

Cambridge Centre
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Reselling shared ownership properties after improvements

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Summary

Previous research identified some issues arising when a shared ownership property is sold, having previously been subject to improvement work by the shared owner. It appeared that the calculation of the value of the improvements and their apportionment between the owner and the housing association often lacks transparency, can be complex and can in some cases be perceived as unfair by either the seller or purchaser.

Two main approaches are in use for dealing with an uplift in value created by a shared owner having invested in improving their home:

- *Approach A:* Some housing associations seek to allow the shared owner to gain the full benefit from any uplift in value as a result of improvements that the owner has carried out. They therefore value the property with and without the improvements. The housing association and the seller then each receive their share of the value without improvements, and the extra sum (which is the whole of the uplift in value that the improvements have created) is paid direct to the seller.
- *Approach B:* Some housing associations simply share any uplift in property value with the owner, in accordance with the respective percentage shares owned.

In examining the complex issues raised, the focus has been on matters such as transparency of approach, complexity, and practical impacts. However, underlying these facets has been a focus on striking the appropriate balance between the different interests involved:

- The shared owner seller, with an interest in being able to take informed decisions about improvements and to receive the benefit from an investment made on their property.
- The buyer, with an interest in paying a fair price and being able to obtain appropriate mortgage finance.
- The HA holding the retained share, and with an interest in growing its capital assets, protecting its income stream and keeping administration costs down.

Well-functioning markets rely on the existence of a balance between the interests of the parties involved. When that balance is lacking then distortions in markets can and usually do occur.

Thirty two housing associations responded to a survey, covering between them nearly a third of the shared ownership stock in England.

Key findings

Valuing improvements for the purposes of resale

- The survey respondents reported a total of 3,047 resales of shared ownership properties in the last two years, a turnover rate of 3.5 percent per annum. In around ten percent of these (304), the shared owner had made improvements that they believed added value to their property, and in two thirds of these cases (203) the valuer agreed that there had been an uplift in value.
- Typical uplifts in value were in a range of one to ten percent of the total property value.
- Shared owners had sought prior approval for the improvements to their property in only around half of all cases.
- Six of the 32 survey respondents (19 percent) indicated that they did not know what approach their housing association took (or would take) to valuing improvements during resales.
- Of those who knew which system was in use, the majority (17) used Approach B, whilst four used Approach A and a further four responded “something else”
- Responses around how subsequent resales would be dealt with (where a property is sold, having been improved by a previous owner) suggest a lack of uniformity across the sector.
- The legal framework in terms of the model shared ownership lease and the Capital Funding Guide suggest that housing associations have discretion over how to value improvements at the point of resale.
- The lack of consistency in the approach to handling improvements contributes towards the reluctance of lenders not currently lending for shared ownership to enter that market.

Staircasing to 100 percent and selling the whole property

- By staircasing to 100 percent ownership, a shared owner can be compensating for the full value of any uplift they have created by improving their property.
- The majority of housing associations usually allow staircasing to 100 percent at the point of resale and a further third indicated that this would be allowed sometimes. Only one responded that it was never allowed.

Understanding and communicating the policy

- Not all housing associations ensure that they communicate their policies on improvements to shared owners. 77 percent were confident that shared owners

were aware of their policies and most were confident that their frontline staff would have the knowledge to answer queries about the process.

- Some housing associations appeared overly confident about their new shared owners' understanding of the policy whilst reporting that they themselves did not know what it was. Others acknowledged that this was an area they could improve.
- Shared owners appear unaware of their obligation to inform their landlord in advance about proposed improvements, resulting in around 50 percent of permissions being granted retrospectively. Again, this suggests that communication of shared owner rights and obligations could be improved.
- Valuers and estate agents were concerned that there was often a lack of understanding of what work constitutes an improvement likely to add value to the property as opposed to repairs or maintenance, and that some shared owners expected the cost of an improvement to result in an uplift to the same value, which did not always occur.

Difficulties with mortgages

- There are concerns amongst housing associations and lenders that using Approach A can create difficulties for buyers in obtaining a mortgage for the full price they are paying. This is because the property is being valued net of the uplift created by the improvement, yet they must pay this cost in full to the seller.
- Three of the four housing associations following Approach A were aware of buyers encountering difficulties obtaining mortgages, compared to only one of the 17 housing associations using Approach B.
- Lenders were clear that they would not offer a loan on a property based on a price that was higher than the valuation figure.
- Where the total mortgage required is higher than the valuation figure (because of the additional sum payable in respect to the improvements), it was reported that negotiations usually take place and sellers are often forced to accept a smaller sum in respect to the improvements. Lenders were aware of some sales that had fallen through in these situations.

Alternative approaches?

- Two research participants suggested an alternative model, whereby the proportions owned by the housing association and the seller could be altered after a significant improvement had taken place, so that the value of the housing association's share remained the same in absolute terms, but reduced as a proportion of the (now increased) value of the property
- The research found no known instances of such a model being used.

- Housing associations were not in favour of this approach because of the costs involved in re-assigning shares, and perceived loss of rental income and capital appreciation. It was also seen as cumbersome to be marketing odd sounding shares and there were fears that loan security could be adversely affected although such fears appeared to be exaggerated.

Conclusions

Approach A appears fairer in principle than Approach B, but this is only realised in practice if sales can proceed quickly without problems obtaining mortgages causing last minute renegotiations of sales prices, and incurring legal costs to resolve.

Allowing staircasing to 100 percent provides an alternative route for a shared owner who has made a substantial improvement to their property to be compensated in full where a housing association employs Approach B. Approach B is simpler and more transparent approach, and causes fewer difficulties at the point of sale.

Communication of the policy around making improvements and how they will be valued at the point of resale could be improved, regardless of which approach is used.

Introduction

The Cambridge Centre for Housing and Planning Research carried out research for Thames Valley Housing Association in 2012 which resulted in the high-profile report *Understanding the second-hand market for shared ownership properties* (Clarke and Heywood, 2012).

