).

The responsibility for selling or leasing the dwelling then reverts to the owning entity.

## The role of the developer

The developer will need to bring its development expertise to the fore to reduce the total costs and also to deliver the completed homes in a cost efficient manner.

The developer forgoes its development margin but must recover all the costs of the development including land purchase, holding fees, construction costs, construction financing costs through the sale of leaseholds. Development margins are typically a 15% to 20% in most development scenarios.

Multi-scale developments should reduce costs of individual dwellings.

There is a need to further explore innovative use of shared spaces to reduce costs. Simple examples commonly achieved on commercial developments include shared driveways, car parking, garages and lifts.

Costs can be further allayed by innovative usage of other facilities that could be successfully shared depending on the scale and marketing of the development. Examples are shared open space, shared gardens, shared storage facilities, sheds and equipment, laundries, visitor rooms etc.

Housing Associations such as CEHL have completed numerous multi unit developments that have demonstrated that individual unit costs can be reduced considerably and that social and community outcomes can be achieved through thoughtful design and use of shared areas.

## Sharing property appreciation with leaseholder

Whilst it is assumed that over the longer term property prices will continue to appreciate this is not guaranteed but it is possible to establish models where leaseholders agree to forgo any capital appreciation or agree to share any capital appreciation with the owning entity.

In the first scenario investors would be guaranteed the return of their initial investment when they wish to depart and the owning entity would make a profit (or loss) if the market value of the leasehold changed over time.

Alternatively the parties could agree to share the profit or loss as the market value changes.

This could be under a simple formula distributing the change of value between the parties in an agreed ratio.

It would be advantageous if any profit derived by individuals through the sale of their share could also be capital gains tax exempt as per sale of primary place of residence but this would need to be considered by the ATO.

# Legal structures

People are not familiar with purchasing a long term lease and certainty must be assured that they will have a marketable asset if for whatever reason they want to sell their share/leasehold.

It is essential that purchasers have the right to sell their lease at their discretion with minimal restrictions as per any house or apartment buyer.

The guarantee that after an agreed length of marketing the owning entity would purchase the share is something that is not available in the open housing market.

Documentation would need to be developed to ensure the integrity of the master leasehold of the complex to the operating entity.

The operating entity would have to be responsible not only for the good management of the complex but also ensuring all dwellings are responsibly maintained and ample funds are set aside for cyclical maintenance obligations.

The legal structure of the operating entity would need to be documented though existing Co-operative and Owners Corporation legislation providing a framework that could easily be customised to meet the proposed functioning of the operating entity.

There needs to be requirements for shareholders to meet their obligations to both the operating entity and also their financiers that can trigger a buy out by the owning entity if they are not being met.

## Accessing and securing finance

Again lending institutions would need to be agreeable to the model and making finance available to potential purchasers.

The security would be offered by the Owning Agency.

It is assumed that the owning entity is an established Housing Association, regulated by the State Government Housing Regulator and with an established loans portfolio with financial institutions.

If a borrower defaults on their loan, their lease would be terminated with the owning entity paying out the value of their lease and effectively purchasing their share in the operating entity, with the borrowing institution having first call on funds to the value of the outstanding loan.

In effect the finance institution lends funds to the owner to develop the site. These loans are effectively transferred to individual investors as they buy a share in the operating entity but the owning entity provides the necessary security to the financier.

Depending on the financial situation of the owning entity (HA) there could be some flexibility insofar as a purchaser could negotiate to buy a leasehold at a discounted price and agree to rent the balance of the property directly from the owning entity if they could not immediately raise the full capital cost of the lease. It would be assumed that the purchaser would still intend to pay for the full cost of the share when their financial position enabled them to do so.

## CASE EXAMPLE:

The model could be applied to developments as small as three dwellings on a site up to much larger developments such as multi storey complexes.

A site is purchased and 10 dwellings are constructed on the site. The total cost of the development to the HA is $3 million. The HA leases the site to a co-op or mutual organisation (Operating Entity) and individuals  are able to purchase a share in the Operating Entity for 1/10 of the total costs of the completed complex.

This would mean that individuals would need to pay $300,000 for their long term lease of the property.

The assumption is that the HA, by providing the leasehold to the Operating Entity at cost can provide a dwelling that individually would market for closer to $400,000 if it was marketed as a traditional house and land package.

The purchasers would need to access finance to raise the $300,000 but could use their share in the Operating Entity as their security. The Operating Entity can ‘sell’ the share to the Owning Entity if the shareholder does not meet the obligations of their lease including satisfying their financier requirements.

The Operating Entity would need to set an appropriate fee structure to meet all operating and maintenance costs as per any owners corporation.

The purchasers would be equal shareholders in the Operating Entity and have responsibility to contribute to its successful functioning. As per an owners corporation this can be done through voluntary contribution or contracted to a professional agency.

The level of involvement and the sharing of common areas would be self determined by the shareholders of the Operating Entity.

The Owning Agency would guarantee to step in if any shareholder wishes to sell (or defaults on their obligations) and effectively buy back the share and assumed the voting right of the shareholder until a new buyer is contracted.