This previous research identified some issues arising when a shared ownership property is sold, having previously been subject to improvement work by the shared owner. It appeared that the calculation of the value of the improvements and their apportionment between the owner and the housing association often lacks transparency, can be complex and can in some cases be perceived as unfair by either the seller or purchaser.

The issue

If a shared owner sells their share of their property after having made improvements that increase the value of the property then the question arises as to how the shared owner is to benefit from that uplift. This is not an issue for full home owners they will always receive the full benefit of any uplift in value to the property. However, in the case of shared owners, although they will benefit from the use value of any improvements while they live in the property, they will not receive the full uplift in value from improvements on resale because they only own a share in the property. Thus the housing association will share in the increased value due to improvements unless some provision is made to apportion that increased value solely to the shared owner. Some difficulties around valuing improvements were noted in the 2008 report funded by the Joseph Rowntree Foundation *Achieving mobility in the LCHO market*, which notes that it was a problem for some purchasers and that housing associations' practice varied in terms of how they valued improvements, with some requiring the purchaser to pay the buyer a separate sum in respect to the valuations, but others simply expecting to retain the proportion of the full sale price that they own. This report concludes that:

Best practice guidance on valuations and the status of shared owners' home improvements should be disseminated to overcome circumstances where the owner is financially disadvantaged when selling their property. (Wallace, 2008)

There is increasing recognition that for many shared owners shared ownership is a long-term tenure. (Clarke and Heywood 2012) The recently published Shelter report *Homes for forgotten families- towards a mainstream shared ownership market* states:

Billed as a stepping stone, a low proportion of shared owners have actually moved on to full ownership, suggesting that it needs to be more of a long-term market than it was originally intended to be. (Shelter, 2013)

In this context, a well-functioning resale market will be of growing importance. It is important to ensure that aspects of the resale process such as how improvements are dealt with, work well for existing shared owner sellers, buyers and housing associations.

The recent research commissioned by Thames Valley (Clarke and Heywood, 2012) found that it was common, although not universal, for housing associations to seek to allow the shared owner to gain the full benefit from any uplift in value as a result of improvements that the owner has carried out. They therefore valued the property with and without the improvements. The housing association and the seller then each receive their share of the value without improvements, and the extra sum (which is the uplift in value that the improvements have created) is paid direct to the seller. The following worked example illustrates the practice:

Approach A: Worked example

- Shared owner share **50%**; Housing association share: **50%**
- Value of property without improvements: **£200,000**
- Value of property including improvements: **£220,000**
- Value of improvements: **£20,000** (£220,000-£200,000)
- Value of the share sold: **£100,000** “plus a sum in respect of improvements of £20,000”
- Buyer pays: **£120,000** (50% of £200,000 plus £20,000)
- Seller receives: **£120,000**
- Value of housing association’s share: **£100,000** (50% of £200,000)

However, the research also found that a difficulty created by this arrangement is that mortgage lenders base their lending (including loan-to-value calculations) on the valuation of the share the buyer is purchasing. In the above case the buyer’s 50 percent share would be valued at £110,000, yet they are required to pay £120,000. The research suggested that in practice buyers sometimes have to find a larger deposit than normal when obtaining a loan in order to cover the additional sum paid over and above the valuation (in this case £10,000). They will also be paying £120,000 for a share that is only in fact worth £110,000. Alternatively the seller may have to negotiate with the buyer and forgo some of this sum to facilitate the sale.

Should this buyer subsequently resell their share of the property, the treatment of the value of the improvement that they paid for in full, then arises again.

An alternative approach was also noted by Clarke and Heywood, whereby the seller and the housing association both simply receive their share of the full price paid. This approach is shown below.

Approach B: worked example

- Shared owner share **50%**, Housing association share: **50%**
- Value of property without improvements: **£200,000**
- Value of property including improvements: **£220,000**
- Value of improvements: **£20,000** (£220,000-£200,000)
- Value of the share sold: **£110,000** (50% of £220,000)
- Buyer pays: **£110,000** (50% of £220,000)
- Seller receives: **£110,000**
- Value of housing association's share: **£110,000** (50% of £220,000)

This approach is transparent and no issues about loan size relative to valuation arise. However, as the shared owner has only benefited from a proportion of the uplift that their improvements created, it can be perceived as unfair. This is especially the case for shared owners who own relatively small shares (less than 50 percent) of the property value.

What guidelines are there for housing associations in valuing improvements?

The Homes and Communities Agency has issued several model leases over the last seven years¹.

All have similar clauses relating to valuing improvements for the purposes of staircasing, stating that the leaseholder may pay for additional shares in proportion to the market value of the unsold share (HCA, 2013 Schedule 5).

Market value is then defined:

“Market Value” shall at the date of this Lease mean the Initial Market Value and shall at any subsequent date mean the price which the interest of the Leaseholder would then fetch if sold on the open market by a willing seller.....disregarding the following matters:

- *any mortgage of the Leaseholder's interest;*
- *any interest in or right over the Premises created by the Leaseholder;*
- *any improvement made by the Leaseholder or any predecessor in title of his; and*
- *any failure by the Leaseholder or any predecessor in title to carry out the obligations contained in Clause 3.5 (Repair) and Clause 3.6 (Decoration). (HCA, 2013 schedule 6)*

¹ See www.homesandcommunities.co.uk/cfg?page_id=5866&page=170

In other words, the 'market value' for the purposes of staircasing is defined as excluding the effects of improvements. Under the worked examples given above, the seller wishing to staircase from 50 to 100 percent ownership of the property that is now worth £210,000 including the £10,000 arising from the improvements, would pay a further £100,000 to the housing association.

In terms of resales, however, the model lease states that:

The price at which such offer shall be made shall be the open market value of the Property with vacant possession [as assessed by a qualified valuer] (HCA, 2013 Schedule 5)

The model lease does not define 'open market value' at any time, so it is left to housing associations to decide whether they wish to amend it to take account of improvements (or damage) carried out by the owners in the same way as they do for determining 'market value' for the purposes of staircasing. In addition there is no stipulation as to the status of improvements carried out by a previous owner as is the case with the staircasing provisions in the shared ownership lease (see above).

It seems likely that shared owners would struggle to correctly interpret the terms of their lease in relation to valuing improvements, which highlights the importance of housing associations providing further guidance and information to purchasers and existing shared owners who are considering making improvements to their homes.

The HCA Capital Funding Guide states, along similar lines to the model lease, that for the purposes of staircasing, any value added (or subtracted) from a property because of improvements should be disregarded, and the property valued as if these improvements had not occurred:

The staircasing valuation should therefore be based on the market value had the improvement not been undertaken.

If the tenant has not kept the property in good order, as is required by the shared ownership lease, the staircasing valuation should be based on the market value as if it had been.

Therefore a current market valuation may need to be adjusted upwards or downwards depending on any act or omission committed by the tenant.

(HCA, 2013, Clause 2.3.3)

The section of the Capital Funding Guide on valuing properties for the purposes of resales (Clause 7.8) however offers no further guidance on dealing with the issue of improvements.

This research has therefore set out to establish what practice(s) are in use by housing associations that manage shared ownership properties in England. It aims explore the relative merits of the different approaches to valuing improvements by the

current seller or by a previous owner for the purposes of resales, and to make recommendations of best practice in this area.

Methods

This research was based on interviews with five Housing Associations operating both inside and outside London. In addition, other key stakeholders were interviewed. These included the National Housing Federation, the GLA and HCA, two valuers with experience of shared ownership, three estate agents with experience of selling shared ownership properties, one Independent Financial Adviser [IFA], and two solicitors specialising in shared ownership sales. A teleconference was also organised via the Council of Mortgage Lenders involving four lenders with a total market share of around 75 percent of the shared ownership retail mortgage market.

To further assess issues relating to the charging of housing association properties for loan security purposes, a prominent funding adviser to the housing association sector was consulted by email, along with senior representatives of three of the five major lenders to the housing association sector. In addition, an email consultation was carried out with a highly experienced valuer to the housing association sector for loan security purposes.

An online survey was also carried out in June 2013 of housing associations with a significant stock of shared ownership properties. 125 housing associations were invited to take part in the survey, and 32 responded a response rate of 26 percent. The associations that responded owned between them 44,387 shared ownership properties, around 31 percent of the total stock in England in 2012 (SDR return, 2012).

Research Findings

Incidence of resales and improvements

The survey respondents were asked how many resales they had been aware of in the past two years. A total of 3,047 resales were reported in the last two years. This equates to an annual rate of 3.5 percent per annum. For purposes of comparison the incidence of resales according to the CORE data base was 1.8 percent for 2011-12, the same figure as in 2010-11 (CORE, 2012).

The relatively high rate of resales achieved by survey respondents may indicate some degree of self-selection. Those with more resales (and hence with more interest in the issue of improvements) may have been more likely to respond.

Survey respondents reported that of these, 304 took place in circumstances where the owner had made an improvement to their property, of which in 203 cases, the valuer had agreed to this having added value to the property. This would suggest that around seven percent of shared ownership resales involve properties where the value has been increased by improvements made by the occupant.

In interview, valuers, estate agents and housing associations indicated that this situation occurred in a minority of resale cases within a range of around 5-20 percent. It appeared that improvements were relatively less common in London, probably because of the high proportion of flats within the stock, which offer fewer opportunities for improvements.

In 67 percent of cases owners reported improvements that valuers subsequently found to have increased the value of the property. This suggests that in a significant proportion of cases shared owners are over-optimistic about the impact their investment in the property will have on its value. This supposition was borne out in interviews with valuers, estate agents and housing associations and will be examined in more detail later in the report.

Where valuers had confirmed that improvements had increased the value of a property the survey respondents suggested that the uplift fell within a range of one to ten percent. Although the valuers and estate agents were able to point to specific instances of major works resulting in substantial uplift in value, their comments were consistent with a view that uplifts were generally modest and that improvements frequently did not create any significant uplift in value.

Under their lease, shared owners are required to seek approval for improvements they propose to make to their properties. However, respondents to the survey indicated that in only just under half of cases were they aware of the existence of improvements prior to the property being put up for sale. Interviews with housing associations also confirmed that in a high proportion of cases approval was retrospective (usually at the time of sale) with only a proportion of owners informing the housing association prior to the improvements being undertaken. Shared owner awareness of their obligations and of the way in which improvements are handled on resale is an issue that this report will return to.

Approaches to valuing properties after improvements

In order to ascertain how widely used the different approaches to valuing and apportioning the value of shared ownership improvements are, respondents to the survey were given the following scenario:

“If a house was worth £200,000, and improvements had increased its value to £220,000, and the housing association and owner both have a 50 percent share, when they come to sell it, what would happen?”

Respondents were asked to select from a range of options (Table 1):

Table 1: Housing association approaches to valuing properties after improvements

Approach to improvements	Number of Housing Associations
The new buyer pays £120,000 but £20,000 is paid direct by the buyer to the seller, in respect to the improvements, as well as a further £100,000 for their 50% share of the property. So in total the seller gets £120,000. (i.e. Approach A)	4 (13%)
The new buyer pays £110,000 and owner gets £110,000, 50% of the total value of the property (i.e. Approach B)	17 (55%)
Something else (please give details)	4 (13%)
Don't know - we've not encountered this yet	6 (19%)

Source: Housing association survey 2013

Of those who replied 'something else' two gave answers that indicated that they did in fact follow Approach B, one said that it depended on the lease, and one followed Option A if they were made aware of the improvements before they were carried out, and Option B if not.

The above percentages should be treated with caution given the small sample involved. Nevertheless, it does appear that the most common approach to dealing with improvements is a simple split in the uplift of value caused by the improvements according to the respective shares held by the shared owner and housing association, with no other special provision, i.e. Approach B as outlined above. Thus it appears that the majority of housing associations are content to share in the increase in value in the property even though the improvements were funded solely by the shared owner.

This outcome is broadly borne out by the interviews with housing associations: of the five housing associations interviewed, three used Approach B, one reported that they used Approach A on newer properties and Approach B on older properties and one reported that they used a variation on Approach A. Valuers and estate agents had come across both approaches but did not indicate that either was universally adopted. Housing associations did not highlight any other approaches to dealing with improvements beyond the two main approaches illustrated in the worked examples.

A third possible approach, Approach C, was suggested by two participants in the research, and is discussed later.

In two interviews the housing associations indicated that they had used approach A until the onset of the banking crisis but had changed to Approach B thereafter as buyers were having difficulty in obtaining mortgages under the new tighter credit conditions. This issue is dealt with fully later in the report.

Overall, it appears that Approach B is the commonest approach to handling resales after improvements.

Improvements carried out by a previous owner

Respondents to the survey who followed Approach A, or replied 'something else' were asked about their approach to subsequent resales, in a situation where a property had been improved by a previous owner. In this situation three respondents indicated that they would still employ Approach A, two housing associations indicated they would employ Approach B, and three indicated that they had not so far encountered this situation. Given the small numbers involved it is difficult to draw meaningful conclusions from this response. However, it does suggest a lack of uniformity in dealing with subsequent resales.

The two valuers interviewed for this report both indicated that where housing associations generally used Approach A they would continue to do so with improvements in successive resales unless the improvements concerned had ceased to have a significant effect on the value of the property as might be the case with a kitchen over the passage of time. Thus it would seem that use of Approach A does create a position where successive buyers continue to pay a separate selling price and sum for improvements in perpetuity. This perpetuates the complexity inherent in having to calculate the value of improvements and in having an overall sale price made up of two components. The alternative, of shifting to Approach B for subsequent resales, means that the shared owner who paid an extra sum in respect of the improvements does not get this reimbursed when they come to sell themselves.

These are not problems that arise with Approaches B (or C) since the value of improvements is assimilated into the overall sale price.

Staircasing to 100 percent and selling the whole property

One possible way of mitigating the impact of the housing association sharing in the uplift of value from improvements when Approach B is used is for the shared owner to staircase up to 100 percent and "simultaneously" sell the whole property, on the open market, no longer as a shared ownership property. As already discussed, the shared owner has the value of improvements undertaken themselves or by a previous owner disregarded when the cost of staircasing is calculated so is fully compensated for the investment.

Respondents to the housing association survey were asked whether 100 percent staircasing was offered as an option to shared owners wishing to sell their share. Only one respondent out of 31 answered that this would never be allowed². Seventeen respondents would allow 100 percent staircasing at the point of sale "always" or "usually" and a further eight would offer it "sometimes".

² This is sometimes the case in rural areas where additional clauses in the lease restrict staircasing to 100%

It was clear that the reasons for offering this option were by no means always to do with compensating shared owners for improvements. Some housing associations indicated that they would allow this on request from the shared owner. Others would allow it if they had failed to sell the share during the nomination period, while one indicated that it was a useful option where the market for shared ownership shares was weak. Nevertheless, compensating shared owners for improvements undertaken was also given as a specific reason for allowing 100 percent staircase and simultaneous sale:

[Shared owners] do not benefit from the full value of alterations which they have made on a resale. The only current way of avoiding this is for the customer to staircase. (Survey respondent)

It would appear therefore that the option to staircase to 100 percent and sell the whole property exists for many shared owners and that this can be used as a way to ensure they benefit financially from any uplift in value from undertaking improvements.

This approach stands in contrast to Approach A where the compensation for improvements comes from the new buyer rather than the housing association. Under Approach B, in conjunction with the option of 100% staircasing, the compensation comes from the housing association and potential problems caused by a total selling price that exceeds the valuation figure are avoided.

Understanding and communicating the policy

Ensuring new shared owners understand the policy around valuing improvements and resales

The survey asked respondents whether they were confident that their frontline staff would have the knowledge to answer queries about who benefits from the uplift in value created by improvements if a property is sold on an ongoing shared ownership basis (Table 2)

Table 2: Respondent confidence in frontline staff's knowledge of the policy

Confidence level	Number	Percentage
5 - completely confident	13	42
4	9	29
3	6	19
2	2	7
1 - not at all confident	1	3
Total	31	100

Source: Housing association survey 2013

The findings suggested that overall, most housing associations were confident that frontline staff were able to understand their approach to handling improvements and to communicate it to clients.

Respondents were also asked whether they thought that shared owners were aware of the policy around valuing resales when they first purchased. The large majority of respondents (24) answered yes, whilst three said no, and four were unsure. Some did note that this was an area where they could improve their current practice:

We could definitely provide more detailed information to residents about what happens regarding the valuation when they make improvements.(Survey Respondent)

Further research would be needed in order to establish how well shared owners themselves feel they understand the process.

Table 3 shows the difference in the level of confidence in staff and shared owners' understanding of the policy, by which approach is in use:

Table 3: Perceptions of staff confidence and buyers' awareness by approach taken

		Approach A	Approach B	Something else	Don't know - we've not encountered this yet	Total
Confident that staff understand policy	5 - completely confident	6	4	2	1	13
	4	7	0	1	1	9
	3	3	0	1	2	6
	2	0	0	0	2	2
	1 - not at all confident	1	0	0	0	1
	Total	17	4	4	6	31
New shared owners aware of policy	Yes	13	3	3	5	24
	No	2	0	1	0	3
	Don't know	2	1	0	1	4
	Total	17	4	4	6	31

Source: Housing association survey 2013

The numbers here are small, and thus only indicative, but do suggest that housing associations using the more complex Approach B were nevertheless confident that their staff and new shared owners had a good understanding of their approach. The most concerning figure in this table is possibly the five housing associations who replied that they did not yet know what their policy around valuing improvements was, because they'd not yet encountered it, but nevertheless believed that their new shared owners were aware of the policy.

In interviews housing associations tended to believe that Approach A was complicated and/or hard to communicate regardless of which Approach they used themselves. However, those using Approach B tended to believe that their own

approach was relatively straightforward. One of the valuers interviewed had some difficulty understanding Approach A although the other believed it was straightforward to communicate “if you want to”.

Seeking permission for improvements

Of the 304 cases reported on in the survey where properties were sold on after improvements, the housing associations reported that in only 143 cases had permission been sought for the improvement prior to it being undertaken – 43 percent of all cases. Housing associations with the larger shared ownership stock generally reported the highest rates of permission having been sought beforehand, suggesting that it is the housing associations with smaller stock size where systems for asking for permission may be less well developed.

Under their lease a shared owner has obligations in relation to alteration to the property:

“Not to:

- *make any alterations or additions to the exterior of the Premises;*
- *make any structural alterations or structural additions to the Premises;*
- *erect any new buildings on the Premises; or*
- *remove any of the Landlord’s fixtures from the Premises.” (HCA 2013 3.9)*

In addition and more importantly the lease also states that the leaseholder is obliged:

“Not to make any alteration or addition of a non-structural nature to the interior of the Premises without the previous written consent of the Landlord (such consent not to be unreasonably withheld).” (HCA 2013 3.9)

Thus it is clear that shared owners should seek permission from the landlord for permitted improvements prior to any improvement work being undertaken. However, in addition to survey evidence that compliance is poor, interviewed housing associations also confirmed that a high proportion of shared owners do not seek permission until a resale is imminent. One interviewee suggested that those undertaking major works and newer owners were generally more likely to seek permission, suggesting there may be a need to remind longer-term shared owners of the conditions of their lease.

All interviewed housing associations required permission but in practice were prepared to grant it retrospectively on the basis of evidence=:

A high proportion of approvals are retrospective but an approval is essential if increased value is to be apportioned to the seller. (Housing association interviewee)

Housing associations interviewed indicated that shared owners were told about their policies at the time they purchased their share, often by the solicitor. In some cases the information was re-enforced periodically via newsletters etc., although there was

doubt that these were carefully read. In addition, there was doubt that attention was paid to solicitors and in any case advice on improvements from solicitors was not universal. One solicitor who was interviewed indicated that clients had probably forgotten about their obligation to seek permission by the time they came to undertake improvements.

Given that shared ownership is presented as a foothold within home ownership and that shared owners tend to embrace the culture of home ownership it may be that seeking permission to undertake improvements simply does not seem relevant; full home owners do not normally need to seek permission unless they are subject to a lease with that specification. In addition, it is likely that making improvements to a property is not one of the central pre-occupations of prospective purchasers, who may be more concerned about immediate issues such as obtaining a mortgage and taking possession of the property.

Nevertheless, the fact that shared owners do not seek permission in a large number of cases may compound disagreements and misunderstandings about what constitutes a genuine improvement that will add value to the property.

What constitutes an improvement?

Respondents to the survey reported that when valued, improvements resulted in an increase in the value of the property in around two thirds of cases. However, one estate agent claiming to handle around 20 resales a year described situations where improvements actually added value to a property as “very rare”. In addition, the same agent described as “common” situations where shared owners disagreed with the valuer’s assessment of the value added by improvements they had carried out. Another estate agent described disagreements over the valuation as their biggest problem with Approach A.

The issue of specifying precisely what the improvement has added to the value of the property is less significant with Approach B, as only an overall valuation of the property’s value is ever produced.

The valuers and estate agents interviewed were very clear that improvements frequently did not add significantly to the value of the property:

Shared owners need a health warning that improvements are often really maintenance and in any case don’t always improve the value but can detract from the value. (Estate agent interviewee)

The majority of our properties are flats and it’s hard to find genuine improvements. (Housing association interviewee)

The consensus amongst estate agents and valuers was that some home modifications such as new kitchens and bathrooms tended not to add value to the

property a view confirmed by interviewed housing associations. Agents and valuers tended to believe that only substantial improvements such as conservatories and extensions actually added value.

One housing association, dealing mainly with flats, was explicit that they would not accept new kitchens or decorating as improvements and that in the main only extensions or upgrades such as the addition of central heating would be deemed to have added value. This housing association indicated that only 1.7 percent of their resales had been subject to improvements that had been deemed to increase the value of the property. While this may be an extreme case it does indicate the limited potential for genuine improvements, particularly in London, where the proportion of flats is much higher. According to the CORE database 53 percent of shared ownership resales by housing associations in England are flats while the figure for London is 85 percent (CORE, 2012).

Valuers and estate agent interviewees and some housing associations identified a tendency for shared owners to believe that their investment in their property would automatically produce a commensurate increase in value. There was, in their view, a lack of understanding that the amount spent on the property and the value were not directly related and that there was a genuine, if difficult, distinction between improvements and ongoing maintenance such as redecoration and, in many cases, replacement kitchens and bathrooms:

They think that the work they have done will increase the value. They do not understand some home improvements don't have a value increase.

New kitchens and bathrooms are often a source of contention as some owners expect to get back exact value of what they invested.

Often the amount paid out for improvements does not increase the value of the property by the same amount.

(Survey respondents)

Several interviewees were of the view that shared owners should be better informed about the likelihood that a particular improvement would increase the value of their property. An estate agent suggested that shared owners should be required to take advice from a valuer before undertaking improvements. Another believed that buyers should have the position explained with “worked examples” to show which type of improvements commonly did, or did not, increase the value of a property.

Overall, it would appear that shared owners (who are usually first-time buyers) are not always well informed about how improvements are treated by their housing association or about what investments in their property will actually yield increases in its value. Therefore, there would seem to be a case for taking steps to ensure that shared owners are better informed on both counts.

Difficulties with mortgages

There was a consensus amongst housing associations interviewed that Approach A could produce problems with lenders due to the property selling at a total price above its valuation figure, a problem that does not occur with Approach B. Two valuers had encountered situations where difficulties occurred for buyers in obtaining a mortgage where Approach A was used. One claimed to advise sellers to ignore the full value of improvements when negotiating the final price with buyers in order to avoid such difficulties.

The housing association survey asked respondents whether they were aware of buyers encountering any difficulties with obtaining mortgages for properties where they have to pay an additional element in respect of improvements:

Table 4: Incidence of difficulties in obtaining a mortgage

	Yes	No	N/A – no resales with value increased because of improvements
Are you aware of buyers encountering any difficulties with obtaining mortgages where they have to pay an additional element in respect of improvements?	4 (13%)	10 (33%)	16 (53%)

Source: Housing association survey 2013

The four who were aware of difficulties obtaining mortgages, included three of the four housing associations following Approach A, and only one of the 17 who were using Approach B, suggesting that Approach A may be causing more difficulties. However, the numbers who responded to this question were very small and the results should therefore be viewed with caution.

The issues around obtaining mortgages for shared ownership were addressed at the teleconference of four mortgage lenders, whose combined market shares constitute around 75 percent of the shared ownership mortgage market. All the lenders were seeking to maintain their involvement with shared ownership but none were currently seeking to increase their market share. They saw shared ownership as, in the main, following the trends in the wider residential mortgage market. All would, in some circumstances, offer higher loan to value mortgages for shared ownership than for comparable lending to first-time buyers.

When questioned about resales of shared ownership properties they agreed that these were not common and that situations where there had been improvements to the property were still less common. It should be remembered that the lender will not necessarily be aware that a property has been improved unless there is a problem such as the price exceeding the valuation figure. If the housing association survey conducted as part of this report is correct and the majority of lenders use Approach B to deal with improvements, then the number of cases where lenders would be aware

of improvements as an issue in a resale is likely to be small. Nevertheless, the lenders had encountered such situations.

All the lenders were clear that they would not offer a loan on a property based on a price that was higher than the valuation figure for that property. Where such a situation occurred it was common for the solicitor to identify a discrepancy between the amount to be lent and the total price to be paid. The lender would then explain that the additional price to be paid in respect of improvements brings the total price above the valuation figure. Following the lender response there would either be a re-negotiation of the price between buyer and seller, or the sale would fall through. Lenders were aware of instances where sales had fallen through and of situations where delays had occurred because of the need to re-negotiate the price. Lenders were clear that this situation was undesirable:

The problem is that lenders and buyers should not become involved in this issue; the problem should be solely between seller and the housing association. (Lender interviewee)

All the lenders were agreed that transparency and consistency in terms of approach to issues such as resales were most important to them. The lender with the largest market share of the group suggested that failure to achieve consistency in areas like improvements was one reason why lenders were reluctant to enter the shared ownership mortgage market and the others agreed with this assessment.

The number of resales is small (3,167 in England in 2011-12 according to CORE) and the number of resales involving improvements far smaller than that. The housing association survey suggested that resales with improvements were seven percent of the total, which would suggest around 220 nationally each year. Nevertheless, it is clear that difficulties in obtaining a mortgage do exist for a significant number of buyers and sellers where Approach A is used. These problems are frequent enough to have come to the attention of mortgage lenders themselves, which suggests that the problem is worthy of attention, particularly as those lenders consulted as part of this research suggested that the lack of consistency in this area could impact on the willingness of new lenders to enter the shared ownership market. Housing associations will also be affected by this problem. Delay to, or even failure of, sales will inevitably have an effect in terms of administrative and legal costs as well as having some impact on the liquidity of some shared ownership assets.

A further possible approach: “Approach C”

As discussed above, one survey respondent and one interviewee both suggested a possible alternative approach, ‘Approach C’ as described above.

This was suggested that a fair way of giving the shared owner the full uplift in the value of improvements they have carried out would be to value the property with and

without improvements, and adjust the relative percentage shares of the shared owner and housing association accordingly:

Approach C: worked example

- Initial shared owner share **50%**, Housing association share: **50%**
- Value of property without improvements: **£200,000**
- Value of property including improvements: **£220,000**
- Value of improvements: **£20,000** (£220,000-£200,000)New allocation of shares:
 - Shared owner: **54.5%** of £220,000 (**£120,000**)
 - HA: **45.5%** of £220,000 (**£100,000**)
- Buyer pays: **£120,000** for a 54.5% share

It should be noted that as far as is known no housing association has actually used Approach C in practice although the information available via the housing association survey is not exhaustive.

Approach C was the only distinct alternative approach to emerge from lengthy discussions with stakeholders. The maintenance of a consistent balance between the monetary value of a share in a property and the percentage share is in many ways the most “obvious” approach to an outsider considering the issue of improvements. In the light of these considerations and because discussion of an additional option can throw new light on existing Approaches A and B, Approach C is discussed at some length below.

This approach has features that mark it off from Approach A. Firstly the property sells for a price that should reflect the valuation figure. The difficulties associated with properties selling for more than their ‘value’ are thus avoided. It is transparent; there would be one sale price rather than a sale price plus a separate amount in respect of improvements and a valuation reflecting the value of the property including and excluding any improvements. In addition, the shared owner would receive full recompense for the uplift in value derived from improvements in the form of an enhanced percentage share of the property.

The housing association that initially discussed Approach C conceded that such an arrangement was equitable and transparent but they stated firmly that they would not entertain such an approach. Three reasons were given:

- The housing association believed that it would risk upsetting existing lenders by adjusting its percentage share of properties that might be held as security downwards.

- The housing association believed it would incur additional legal costs in applying Approach C compared to Approaches A or B.
- The housing association was concerned that by reducing their percentage share they would be reducing their future capital gains on the property through house price inflation.

In order to assess the fears focussed on loan security issues, an expert in arranging and advising on funding for the housing association sector was consulted along with senior representatives of three of the five large lenders to the housing association sector. Their views cohered closely:

- Shared ownership properties are less commonly charged for loan security purposes than social rented properties as some lenders apply tougher asset cover ratios and retained housing association shares are only valued on the same basis as social rented properties (Existing Use Value- Social Housing). Shared ownership properties are rarely a significant part of a housing association security portfolio. Thus adjusting the percentage share will affect lenders in relatively few cases.
- It is important to meet lender asset cover covenants and this can mean substituting alternative properties if the reduction in the housing association percentage share of shared ownership properties puts this at risk. Alternatively, a housing association may repay part of the loan. However, this situation is no different in principle to that which applies to charged shared ownership properties that are subject to staircasing; a situation that both lenders and housing associations are very used to. Thus the risk of upsetting lenders is small.

Overall, the position in relation to the charging of shared ownership properties for the purposes of loan security was summed up by one lender:

It follows that lenders are usually relaxed about the fluid nature of the valuation of the charged security “pot” provided the housing association is soundly run and has plenty of surplus security to top-up the charged security, within a reasonable timeframe, in the event of a shortfall arising. (Lender email)

While the response from lenders confirms that Approach C is feasible, it does not alter the fact that recording a change in the housing association percentage share of the property would require some additional legal work, particularly if loan security was involved. Clearly there is a cost here, although it is already one which all housing associations meet regularly in relation to staircasing. It is thus a case of balancing an additional cost against other perceived benefits.

The concern that Approach C could weaken the long-term position of housing associations in relation to capital appreciation due to house price inflation is complex and depends on the approach currently employed by the housing association concerned, as well as the future performance of the housing market for different

property types. It is best addressed by a further worked example building on the three set out earlier in the report:

Table 5: Comparative analysis of the impact of house-price inflation under different approaches to improvements

	2013 pre-resale position	2013 post-resale position	Hypothetical 2023 position
Approach A	HA owns 50% share value £100,000	HA owns 50% share value £100,000	HA owns 50% share of £300,000 house (exc. improvement) value £150,000 (Shared owners still owns 100% of the improvement's value)
Approach B	HA owns 50% share value £100,000	HA owns 50% share value £110,000	HA owns 50% share of £330,000 house value £165,000
Approach C	HA owns 50% share value £100,000	HA owns 45.5% share value £100,000	HA owns 45.5% share of £330,000 house value £150,000

Source: Own calculations. Assumptions: 50 percent increase in house prices over 10 years. Assume that the gross value added by the improvement also increases by 50%. House valued at £220,000 in 2013, of which £20,000 is the result of the improvement. In 2023 the house is valued at £330,000, of which the contribution of the improvement is now valued at £30,000.

From the table above It would appear Approach B yields the most favourable level of capital appreciation from an housing association perspective. It also appears that a housing association currently using Approach A would not lose over time in terms of capital appreciation by switching to Approach C. A housing association using Approach B would lose significantly over time by switching to Approach C (or Approach A) if improvements were undertaken by the shared owner. It would therefore appear that a housing association wishing to maximise capital appreciation would find Approach B most advantageous.

The other housing associations approached previously were contacted again and asked for their views on Approach C. They were, uniformly, not in favour of this approach. The loss of potential capital growth was mentioned by two housing associations. Two others pointed out that to be consistent with practice in respect of staircasing and to keep rents in line with shares purchased; the rent charged to the new buyer would have to be proportionately reduced over the rent previously charged to the seller if improvements were dealt with under Approach C in the course of a resale. This was another potential loss to the housing association.

Another housing association was concerned about the additional work of adjusting shares and dealing with properties that had been charged as security as discussed above. They also felt that Approach C would be as complicated to explain to sellers

as Approach A, although this view was not volunteered by other housing associations.

Another point made against Approach C was that it could cut across marketing efforts:

How do you market a 54.5 percent share? (Housing association interviewee).

While all housing associations believed that shared owners themselves would find Approach C fair, they also believed that Approach C would not be acceptable to housing associations on the grounds of increased administration and associated costs, reduced capital appreciation over the longer term (for those on Approach B at present) and additional loss of rental income. One housing association currently using Approach B summed up the consensus:

With public money to protect and grant funding being so restricted, I can't see 'gifting' higher shares to new buyers would be something we would go along with. The arrangement we have is working and as long as people are advised of it from the outset, they can make an informed decision about future plans. (Housing association interviewee)

Thus, while Approach C has merit from the perspective of shared owners undertaking improvements it would appear unlikely that it would gain support from housing associations in a climate of reduced grants, increased borrowing to support new development and heightened financial risk.

Comparing Approaches A and B

Putting Approach C aside, as unlikely to attract support from housing associations in the current business climate, one is left with the need to assess the relative merits of Approach A and Approach B. This can be done under several headings:

Fairness

Approach A aims to ensure that the shared owner, who has paid for the improvement, benefits from the entire of the uplift in value the improvement creates. It is therefore, in principle, the fairer of the two systems.

However this fairness is only achieved in practice if sales can proceed quickly and easily on this basis and there is significant evidence that this does not always happen. Approach B, though less fair in principle, can be fair in practice if shared owners are given the option to staircase to 100% and sell the whole property. Where the option to staircase to 100% is available there would seem to be no compelling argument for Approach A on grounds of fairness.

Transparency

Although housing associations did feel that their staff were able to communicate Approach A, there remain concerns throughout the sector that many shared owners do not fully understand how it will work. They do not appreciate the need to ask permission before undertaking an improvement, often expect its value to reflect the costs they incurred, and are unlikely to appreciate the possible difficulties that a future buyer might have in obtaining a mortgage for more than the professionally assessed value of the share that they are purchasing.

Approach B is the simpler and also the more transparent approach.

Mortgageability

It is clear that Approach A does cause problems for some buyers in obtaining a mortgage and that this can result in delayed or aborted sales with sellers having to negotiate away some of the uplift in value created by improvements that they have paid for.

In contrast Approach B does not create any special problems for mortgage lenders.

Cost

Approach A involves some additional work (and hence ultimately cost) in ascertaining the value of improvements and in arriving at the sale price plus the additional sum to be charged for improvements.

Conclusions and recommendations

The legal framework in terms of the model shared ownership lease and the Capital Funding Guide suggest that the question of how to handle improvements to shared ownership properties in the context of a resale is essentially one to be decided at housing association level and that significant discretion exists as to how issues can be resolved. Consultation with the Greater London Authority [GLA], Homes and Communities Agency [HCA] and National Housing Federation [NHF] confirmed that individual housing associations have discretion in this area. While the above bodies have an overall interest in a well-functioning resale market for shared ownership properties and in the management and standard of housing association shared ownership stock, it is clear that the approach to, and management of, improvements on resale are seen as matters to be dealt with by a responsible housing association within the context of their business plan and the external market within which they operate.

The research findings confirm that two identifiable approaches, Approach A and Approach B, exist in practice.

Recommendation 1: Although well-intentioned, the practical difficulties in implementing Approach A mean that Approach B is, overall, preferable. Housing associations should, when in a position to re-assess the way they handle improvements on resale, give serious consideration to adopting Approach B. If choosing to adopt Approach B, housing associations should also offer shared owners the option to staircase to 100 percent and sell the whole property if they would otherwise be significantly financially disadvantaged.

Recommendation 2: Housing associations already using Approach B should alter their practice to ensure that shared owners, where the lease permits, are offered the option to staircase to 100 percent and sell the whole property if they do not already have this option.

Recommendation 3: Housing associations already using Approach B or intending to do so should consider whether the option to staircase to 100 percent is sufficiently well-publicised to shared owners and should take steps to communicate the existence of this option if necessary. This recommendation should be considered in the broader context of recommendations 4, 5, and 6.

Communications

It is clear from responses to the housing association survey that not all housing associations ensure that they communicate their policies on improvements to shared owners. The survey suggested that 77 percent were “confident” that shared owners were aware of their policies. This picture is not entirely reassuring. Information from interviewed housing associations and valuers suggested that shared owners are often unaware of elements of their rights and obligations as the high proportion of retrospective authorisations for improvements confirms.

The survey and interviews with housing associations also suggested that information is most commonly given at the time of initial purchase and by the solicitor acting for the buyer. This is probably not the only time to inform shared owners of their rights and obligations in respect of improvements. At the time of their initial purchase most buyers of shared ownership properties are first-time buyers and will be wrestling with a range of more immediate issues including obtaining a mortgage and moving into the property within a workable timeframe. It is unlikely that shared owners will consider undertaking improvements until they have settled into their property. Some housing associations indicated that they do re-enforce owner awareness during their occupancy. Such communications were usually in the form of circulars, newsletters, or other standard communications and there was limited confidence amongst housing associations that these were read or understood. The low proportion of improvements found to have occurred without prior consent in some larger housing associations suggests that good practice is possible.

Housing associations, valuers and estate agents identified three key areas where shared owners are not always well-informed:

- Shared owners are apparently unaware of their obligation to inform their landlord in advance about proposed improvements in up to 50 percent of cases. In these circumstances an opportunity to communicate with shared owners about other issues relating to improvements such as what constitutes improvements and how any uplift in value is apportioned is lost.
- Shared owners frequently lack a clear understanding of what work constitutes an improvement likely to add value to the property as opposed to repairs or maintenance, which simply ensure that the property realises its full market value. It appears that this lack of understanding is a frequent cause of disputes between valuers and shared owners and a common cause of disappointment amongst the latter when it is discovered that their investment in “improvements” has not realised an increase in the value of their property.
- Shared owners often are not aware of the approach to apportioning an uplift in value between shared owner and landlord that their housing association operates.

Recommendation 4: Housing associations should take active steps to ensure that shared owners are effectively informed about their obligation to seek approval in advance for proposed improvements. Housing association communications should include specific personal communication by letter and/or email as well as circulars, newsletters etc.

Recommendation 5: Housing associations should use the communication opportunities created by informing shared owners of their obligation to seek approval for improvements and by shared owners seeking that approval, to provide information as to what constitutes an improvement with examples of how different improvements can affect, or not affect, the value of a property.

Recommendation 6: Housing associations should use the communication opportunities created by informing shared owners of their obligation to seek prior approval for improvements and by shared owners seeking that approval to provide clear information as to how any uplift in value arising from improvements is calculated and apportioned between shared owner and landlord. This is particularly important for those owning low shares who will be investing the most heavily in the share of the property they do not own.

Consistency of approach

There was evidence from the housing association survey and via interviews with stakeholders that the approach to handling improvements by individual housing associations is by no means always understood. While this is partly a matter of effective communication (See recommendations 4, 5, and 6 above) this evidence also raises issues about the lack of consistency of approach across the sector.

The discussion with mortgage lenders also suggested that lack of consistency in the approach to handling improvements was one issue that contributed towards the reluctance of lenders not currently lending for shared ownership to enter that market. While the importance of this issue to mortgage lenders should not be over-stated, it raises the question as to what might be done to improve consistency in this area.

The regulator and strategic housing agencies are unlikely to intervene in this area. While the National Housing Federation (NHF) is also rightly concerned to support the ability of individual housing associations to take decisions appropriate to their needs it may be that they would consider encouraging housing associations to achieve more consistency over time though on a voluntary basis from the perspective of housing associations.

Recommendation 7: The NHF should consider whether it is feasible and desirable to promote on a voluntary basis a more consistent approach to handling improvements across the housing association sector in the interests of promoting better awareness amongst stakeholders and a more positive view of shared owners amongst mortgage lenders.

Striking the balance

This research has examined the question of how improvements to shared ownership properties are handled by housing associations when those properties are the subject of a resale. In examining the complex issues raised the focus has been on matters such as transparency of approach, complexity, and practical impacts. However, underlying these facets has been a focus on striking the appropriate balance between the different interests involved:

- The shared owner seller, with an interest in being able to take informed decisions about improvements and to receive the benefit from an investment made on their property.
- The buyer, with an interest in paying a fair price and being able to obtain appropriate mortgage finance.
- The housing association holding the retained share, and with an interest in growing its capital assets, protecting its income stream and keeping administration costs down.

Well-functioning markets rely on the existence of a balance between the interests of the parties involved. When that balance is lacking then distortions in markets can and usually do occur. It is hoped that this report will improve understanding in the sector of this particular issue around resales following improvements.

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